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THE PROPOSED BANKRUPTCY LAW

By Ivor O. Wingren of the Denver Bar

ON March 1, 1932, the proposed new Bankruptcy Law was introduced in the United States Senate as Senate Bill No. 3866, by Senator Hastings, of Delaware; and in the House of Representatives as H. R. 9968, by Representative Michener, of Michigan.

The proposed law originated in the City of New York as a result of certain frauds practiced by some receivers and others—here was born the idea that something ought to be done to rescue the Goddess of Justice from the get-rich-quick methods of a few crooks.

The irregularities in New York were investigated in 1929 by a Committee of the Bar of New York, headed by Col. William J. Donovan, assisted by Floyd R. Garrison, and data was gathered by this Committee through extended questionnaires sent to Referees in Bankruptcy in all large centers, trade associations and credit associations, Bar organizations and from many other sources. The New York situation seemed to reflect irregularities of receivers, trustees and attorneys, and the newspapers reflected the light of the flame to Washington, causing President Hoover, under date of July 29, 1930, to direct the Attorney General to make a Nation-wide investigation of the administration of the Bankruptcy Law. On December 8, 1931, the Attorney General transmitted to the President a report which purports to include "the defects which were found in the law and its administration, and the Amendments to the Law which are believed to be necessary."

On February 29, 1932, the President addressed a message to the Congress in which he refers to his Annual Message on the State of the Union relating to "important reforms in organization and procedure in Criminal Law enforcement, and the practices of the Federal Courts."

In this message, he states, *inter alia:*

"The Federal Government is charged under the Constitution with the responsibility of providing the country with an adequate system for the administration of bankrupt estates."

The message suggests three essential elements of such a law:

FIRST: To relieve honest debtors of an overwhelming burden of debt.

SECOND: To effect a prompt and economical liquidation and distribution of insolvent estates.

THIRD: To discourage fraud and needless waste of assets by withholding relief from debtors in proper cases.

The message proceeds:

"The present Bankruptcy Act is defective in that it holds out every inducement for waste of assets long after business failure has become inevitable" . . . "Except in rare cases it results in the grant of discharge of all debts, without sufficient inquiry as to the conduct of the bankrupt or of the causes of failure" . . . "The Bankruptcy Act should be amended to provide remedial processes in voluntary proceedings under which debtors, unable to pay their debts in due course, may have the protection of the Courts without being adjudged bankrupt, for the purpose of composing or extending the maturity of these debts, of amortizing the payment of their debts out of future earnings, of procuring the liquidation of their property under voluntary assignment to a trustee; or, in the case of corporations, for the purpose of reorganization."

"The present statute is susceptible of improvement to eliminate delay in its cumbersome processes."

"The inquiry has not stopped with the collection of information and an expression of general conclusions. Its results have been embodied by the Attorney General in a Bill for revision of the present Bankruptcy Act in order to present the proposal in concrete form. I earnestly commend them to your consideration."

As indicated, the proposed new Bankruptcy Law was prepared by the Solicitor General and Mr. Floyd R. Garrison, his assistant, formerly the assistant to Col. William J. Donovan.

The matter of the necessity for amending the law was considered by the Senior Circuit Judges, and changes were recommended by them.

Obviously, it will be impossible, in the time available here, to completely analyze the New Law in comparison with the one now existing, but a discussion of the main features may serve to convey a fair picture of what is sought to be accomplished.

An explanation of the proposed law may be better understood by the following division:

(1) The substantial features of the new law which are not contained in the present law, are Sections 73, 74, 75 and 76.

(2) The amendments to sections of the present law, which may be considered important are mostly to Sections 3, 4, 14 and Section 29. *Section 3* adds one new act of bankruptcy—that is: "While insolvent, authorizing in writing an agent to take possession and liquidate his property." This was put in to cover those cases where unofficial Trustees have been closing out businesses under a power of attorney. *Section 4:* Involuntary petitions cannot be filed against a wage-earner whose rate of compensation is less than $1500.00 a year. *Section 14* relates to discharges and provides for suspended discharges; and in *Section 29:* Adding a provision making the removal, destruction or concealment of property within six months prior to the commencement of proceedings with intent to hinder, delay or defraud creditors a felony.

(3) Changes in administrative features and machinery are the main object of the Bill, and are drastic.

Sections 74, 75 and 76 of the proposed law are new.

Section 73 is a complete substitution for Section 12, on composition, or extension of debts. The new section provides that if a debtor files a voluntary petition, the offer of composition or terms of extension are embodied in the petition. If it is an involuntary proceeding, the terms desired may be set out in the answer. The terms, if acceptable, are carried out by a Receiver appointed by the Court; and if the proceeding is not for extension of time, but for composition, the proceeding is similar to a composition under the present Act, except the orders confirming may be entered by the Court (meaning either the Judge or the Referee), while now the *Judge only* may make the order of confirmation. If the offer is merely an application for extension, when confirmed by the Court, it is binding on all creditors, and the case is then dismissed; but a composition or extension may be set aside within six months for fraud.

In cases where the composition or extension has not been carried out, a trustee is appointed and the case proceeds in the usual way.

Section 74 provides for voluntary assignments for the benefit of creditors, by any person except a municipal, railroad, insurance or banking corporation, by filing the assignment with the Clerk of the United States Court, and giving

notice to the creditors. An assignee named in the assignment may be changed by petition of the creditors. If the debtor fails to comply with the Act or asks for a discharge, which is suspended or denied, he is adjudicated a bankrupt.

Section 75 applies only to wage-earners and allows a wage-earner to file a petition alleging insolvency, setting up the property that he has that is non-exempt, and alleging his ability to pay his debts out of future earnings over a period not exceeding two years. A trustee appointed by the Court collects the payments, and if paid in full, the case is dismissed; but if not paid in full, an application may be made for a discharge, which the Court has power to grant if the facts warrant. If the showing is not sufficient, the Court may adjudicate the petitioner a bankrupt.

Section 76 applies to corporate reorganizations, open to any corporation that could be adjudicated a bankrupt. The proceeding may be either voluntary or involuntary, and the object sought is reorganization. The powers given are such as to deal with any class of creditors; may alter rights of stockholders of any class; may provide the method of reorganization, either within the old corporation or by forming new ones; may provide for issuing of new securities and similar powers.

If the *Judge (not* the *Court)* approves the petition setting up the plan requested for reorganization; or, if involuntary, the answer sets up the plan, the Judge appoints a temporary trustee to call a meeting of debtors, creditors and stockholders, and the machinery of the Court then aids the Trustee in carrying through the plan. Confirmation of the plan is dependent on its acceptance by two-thirds of the creditors. If the plan fails for any reason, an adjudication follows.

This section is considered very important as it is intended, in a large measure, to take the place of reorganizations under equity receiverships, which, in the Federal Court, must be founded on equity jurisdiction in suits based on diversity of citizenship. It will eliminate the necessity of ancillary proceedings in order jurisdictions where the corporate property extends into other states, and do away with the present cumbersome proceeding of a foreclosure sale.

Under this section, it is proposed to reorganize insolvent railroad corporations and other large corporations with property located in many states.

In order to aid this section and simplify the procedure, an amendment is proposed to Section 69 of the present Bankruptcy Act which provides in substance that the Receiver of a bankrupt estate, upon filing a certified copy of his order of appointment with a bond in the Court of any other judicial district wherein property of the bankrupt is located, shall have all the powers of an ancillary Receiver.

It is somewhat difficult to designate other changes to be strictly new provisions. Better it is to say that there are many new provisions appended to old sections in the form of amendments and which, as to the added parts, are new; and with few exceptions hereafter noted, relate to procedure only.

Section 23: Under the title "Jurisdiction," allowing accounts owing to bankrupts to be entered as a summary judgment upon admission by the debtor of the correctness of the amount. This judgment is entered after notice.

Section 45: Qualifications of Trustees Provides—Trustees shall be individuals who are competent to perform their duties; if non-residents or without an office in the judicial district, they must file with the clerk a designation of an agent upon whom processes may be served; corporations may be trustees; non-profit trade associations, authorized by their articles to do so, may be trustees. Other persons under peculiar circumstances and upon showing made to the court may be authorized to act as trustees; in other words, any "authorized" person may be appointed as a trustee.

In order to become "authorized" to act as a Trustee, the applicant must file with the Clerk of the Court an application in duplicate on a form prescribed by the Attorney General, setting forth applicant's reputation, responsibility, and experience. This application is then forwarded to the administrator, an office created by the new Act; notice is published for two weeks in a newspaper; the administrator investigates the merits of the application; reports his finding to the Court and if qualified, he may be appointed a Trustee upon the filing of a bond, required by the Act; so the Act really creates a list of authorized, bonded trustees from whom trustees must be appointed, except under peculiar circumstances.

Trustees are required to make distribution of dividends every three months.

Perhaps the most important amendment to the substantive law (to the bankrupt, at least), is in Section 14, relating to discharges. The new features are the following:

(1) Voluntary wage-earner bankrupts, whose scheduled debts do not exceed $5,000.00, shall be granted or denied a discharge, or have a discharge suspended, at the first meeting of creditors.

(2) As to all others, the bankrupts must apply for discharge within six months after adjudication, or within three months thereafter if an extension is granted. The discharge is granted, denied or suspended at the meeting called to consider it, and is made by the Court, instead of the Judge alone. The grounds for denial of discharge are identical with those in Section 14 of the present Act.

Discharges shall be suspended not exceeding two years if the evidence shows (a) that the assets of the Bankrupt at the commencement of the proceeding were not of a value equal to fifty cents on the dollar of provable debts, unless properly explained; (b) contracted any debt within four months without any reasonable or probable ground of expectation that he could pay for it; (c) that he precipitated his bankruptcy by "rash and hazardous speculation or by extravagance in living, gambling, or culpable neglect of business"; and during the period of suspension the bankrupt shall turn over to his trustee his earnings "except a reasonable allowance for living for himself and dependents, with power in the Court to set aside property necessary to conduct a business.

If the bankrupt fails to pay up according to the order, his discharge may be denied. A bankrupt has a right of appeal from the order of a referee granting, denying or suspending a discharge.

A new duty is imposed on bankrupts by requiring them to file a statement of their affairs, showing:

(a) cause of failure; (b) disposition of property when solvent (for two years past); (c) situation in life; and (d) such other information as the form may call for.

Building and loan associations are not allowed to file a voluntary proceeding, and cannot be filed against in an involuntary proceeding (This by the amendment of February 11, 1932).

The tenure of Referees is changed to six years, and compensation to a salary fixed by the Attorney General.

Trustees' compensation is changed from the old percentage rate of 6, 4, 2 and 1 per cent to such sum as the Trustee may agree upon with Creditors' Committees, or allowed by the Courts, not to exceed 10% on $2,000.00 or less; 7% on from $2,000.00 to $10,000.00; 4% on from $10,000.00 to $20,000.00; 2% on from $20,000.00 to $1,000,000.00; and ½ of 1% in excess of $1,000,000.00 with the rate the same in composition cases.

There are created, to be appointed by the Attorney General, ten "Administrators" at a salary not exceeding $7,500.00 per year, and as many "Examiners" as may be required, and estimated at 200 to start, at salaries not to exceed $4,000.00. The outlay for salaries, under the new Bill, is estimated at $2,882,127.00. It is proposed to save the Government Treasury harmless on this by imposing a percentage tax of 1% in composition and 2% in others, on realized assets plus a 25c fee for each claim filed, which would go to the Government; and the revenues from clerks' filing fees, which are increased to $35.00. These fees, according to the figures submitted by the Attorney General, would raise $3,183,949.00, leaving a surplus of $301,822.00 to the Government.

The new Act is based generally on the present law, but with such modifications to main features as to create a new basis for its administration. These changes, together with the enlargement of amounts to be paid out for administration, and the provisions for the appointment of administrators and examiners, has been the basis of opposition to its enactment. The opposition comes from different sources, and that the trend of such opposition may be noted, we quote from a few of such objections.

(1) Harold Remington, author of "Remington on Bankruptcy", says: "The amendatory Bill contains nearly twice as many words as the present Bankruptcy Act, and there is scarcely a single section of the Act that is not proposed to be amended thereby. Indeed, in most instances, amended in many places, and by radical re-wording in the same section. The present Bankruptcy Act, so far as administrative features are concerned, will be completely re-made."

Mr. Remington then registers the following objections to the new Bill: "The amendatory Bill attempts to cover more than bankruptcy litigation. It seeks to create a new kind of Federal litigation—Debtor Proceeding—where the debtor is not bankrupt." This he holds is not within the power of Congress under the Constitution.

(2) As to Section 76—corporate reorganization—he says: "There is no need of any amendment of the Bankruptcy Act to cover legitimate corporate reorganizations. They can be had now, in the Bankruptcy Court, under the present act, unamended, whenever the facts justify them." "Federal Receiverships have improperly displaced bankruptcy proceedings."

(3) As to the creation of two new sets of officers, administrators and examiners, Mr. Remington says: "It is made clearly evident that the fundamental purpose of the new Bill is to take away from the creditors the administration of bankrupt estates, and to place it in the hands of the Attorney General, through his "administrators and examiners."

He designates Section 74, on assignments, as "wholly inadequate and dangerous."

Mr. Remington is wholly unreconciled to the necessity of the new law on the ground that we have no need to go to England to copy a law which is not within the powers of our Constitution to enact; that the present law is adequate where properly administered; that the bankruptcy system can reorganize corporations, extend time for payment, handle cases usually erroneously handled under equity receivers; and that a single amendment to Section 69, which he proposes on the subject of discharges, will meet every need.

As a parting shot, Mr. Remington says of the discharge provision of the new Bill, that "if the Angel Gabriel were a bankrupt, he could scarcely get his discharge."

The Bankruptcy Committee of the American Bar Association is not in sympathy with the proposed Bill. Mr. Lashley, the Chairman, speaking for the Committee before the joint Sub-Committee on Judiciary, of the House and Senate, on May 4th and 5th, 1932, said:

"The American Bar Association has been studying this subject of bankruptcy—the proposed revision of the Bank-

ruptcy Law—and has exchanged views with such sections of the public as we have been able to since the legislation has been projected, and has reached the conclusion that this legislation cannot have the approval of the American Bar."

The proponents of the Bill are those who have participated in the New York bankruptcy investigation, Judge Thatcher, now Solicitor General, formerly United States District Judge in New York; Col. William J. Donovan, with his Assistant, Floyd R. Garrison, who were attorneys for the New York Bar Association in the New York inquiry. Mr. Garrison has accomplished the burden of the work of bankruptcy investigation ordered by President Hoover; actively handled that investigation; compiled its results; made the report which was the basis of the proposed law; and is a strong advocate of its necessity, workableness and constitutionality.

The new Bill displaces creditor control and substitutes Government control, on the theory that the people themselves are vitally concerned in a bankruptcy proceeding because of the wastage due to extravagant, dishonest, or unfortunate business ventures being a drain upon the economic resources of the country at large, which might seriously affect the general health and prosperity of the Nation; and in that sense the public is thought an interested party in a bankruptcy proceeding; but it may be asked, is the question sufficiently important to justify displacing the creditors, and in large measure, the Courts and making bankruptcy an administrative function of Government? At any rate, the Bankruptcy Law is listed with narcotics and whiskey as a public calamity which needs regulating.

Should the new Bill be passed, the old one retained, or some new and unthought-of plan worked out to supplant both? The question should not be settled hastily, but should be given that mature reflection necessary to a business venture, Nation-wide in extent, attempting to find a way to prevent losses which, in 1931, amounted to about $912,000,000.00; and where the number of bankruptcies has increased from 23,000 in 1921 to 65,000 in 1931; and the liabilities have increased from $171,000,000.00 in 1921 to $1,008,000,000.00 in 1931.

Would it not seem that these laws should tend more to the aid of the deserving unfortunate debtor, with less generous bestowal of releases of other people's debts.

If a Bankruptcy Law is desirable—and commerce thinks it is—then its aim is, or ought to be, to release the honest and unfortunate man. Why the necessity of a Bankruptcy Law to release a corporation as "release" does not uniformly mean "relieve." Why release with benefit of cession of debt? Why not make such a law just a temporary crutch to aid the worker across a bridge of trouble, which was not built in the pursuit of profits?

It seems like putting a premium on speculation, hazard, chance and recklessness, to allow hazard debts to be wiped out; and it does not help the community.

If it is desirable to have the Act apply to all now included in the law, should not its provisions extend, by voluntary petition, to all classes of individuals and corporations, including National banks? To granting discharges only where debts are paid in full, so that a continuing moratorium is in effect? Would this not be more equitable and an aid to the morale of the bankrupt and a benefit to the community? It would then not be necessary to draft a bankruptcy law that presupposes a bankrupt is a crook, with hidden assets, but on the contrary it would temper the wind to the shorn lamb and prevent the wolves from biting at his heels.

UNNECESSARY EXPENSE ON APPEAL

"I picked up a record one day and discovered that of the forty-eight pages of the printed record on appeal seventeen of those pages were printed repetitions of titles. In other words, there had been the printing of the title on the summons, then again on the complaint, then again on the reply, then again on the demand for a bill of particulars, etc. It is true that it was a long title, but as I saw the seventeen pages of repetitious printing of titles, which brought no advantage to anyone and was a pure waste of money, and then realized for how many generations this same waste had been going on in appeal books, I asked the Association of the Bar if they would not help me to draft a rule which would stop this waste. Of course, we soon had a rule which simply permitted the title to be printed once and, where it occurred again, to state the words "Same title." As this could be changed by rule of court, it was only necessary for the presiding justices of the four departments to make this change. And straightway this waste was stopped."

From speech by Hon. Edward R. Finch, Presiding Justice Appellate Division, First Department, New York.