

# Privileged Testimony Under the Bankruptcy Act

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of "calculated risk." The editor,<sup>111</sup> after concluding that the article would appeal to his readers, considers whether there is any possibility of a libel suit resulting from its publication. This latter consideration is governed by the editor's awareness—developed from past experiences—of those people who are litigious. The editor knows, for example, that certain public figures, people of very limited means, or persons with unsavory pasts will usually not sue. Thus, if the potential plaintiff falls into the non-litigious category, the editor will risk a lawsuit and print the article.

However, the newspaper will be discouraged from printing articles on the basis of "calculated risk" if the risk becomes too expensive.<sup>112</sup> They will be less inclined to print potentially libelous articles if more people are aware that they have causes of action against the newspaper. An awareness of the newspaper's liability for repeating statements of others, reports, rumors and press dispatches, together with a realization of the hidden dangers involved in seeking punitive damages, should encourage libeled parties to bring suit when their rights to a good name have been violated by a newspaper.



## PRIVILEGED TESTIMONY UNDER THE BANKRUPTCY ACT

### *Introduction*

In its origin, bankruptcy law was penal in nature.<sup>1</sup> It was based upon the premise that all debtors are dishonest, and was designed as a means of retribution. As civilization developed, however, it was recognized that one might become insolvent through circumstances entirely beyond his control. Bankruptcy law gradually became an instrument of reorganization and rehabilitation rather than of punishment and revenge. As a result, modern legislation in this field is remedial in nature<sup>2</sup> and is advantageous to the unfortunate debtor as well as to his creditors. In general, the insolvent may begin anew financially, while those to whom he is indebted are satisfied as fully as possible out of the assets available upon the adjudication of bankruptcy. In this manner the principles of justice are preserved and the interests of all the parties are protected.

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<sup>111</sup> Although many large newspaper companies have legal departments (often located in the same building), news stories are usually not pre-censored by the legal departments.

<sup>112</sup> See THOMAS, *LIBEL AND SLANDER* 54-57 (1949) (charts showing the amount of damages that have been awarded for various defamatory statements).

<sup>1</sup> See NADLER, *THE LAW OF BANKRUPTCY* § 1 (1948).

<sup>2</sup> *Ibid.*

The Constitution of the United States empowers Congress to establish "... uniform Laws on the subject of Bankruptcies. . . ." <sup>3</sup> and exclusive jurisdiction is vested in the federal courts. The first of such laws to be enacted was the Bankruptcy Act of 1800.<sup>4</sup> This was repealed in 1803,<sup>5</sup> and it was not until almost a century later that legislation of a permanent nature dealing with the subject was passed.<sup>6</sup> This statute, together with the modernizing amendments of the Chandler Act of 1938,<sup>7</sup> continues in effect as the national bankruptcy legislation of the United States today.

One of the most essential elements in the administration of bankruptcy proceedings is the process of discovery. The nature, amount and location of the bankrupt's assets must be ascertained so that the court may effectuate an equitable distribution of the bankrupt's estate upon final adjudication. This information is elicited by means of examinations, not only of the bankrupt himself, but of other interested parties as well. Testimony is taken, documents and papers are required to be produced; in short, all practicable steps are taken to bring to light matters concerning the property of the bankrupt and the conduct of his business. The purpose of this paper is to discuss and to compare the specific provisions relating to examination, particularly with regard to the question of the admissibility of testimony given thereunder in subsequent proceedings of either a civil or a criminal nature.

#### *Examination in General*

Provisions for examination of the bankrupt and other persons are found in two sections of the Act. Section 7<sup>8</sup> applies to the bankrupt himself, while Section 21a<sup>9</sup> applies to other persons as well as to the bankrupt. If the bankrupt is a corporation, Section 7b, which was added in 1938,<sup>10</sup> provides that the duties imposed on the bankrupt by the statute are to be performed by the officers, directors, stockholders or members thereof. Those who held such positions before the bankruptcy proceedings are not included in either Sections 7 or 7b and so can be examined only under Section 21a.<sup>11</sup> These sections are interrelated and are intended to supply as searching and as exhaustive an examination into the relevant data as possible. Under Section 7, the bankrupt, upon notice, has an absolute duty to

<sup>3</sup> U.S. CONST. Art. I, § 8.

<sup>4</sup> 2 STAT. 19 (1800).

<sup>5</sup> 2 STAT. 248 (1803).

<sup>6</sup> 30 STAT. 544 (1898).

<sup>7</sup> 52 STAT. 840 (1938). The combined act is now found in Title 11 of the United States Code.

<sup>8</sup> 30 STAT. 548 (1898), as amended, 11 U.S.C. § 25 (1946).

<sup>9</sup> 30 STAT. 552 (1898), as amended, 11 U.S.C. § 44(a) (1946).

<sup>10</sup> 52 STAT. 848 (1938), 11 U.S.C. § 25(b) (1946).

<sup>11</sup> *In re* Bush Terminal Co., 102 F.2d 471 (2d Cir. 1939).

testify on the specified occasions;<sup>12</sup> Section 21a, on the other hand, requires a court order pursuant to proper application.<sup>13</sup> The bankrupt's spouse is expressly included under Section 21a. The persons included under both sections are compelled to testify and may be punished for contempt should they fail to do so.<sup>14</sup>

### Section 7

Section 7 sets forth the duties of the bankrupt. Included are: attendance at the first meeting of the creditors, at the hearing upon objections to his discharge, and at such other times as the court may order; delivery of such papers as the court may order; submission of a schedule of assets, and numerous other obligations not germane to this discussion. The provisions of this section apply to the bankrupt alone. The scope of the examination includes the divulgence of information concerning ". . . the conducting of his business, the cause of his bankruptcy, his dealings with his creditors and other persons, the amount, kind, and whereabouts of his property, and, in addition, all matters which may affect the administration and settlement of his estate or the granting of his discharge. . . ." <sup>15</sup>

Subdivision 10 of this section contains an express privilege against the subsequent use of the testimony given in such examinations. It declares that no testimony of the bankrupt shall be offered against him in any subsequent criminal proceeding, except that testimony which is given in the hearing on objection to his discharge.<sup>16</sup> This immunity is confined by the statute to the testimony of the bankrupt himself and has been strictly construed in that particular.<sup>17</sup> It precludes the subsequent introduction of oral testimony only, and has no bearing upon the use of such schedules and other documents which are required to be produced under the section.<sup>18</sup> Furthermore, it applies only to criminal proceedings. Thus it was held that the bankrupt's testimony upon examination could be used against him in a proceeding on his application for discharge, since that is civil in nature.<sup>19</sup> Similarly, it would seem that such evidence could be in-

<sup>12</sup> The language there is mandatory: "The bankrupt shall . . ." No conditions are imposed on his performance.

<sup>13</sup> "The court may, upon application of any officer, bankrupt, or creditor, by order require any designated persons . . ."

<sup>14</sup> Section 2a(13) of the Act gives the bankruptcy court the broad power to ". . . [e]nforce obedience by persons to all lawful orders, by fine or imprisonment or fine and imprisonment. . . ." 52 STAT. 843 (1938), 11 U.S.C. § 11(a)(13) (1946).

<sup>15</sup> 52 STAT. 847 (1938), 11 U.S.C. § 25(10) (1946). This was originally subdivision 9 of Section 7 in the Act of 1898. 30 STAT. 548 (1898).

<sup>16</sup> 52 STAT. 847 (1938), 11 U.S.C. § 25(10) (1946).

<sup>17</sup> The subdivision reads: ". . . no testimony given by *him* [the bankrupt] shall be offered in evidence against *him* in any criminal proceeding. . . ." (emphasis added). See *In re Feldstein*, 103 Fed. 269 (S.D.N.Y. 1900).

<sup>18</sup> *Ensign v. Pennsylvania*, 227 U.S. 592 (1913).

<sup>19</sup> See *In re Leslie*, 119 Fed. 406 (N.D.N.Y. 1903).

roduced in contempt proceedings which were not criminal as well as in other proceedings not punitive in nature.<sup>20</sup> Of necessity, an exception to the general application of the immunity in criminal actions against the bankrupt was recognized in the case of perjury.<sup>21</sup> If the privilege extended to such a prosecution, it obviously would be impossible to prove the offense charged. Consequently, the bankrupt has no privilege in such an instance. Finally, the immunity may be waived and, in fact, will be deemed waived unless timely objection is taken to the introduction of such testimony.<sup>22</sup>

Although the bankrupt is thus protected with regard to the information he discloses upon examination, that protection, it will be observed, is not absolute. The statute does not exempt him from future prosecution; it merely prohibits the introduction of his testimony in a subsequent criminal action. It does not preclude his indictment and trial for crimes brought to light in the examinations and, in so far as his disclosures supply some facts or clues warranting investigations and possible penal action, a prosecution may be based thereon. As a result, the bankrupt need not, upon examination, reply to questions the answers to which would tend to be self-incriminating. Because the statutory immunity is not total, he retains his constitutional privilege under the Fifth Amendment.<sup>23</sup>

In 1938 an amendment was added to Section 7 which provided that in the event the bankrupt was a corporation the duties imposed by the section shall be performed by the corporation's officers, directors, trustees or stockholders or such of them as the court may appoint.<sup>24</sup> Because of the very nature of a corporation, which is an artificial being unable to act but through its officers or agents, this necessarily had been the practice even before such provision was enacted.<sup>25</sup> What relation this amendment has to the question of immunity will be considered below.

### *Section 21a*

A provision for examination even broader than that which is allowed under Section 7 is found in Section 21a. This is the only portion of the Act which specifically permits examination of persons other than the bankrupt. Pursuant to its terms the court may, upon proper application, order any designated persons to appear and testify including, in addition to the bankrupt, his or her spouse. The application may be made by any officer, bankrupt or creditor and

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<sup>20</sup> See *Wakefield v. Housel*, 288 Fed. 712 (8th Cir. 1923).

<sup>21</sup> *Glickstein v. United States*, 222 U.S. 139 (1911); see *Cameron v. United States*, 231 U.S. 710, 719 (1914).

<sup>22</sup> See *Bain v. United States*, 262 Fed. 664 (6th Cir.), *cert. denied*, 252 U.S. 586 (1920) (alternative holding).

<sup>23</sup> *In re Scott*, 95 Fed. 815 (W.D. Pa. 1899).

<sup>24</sup> 52 STAT. 848 (1938), 11 U.S.C. § 25(b) (1946).

<sup>25</sup> See *In re Alphin & Lake Cotton Co.*, 131 Fed. 824, 825 (E.D. Ark. 1904).

there is no limitation upon the number of persons to be designated, or the scope of the examination, except that the bankrupt's spouse may be interrogated only with regard to transactions entered into by the spouse or to which he or she was a party.

Section 21a permits examination at any time after the filing of a bankruptcy petition and upon any matters relating to the "acts, conduct or property of the bankrupt." So wide is the latitude of permissible inquiry under this section that it has been described as allowing "fishing expeditions" into any and all matters of reasonable interest to the creditors.<sup>26</sup> There is no attempt to prove anything in such an examination; there are no issues.<sup>27</sup> The sole purpose is to elicit as much information as possible which may be legitimately pertinent, *i.e.*, which may reasonably tend to establish something of importance in the administration of the estate.

Unlike Section 7, no statutory immunity is afforded those persons called as witnesses under Section 21a. Their testimony may be used in any subsequent proceeding whether civil or criminal. They retain, of course, their constitutional privilege and may refuse to answer questions on that ground.<sup>28</sup>

### *Major Difficulties*

The immunity afforded the bankrupt under Section 7 would appear, on principle, to extend to his testimony when he is called pursuant to Section 21a.<sup>29</sup> Since it appears unreasonable to grant him a privilege in the one instance and not in the other, the two sections should be read together in this connection. The other persons encompassed by 21a, however, receive no such immunity. They are given none under that section and the one contained in Section 7 is confined to the bankrupt alone.

The major problem created by this unequal grant of immunity involves the testimony of directors, officers and stockholders of a bankrupt corporation under whichever section they testify. Is their testimony privileged? There has been some diversity of opinion on this point. In *People v. Lay*,<sup>30</sup> the Supreme Court of Michigan decided that a vice-president and director of a bankrupt corporation came within the term "bankrupt" under Section 7. Testimony given by him in the bankruptcy proceeding was held privileged and inadmissible in a subsequent prosecution for embezzlement. Later, however, a federal court expressly rejected this theory in *Kolbrenner v. United*

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<sup>26</sup> See 5 REMINGTON, BANKRUPTCY LAW 69 (5th ed., Henderson, 1953).

<sup>27</sup> See *In re Wilcox*, 109 Fed. 628, 631 (2d Cir. 1900) (on rehearing, 1901).

<sup>28</sup> *In re Ehler*, 18 F.2d 358 (E.D.N.Y. 1926) (manager of bankrupt's business); *In re Hooks Smelting Co.*, 138 Fed. 954 (E.D. Pa. 1905) (officer of bankrupt corporation); see *In re Smith*, 112 Fed. 509 (S.D.N.Y. 1902) (trustee in bankruptcy).

<sup>29</sup> See 5 REMINGTON, BANKRUPTCY LAW 97 (5th ed., Henderson, 1953).

<sup>30</sup> 193 Mich. 17, 159 N.W. 299 (1916).

States.<sup>31</sup> In that case, it was held that officers of the corporate bankrupt who testified under Section 21a were not entitled to any privilege since they were distinguishable from the bankrupt. The court pointed out that the grant of immunity should be strictly construed and should be extended no further than the literal words of the statute allow.<sup>32</sup> A similar result was reached concerning the organizers and managers of a corporation which became insolvent.<sup>33</sup> These witnesses had testified in a Section 7 proceeding and their testimony was admitted in a subsequent prosecution for conspiracy to conceal assets from the trustee in bankruptcy.

This distinction drawn between the "bankrupt" and the officers of a bankrupt corporation appears neither reasonable nor just. Such officers are bound to perform the duties of the bankrupt and were so bound even before the enactment of Section 7b. To apply the privilege so strictly as to deprive them of its protection seems unwarranted. Whether the addition of Section 7b will bring about any change in the application of the privilege still remains to be seen.<sup>34</sup> An indication that the old rule will prevail appeared, by way of dicta, in *In re Bush Terminal Co.*<sup>35</sup> Cases decided prior to the amendment were cited in support of the proposition that the testimony of such persons is admissible.<sup>36</sup>

Since even the officers, directors and stockholders, through which a corporate bankrupt must act, are not accorded any privilege concerning the use of their testimony, it seems obvious that other persons, less closely connected, are likewise without such protection. Thus, the spouse of the bankrupt, the creditor, trustee or any other person designated pursuant to Section 21a and required to testify in a proceeding thereunder, does so without benefit of any statutory privilege. For example, former stockholders or directors of a corporation, who can be compelled only under Section 21a, would not be protected by the privilege and their evidence would be admissible against them in a subsequent criminal proceeding.<sup>37</sup> As indicated above, no one has any privilege with regard to subsequent civil actions.<sup>38</sup>

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<sup>31</sup> 11 F.2d 754 (5th Cir.), *cert. denied*, 271 U.S. 677 (1926).

<sup>32</sup> *Id.* at 756.

<sup>33</sup> *Kaplan v. United States*, 7 F.2d 594 (2d Cir.), *cert. denied*, 269 U.S. 582 (1925).

<sup>34</sup> Although this section has been in effect for sixteen years, the direct issue under discussion has not, during that period, been presented.

<sup>35</sup> 102 F.2d 471 (2d Cir. 1939).

<sup>36</sup> The cases cited include *Kaplan v. United States*, *supra* note 33, and *Kolbrenner v. United States*, 11 F.2d 754 (5th Cir. 1926).

<sup>37</sup> *In re Bush Terminal Co.*, *supra* note 35.

<sup>38</sup> See *In re Leslie*, 119 Fed. 406 (N.D.N.Y. 1903) (testimony of bankrupt admissible in proceeding on his application for discharge); *Wilkinson v. Livingston*, 45 F.2d 465 (8th Cir. 1930) (testimony of a witness before referee in bankruptcy admissible in an action to set aside a fraudulent assignment).

*Conclusion*

Examination of witnesses is essential to the orderly and equitable administration of a bankrupt's estate. Not only is the information derived from the bankrupt necessary but also that which is obtained from other informed persons. This is recognized by the requirements in both sections discussed above. Under both, the persons involved are compelled under threat of contempt proceedings to appear and submit to interrogation.

But the bankrupt's testimony is privileged while that of the other witnesses is not. Such a discrimination is unwarranted and inequitable. All parties should be protected to the same degree. Particularly is the injustice reflected in the case of corporate representatives wherein the discrimination is based upon a superficial and invalid distinction. Since the terms of the statute do not admit of the necessary extension of immunity, it should be granted by legislative amendment.



## TORT LIABILITY OF ADMINISTRATIVE OFFICERS IN NEW YORK

*Introduction*

“. . . [G]overnment means those innumerable officials who collect our taxes and grant us patents and inspect our drains. . . . They are fallible beings because they are human, and if they do wrong it is in truth no other derogation than the admission of their human fallibility. . . .”<sup>1</sup>

The tremendous expansion in recent years of governmental activity and the concomitant increase in the number of public officers have emphasized the truth of the statement that few can avoid contact with administrative authorities.<sup>2</sup> Almost every phase of human endeavor involves, directly or indirectly, recourse to an administrative agency or dealings with a public official. These officials in the course of their duties are sometimes guilty of wrongs. It is when these wrongs proximately cause injury to third parties that the question arises with regard to the tort liability of administrative officers.

The tort liability of a public officer is materially distinct from that of a private citizen. Rarely does the latter have imposed upon

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<sup>1</sup> Laski, *The Responsibility of the State in England*, 32 HARV. L. REV. 447, 472 (1919).

<sup>2</sup> See Freund, *Historical Survey in THE GROWTH OF AMERICAN ADMINISTRATIVE LAW* 17 (1923).