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ARE BANKRUPTS CRIMINALS? *

SAMUEL C. DUBERSTEIN †

DURING the discussion period following an address on bankruptcy delivered by me at a recent meeting of the local Federal Grand Jurors Association, one of its members posed the rather curious and provocative question, "Are bankrupts criminals?" While this question was then answered briefly, I felt that its implication deserved more serious consideration, eventually giving rise to this discussion with its odd title.

History informs us that in ancient times a debtor who was unable to pay his debts was considered a felon or a virtual slave of his creditors. In certain instances the unfortunate debtor suffered the penalty of capital punishment. Later a more enlightened view eliminated the death penalty, but still the debtor was dragged to prison, from which he could be released only upon the payment of his debts. Early English bankruptcy laws were quasi-criminal in their nature, and the bankrupt-debtor was referred to as "the offender."

In colonial days, a delinquent debtor was thrown into a debtors' prison. Perhaps it is not generally known that Robert Morris, the patriot whose financial aid saved materially the Continental Army in the Revolutionary War and who signed both the Declaration of Independence and the Constitution, was confined in the Prune Street Debtors' Prison in Philadelphia for three years because he was unable to pay his debts following the loss of his fortune. Likewise, James Wilson, while a Justice of the United States Supreme Court, fled the jurisdiction of the State of Pennsylvania to avoid the action of hostile creditors who were seeking to

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lodge him in a debtors' prison when the learned jurist met with unexpected financial reverses.

But there was an awakening. The enslavement or imprisonment of an honest but unfortunate debtor was not considered legitimate, conscionable or proper. The authors of the Constitution were men of deep religious faith who were acquainted with the Bible, and who knew of the Lord's Release in Deuteronomy Chapter 15, the Golden Rule of doing unto others as we would they should do unto us, the lofty and inspiring appeal "Come unto me all ye that labor and are heavy laden and I will give you rest," and the practical idealism of "Love is the fulfilling of the law." They must have known that human law is right only as it patterns the divine.

It was therefore not unreasonable to expect that our Constitution would provide—as it does—that:

the Congress shall have power . . . to establish . . . uniform laws on the subject of Bankruptcies throughout the United States.¹

Congress, in enacting bankruptcy laws, which now include debtor-relief laws, sought, from time to time, to establish a stable business and social economy in order to curtail the tremendous annual debt losses, and evinced a real interest in the economic rebirth of the honest insolvent debtor in order to maintain and sustain the dignity of man. The rehabilitation of an individual and his reinstatement in the business world, is the theme that runs through the bankruptcy statute.

The United States Supreme Court² has expressed in clear terms that the "bankruptcy power" in the Constitution is flexible enough to serve the varying economic and social needs of changing generations and conditions; and one of the beneficent features of the bankruptcy law is the privilege granted to those bankrupts, who have surrendered their property and otherwise complied with the duties imposed

¹ U. S. Const. Art. I, § 8, cl. 4.

² *Continental Illinois National Bank v. Chicago, R. I. & P. Ry.*, 294 U. S. 648 (1935). The economic history of our country teaches us that following a depression or panic, appeals are inevitably made to Congress for the enactment of laws on "the subject of bankruptcies." We have passed through about twenty major depressions; and the alternating *booms* and *panics* have presented acute distressing problems to business men, wage earners, bankers and Congress.

upon them, to receive a discharge³ of their provable debts with certain exceptions.⁴

Despite the kindly reference to the treatment accorded debtors under the bankruptcy law, it should be borne in mind that the statute also contains provisions for the denial of a dishonest bankrupt's discharge and for the indictment and prosecution of crooked bankrupts and their confederates.⁵

For the purpose of this address it is only necessary to refer to the first ground of objection to a bankrupt's discharge which is set forth in Section 14c(1) of the Bankruptcy Act. That section provides that the court shall grant a discharge unless "the bankrupt has committed an offense punishable by imprisonment under Title 18, United States Code, Section 152."⁶

Until recently the various crimes relating to bankruptcy were to be found in Section 29 of the Bankruptcy Act (United States Code, Title 11, Section 52). By the Act of June 25, 1948, as amended by the Act of May 24, 1949⁷ the provisions of Section 29 of the Bankruptcy Act were repealed and incorporated in Title 18, United States Code,⁸ but *any rights or liabilities existing under the repealed provisions were preserved.*⁹

Section 152, Title 18, United States Code,¹⁰ refers to the several offenses relating to bankruptcy, punishable by imprisonment, any one of which, if established, will bar a bankrupt's discharge. Succinctly stated, the offenses are: (a) fraudulent concealment of assets of a bankrupt estate;¹¹

³ BANKR. ACT § 14, 11 U. S. C. § 32 (1927).

⁴ BANKR. ACT § 17, 11 U. S. C. § 35 (1927).

⁵ Persons who commit bankruptcy offenses punishable under the law and also those persons who aid or induce the commission of any offense defined in any law of the United States, are guilty of a felony warranting their indictment as a principal, and not as a mere accessory to the crime. 18 U. S. C. § 2 (1948).

⁶ BANKR. ACT § 14c(1), 11 U. S. C. § 32(b) (1927).

⁷ Pub. L. No. 72, 81st Cong., 1st Sess. § 4 (May 24, 1949).

⁸ 18 U. S. C. §§ 151-155 (1948).

⁹ 1 U. S. C. § 109 (1947); *United States v. Lynch*, 180 F. 2d 696 (7th Cir.), cert. denied, 339 U. S. 981 (1950); *In re Cole*, 88 F. Supp. 842 (E. D. N. Y. 1950).

¹⁰ Formerly Section 29 of the Bankruptcy Act.

¹¹ *Noell v. United States*, 183 F. 2d 334 (9th Cir. 1950) (presumption of continued possession); *In re Lenoble*, 182 F. 2d 1020 (2d Cir. 1950) (concealment of bank accounts); *United States v. Wodiska*, 147 F. 2d 38 (2d Cir.), 57 Am. B. R. (n.s.) 327 (1945); *Coghlan v. United States*, 147 F. 2d 233

(b) making a false oath or account;¹² (c) presenting a false claim for proof;¹³ (d) receiving property from a bankrupt after bankruptcy with intent to defeat the bankruptcy law;¹⁴ (e) *giving*, offering, *receiving* or attempting to obtain money, property or advantage for acting or forbearing to act in any bankruptcy proceeding¹⁵ (note that now both the person who *gives* as well as the person who *receives* is guilty of the offense); (f) transferring or concealing property of any person or corporation in contemplation of such person's or corporation's bankruptcy or with intent to defeat the bankruptcy law;¹⁶ (g) concealing, destroying or falsifying

(8th Cir.), 57 Am. B. R. (n.s.) 331 (1945) (attorney charged with intentionally failing to disclose debtor's assets in schedules prepared by him); *United States v. Tatcher*, 131 F. 2d 1002 (3d Cir.), 52 Am. B. R. (n.s.) 120 (1942) (record insufficient to sustain concealment charge); *United States v. Agresti*, 130 F. 2d 152 (2d Cir.), 50 Am. B. R. (n.s.) 499 (1942) (crime to conceal assets from a receiver as well as from a trustee); *Miller v. United States*, 125 F. 2d 517 (6th Cir.), 48 Am. B. R. (n.s.) 585 (1942); *United States v. Weinbren*, 121 F. 2d 826 (2d Cir.), 46 Am. B. R. (n.s.) 730 (1941); *United States v. Martel*, 103 F. 2d 343 (2d Cir.), 39 Am. B. R. (n.s.) 659 (1939) (question whether bankrupt owned beneficial interest in corporation); *Kutler v. United States*, 79 F. 2d 440 (3d Cir.), 30 Am. B. R. (n.s.) 142 (1935) (indictment insufficient because referee's name is mentioned instead of receiver's); *Goetz v. United States*, 59 F. 2d 511 (7th Cir. 1932) (concealment of realty interest).

¹² *Morris Plan v. Henderson*, 131 F. 2d 975 (2d Cir.), 51 Am. B. R. (n.s.) 79 (1942) (no offense unless bankrupt swears to what he knows to be false); *Sharcoff v. Schieffelin*, 70 F. 2d 725 (2d Cir. 1934); *Cohen v. United States*, 36 F. 2d 461 (3d Cir.), 15 Am. B. R. (n.s.) 556, *cert. denied*, 281 U. S. 742 (1929); *Magen v. United States*, 24 F. 2d 325 (2d Cir.), 11 Am. B. R. (n.s.) 573, *cert. denied*, 277 U. S. 595 (1928) (merchandise unaccounted for); *Grossberger v. Goodrich*, 8 F. 2d 964 (6th Cir.), 7 Am. B. R. (n.s.) 294 (1925) (wine, women and gambling); *In re Crenshaw*, 95 Fed. 634 (D. C. Ala. 1899) (untrue testimony through mistake); *Schonfeld v. United States*, 277 Fed. 934 (2d Cir. 1921); *In re Bergman*, 6 F. Supp. 898 (S. D. N. Y. 1934) (elements involved in perjury).

¹³ *Levinson v. United States*, 263 Fed. 257 (3d Cir. 1920).

¹⁴ *In re Lavery*, 235 Fed. 910 (D. C. Mass. 1916) (bankrupt delivers property to satisfy state court judgment after bankruptcy).

¹⁵ *In re Sims*, 26 F. Supp. 933 (N. D. W. Va.), 39 Am. B. R. (n.s.) 185 (1939); *United States v. Dunkley*, 235 Fed. 1000 (N. D. Cal.), 38 Am. B. R. 127 (1916) (extortion); *United States v. Five Boro Personal Loan Corp.* (E. D. N. Y. Criminal Docket No. 40139); *United States v. Safety Investment Corp.* (indictment filed Sept. 19, 1947 D. C. Minn.); *cf. Meyer v. Price*, 250 N. Y. 370, 13 Am. B. R. (n.s.) 485 (1929).

¹⁶ *In re Lenoble*, 182 F. 2d 1020 (2d Cir. 1950); *United States v. Lynch*, 180 F. 2d 696 (7th Cir.), *cert. denied*, 339 U. S. 981 (1950); *United States v. Rosenberg*, 145 F. 2d 653 (2d Cir.), 57 Am. B. R. (n.s.) 285 (1944); *United States v. Knickerbocker Fur Coat Co.*, 66 F. 2d 388 (2d Cir.), 23 Am. B. R. (n.s.) 598, *cert. denied sub. nom.*, *Zuckerkandel v. United States*, 290 U. S. 673 (1933); *United States v. Zisblatt Furniture Co.*, 78 F. Supp. 9 (S. D. N. Y. 1948), *appeal dismissed*, 172 F. 2d 740 (2d Cir. 1949); *United*

records relating to a bankrupt's property or affairs;¹⁷ (h) withholding documents relating to a bankrupt's property or affairs.

At this point it may be appropriate to give you some idea of the scope of these offenses by directing your attention to a few of these criminal-bankruptcy cases.

*United States v. Lynch*¹⁸

A paper mill corporation filed a petition for reorganization. The plan failed and the debtor was adjudicated a bankrupt. When the debtor's petition was originally filed, the court authorized the debtor to continue business and to employ the defendant (its secretary and treasurer) at a salary of \$62.50 a week. After adjudication, defendant filed a report covering the debtor's transactions from which it appeared that defendant issued debtor's checks totaling \$7,982.33 payable to himself or "cash". During this same period, the defendant's salary (at \$62.50 a week) amounted to \$1,750. Crediting the defendant with this sum and other deductible items, the overpayments amounted to \$4,236.54. The defendant was indicted, charged with misappropriation of funds of a bankruptcy estate by an agent of the debtor in possession. After trial, the jury found him guilty. The district court upheld the jury's verdict and, later, the court of appeals affirmed, stating that the jury was justified in finding that defendant had knowingly and fraudulently appropriated to his own use property of the bankrupt estate.

*United States v. Safety Investment Corp.*¹⁹

A money-lending institution, a creditor, filed specifications of objections to a bankrupt's discharge on the ground

States v. Gale, 35 F. Supp. 659 (E. D. N. Y. 1940); United States v. Cole (E. D. N. Y. Criminal Docket No. 42498).

¹⁷ Somberg v. United States, 71 F. 2d 637 (7th Cir.), 26 Am. B. R. (n.s.) 130 (1934).

¹⁸ 180 F. 2d 696 (7th Cir.), cert. denied, 339 U. S. 981 (1950).

¹⁹ Indictment filed Sept. 19, 1947 D. C. Minn.; United States v. Five Boro Personal Loan Corp. (E. D. N. Y. Criminal Docket No. 40139). See note 21 *infra*.

that the bankrupt obtained money on credit by making a materially false statement in writing respecting his financial condition. Before the hearing on the objections came on for trial, the creditor arranged to receive a consideration for the withdrawal of the objections. The creditor was indicted for receiving or attempting to obtain remuneration for forbearing to act or proceed on the specifications.

*United States v. Walsh*²⁰

Without authorization, a trustee of a bankrupt estate drew checks for various sums drawn on the trustee's account, forged the name of the referee whose countersignature on all checks was required by local rules, cashed the checks and applied the same to his own personal use. The trustee, indicted for embezzlement and pilferage of property belonging to the bankrupt estate which came into his possession as trustee, pleaded guilty.

*United States v. Knight*²¹

In the reorganization proceedings of Central Forge Co. a plan was approved under which Maxi Manufacturing Co. was to acquire the debtor's assets for the consideration of \$26,404.33 in cash and \$17,000.00 in bonds. After the fees and expenses of the trustee and his attorney had been approved by the court and paid to them, the defendants (Maxi Manufacturing Co.'s attorneys) arranged to have their client draw a check for \$3,000.00, had it cashed, and after deducting \$500.00 for income tax, paid the difference to the trustee and his attorney. The defendants were indicted for aiding and abetting the trustee to appropriate property of the bankrupt estate and for conspiring with the trustee and others to divert \$3,000.00 of the purchase price of the debtor's assets to the personal ends of the trustee and his attorney. The defendants were found guilty. The Supreme Court, in upholding the verdict, said in part:²²

²⁰ S. D. N. Y. Criminal Docket No. 126, 1947.

²¹ 336 U. S. 505 (1949).

²² *Id.* at 508.

All the consideration which is paid for a bankrupt's assets becomes part of the estate. No device or arrangement, however subtle, can subtract or divert any of it. It is the substance of the transaction, not its form, which controls. If that requirement were not rigidly enforced, control of the plan of reorganization and control of allowances would pass from the Court to the parties. That would subvert the statutory scheme.

*Levinson v. United States*²³

In the bankruptcy proceeding of Saunders Shoe Co., one Levinson (defendant) filed a proof of claim for \$18,000.00 for money loaned. The Government charged that the claim was not for money loaned, but that the money was paid for purchase of stock. Defendant, indicted for filing false proof of claim, was convicted.

In addition to the grounds of objections to a bankrupt's discharge based upon offenses punishable by imprisonment, Congress, seeking to eliminate certain evils arising from bankruptcy and its administration, made provision for the punishment of (a) a receiver, custodian, marshal, trustee or other officer of the court who appropriates to his own use or embezzles any property belonging to a bankrupt estate;²⁴ (b) one who knowingly acts as referee in a cause in which he is interested, or who, being a referee, receiver, custodian, trustee, marshal, or other officer of the court, knowingly purchases any property of a bankrupt estate of which he is such officer, or who, being such officer refuses to permit documents and accounts to be inspected when directed by the court.²⁵ Also, it is of interest to note that in a prosecution for any of the foregoing offenses, which may arise in relation to any type of proceeding under the Bankruptcy Act, it must be alleged and proven that the offense was knowingly and fraudulently committed.

In addition to the above-mentioned offenses the Borah Act, which prohibited certain fee-fixing arrangements and

²³ 263 Fed. 257 (3d Cir. 1920).

²⁴ 18 U. S. C. § 153 (1948), formerly BANKR. ACT § 29(a); *United States v. Goldman*, 118 F. 2d 310 (2d Cir. 1941), *aff'd*, 316 U. S. 129 (1942); *Ashbaugh v. United States*, 13 F. 2d 591 (6th Cir. 1926); *United States v. Meagher*, 36 F. 2d 824 (D. C. Mont. 1929).

²⁵ 18 U. S. C. § 153 (1948), formerly BANKR. ACT § 29(a).

appointments to be made in bankruptcy proceedings, was repealed but re-enacted as a permanent part of the new Title 18, United States Code.²⁶

The concealment of assets of a bankrupt's (or debtor's) estate is a *continuing offense* until bankrupt's discharge is granted or denied, when the three-year statute of limitations begins to run.²⁷

Of salutary effect is the provision whereby there may be referred to the United States Attorney the matter of inquiring into and investigating "any violations of the bankruptcy laws or other laws of the United States relating to insolvent debtors, receiverships or reorganization plans." The United States Attorney thereupon conducts the inquiry and reports to the referee. If the United States Attorney believes an offense was committed, he presents the matter to the grand jury. However, if the ends of justice do not require prosecution, the United States Attorney must report the facts to the Attorney General for his direction.²⁸

Incidentally, the United States Attorney is entitled to receive notice of hearing of the bankrupt's application for discharge and may, in the public interest, file specifications of objections to the discharge.²⁹

Bankrupts have raised questions as to the invasion of their constitutional rights. The Supreme Court has upheld the bankrupt's claim of immunity from testifying³⁰ but has required the bankrupt to turn over his books and records, because title to them passes by operation of law to the trustee in bankruptcy.³¹

Another phase of bankruptcy which borders closely on the question of crime is the summary (turn over) proceeding instituted by a trustee against a bankrupt, and the contempt proceedings which usually follow the granting of the "turn

²⁶ 18 U. S. C. §§ 155, 1910 (1948).

²⁷ 18 U. S. C. §§ 3282, 3284 (1948).

²⁸ 18 U. S. C. § 3057 (1948).

²⁹ 11 U. S. C. § 32d (1938).

³⁰ *McCarthy v. Arndstein*, 266 U. S. 34 (1922); 11 U. S. C. § 25a(10) (1938).

³¹ *In re Fuller*, 262 U. S. 91 (1923).

over" order. This subject was discussed fully by the Supreme Court in *Maggio v. Zeitz*.³²

A word or two on the question of evidence. While any one of the offenses mentioned in this discussion must be proved beyond a reasonable doubt in a criminal cause, it should be noted that in bankruptcy, on the hearing on the specifications of objection to a discharge, the objecting creditor is *not* required to prove this objection by more than a *preponderance* of evidence.³³ Furthermore, even though a bankrupt may be tried and acquitted on a criminal charge based on the same allegations of facts as the specifications of objection, such acquittal has no bearing on the bankruptcy court's determination of the question of a bankrupt's discharge. On the other hand, a discharge granted a bankrupt is *not res adjudicata* in the criminal prosecution of a bankrupt for concealment of assets.³⁴ But when a bankrupt's application for a discharge was opposed upon the ground that he committed a bankruptcy offense, it was held that the bankrupt's conviction for that offense was conclusive proof that he committed the offense charged, requiring a denial of discharge.³⁵ Under the present law, no testimony given by a bankrupt should be accepted in evidence against him in any criminal proceeding *except such testimony as may have been given by him in the hearing upon objections to his discharge*.³⁶

To the question, "Are bankrupts criminals?", it must be acknowledged at the outset that the percentage of "criminal-bankrupts" is very small; and, in any event, the answer must naturally depend upon the facts in each case. While the bankruptcy law is humane—and generous—in granting discharges and other debtor relief, nevertheless that law and the correlated provisions of Title 18, United States Code, are

³² 333 U. S. 56 (1948).

³³ *United States v. Greenstein*, 153 F. 2d 550 (2d Cir. 1946); *United States v. Weinbren*, 121 F. 2d 826 (2d Cir. 1941); *Arine v. United States*, 10 F. 2d 778 (9th Cir. 1926) (charts and summary of record by expert accountant admissible).

³⁴ *Douchan v. United States*, 136 F. 2d 144 (6th Cir.), 54 Am. B. R. (n.s.) 148, *cert. denied*, 319 U. S. 773 (1943).

³⁵ *In re Gophrener*, 20 F. Supp. 922 (E. D. N. Y.), 34 Am. B. R. (n.s.) 482 (1937).

³⁶ 11 U. S. C. § 25(a) (10) (1938).

sufficiently adequate to drive the crooked bankrupt out of the business world *by denying his discharge, and by punishing him by imprisonment upon conviction of any of the enumerated crimes.* Giving effect to what has been said, it is evident that the bankruptcy law, although a statute of mercy, cancels debts only when justice approves.

It is no mere rhetorical expression and no exaggeration to say that while the success of bankruptcy administration depends largely upon the referees in bankruptcy—"the unsung heroes of the federal judiciary,"³⁷ commendation in many cases must also be given to vigilant creditors, credit associations and their attorneys. And we hasten to sing the high praises of the judges of the federal courts, the staffs of the United States Attorney, the Federal Bureau of Investigation, and the Federal Grand and Petit Juries. Prompt and persistent investigations, indictments, prosecutions and trials have frustrated and defeated the fruition of the scheming machinations of many an unscrupulous debtor who has sold himself to the devil. The criminal bankrupt may flourish "like a green bay tree" and even elude the clink of the prison door closing behind him, but he cannot escape the agonizing torture of a searing guilty conscience which in deep profound voice intones over and over again in sonorous monotone—crime does not pay.

"For what shall it profit a man, if he gain the whole world, and suffers the loss of his soul?"³⁸

³⁷ Mr. Justice Burton's address reported in 24 J. N. A. REF. BANKR. 4 (1950).

³⁸ Mark 8:36.