

# Bankruptcy and Reorganization (Transcript of a Radio Interview Broadcast Over WBBC as Part of a Series Called "Law of Interest to Layman and Lawyer")

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## BANKRUPTCY AND REORGANIZATION\*

**K.** Today we hold forth on "Bankruptcy," a subject important to everyone. The present millionaire may be the future pauper. The uncertainties of wealth were never more clearly proven, than during the course of the recent depression. Comparatively few escaped its effects. There were no wisecracs. Even brilliant men became impoverished. *Years ago* this might have entailed fearful hardship, perhaps imprisonment, plus the poverty. *Now*, we have beneficent laws which recognize that destitution is woe enough—laws which permit those in want to be relieved of their debts.

We are privileged to have with us as our guest, Professor Samuel C. Duberstein, instructor in "Bankruptcy and Reorganization" at the St. John's University School of Law. Professor Duberstein's knowledge is not alone the pedantic learning of research, but also the wisdom that comes from a most active practice in his specialty. \* \* \* And now we proceed to our interview.

**K.** Professor, I have some recollection that somewhere I came across the statement that bankruptcy finds its origin in the Bible. Am I correct in this recollection?

**D.** Yes. Although disputed, there are several writers on the subject who have stated that the provision of the Bankruptcy Law relating to discharge or release of one's debts finds its origin in the Bible,<sup>1</sup> where we read—"At the end of every seven years, thou shalt make a release. And this is the manner of the release: every creditor that lendeth ought unto his neighbor shall release it; he shall not exact

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\* This is a radio interview of Professor Samuel C. Duberstein, broadcast over Station WBBC, and conducted by Edward A. Kole, Esq., a member of the New York Bar, who is conducting a series of broadcasts on "Law of Interest to Layman and Lawyer." It is included here with the consent of Professor Duberstein in the belief that its timeliness and concise method of presentation will prove to be an aid to both the student and the profession.

The letter "K" will hereinafter represent Mr. Kole, and the letter "D", Professor Duberstein.—Ed.

<sup>1</sup> Deut. 15:1, 2.

it of his neighbor or of his brother because it is called the Lord's release."

K. I am informed that imprisonment for debt was nothing unusual in years gone by. Has this anything to do with the historical background of bankruptcy?

D. Several centuries ago, the bankrupt was treated as a criminal and was punished by imprisonment—even death—and no provision was made to release him from the payment of his obligations.<sup>2</sup> It is interesting to know that the first English Bankruptcy Law was enacted in 1542 in the reign of King Henry the Eighth but made no provision for the discharge of the bankrupt. A more enlightened view was taken later in the reign of Queen Anne in 1705, when the debtor was not imprisoned and where provision was made for a release of his debts.

K. Generally, I presume the idea of the Bankruptcy Law is to release a person or a corporation that is insolvent from all its obligations, provided that person or corporation surrenders its assets. Am I correct in that?

D. The Bankruptcy Law has a two-fold purpose. The primary purpose is the marshaling of a debtor's assets and the distribution thereof among creditors on a *pro rata* basis. Its secondary purpose is the discharge and release of the payment of a bankrupt's obligations provided he has surrendered all of his assets to the United States Court and has dealt honestly with his creditors.<sup>3</sup> Of course, in cases of fraud and dishonesty of a bankrupt, his discharge would be denied,<sup>4</sup> and certain acts are even made punishable by imprisonment.<sup>5</sup>

K. Professor, I have heard a great many complaints in recent years about the exorbitant costs of administering bankrupt estates. Is there any truth in these complaints?

<sup>2</sup>BUCKLAND, TEXTBOOK OF ROMAN LAW 638-640; 34, 35 HENRY VIII, c. 4 (1542); JUSTINIANS'S CODE DIG. 2, 4, 19, 25, 48, 49.

<sup>3</sup>Hanover National Bank v. Moyses, 186 U. S. 181, 22 Sup. Ct. 857 (1902); Sexton v. Dreyfus, 219 U. S. 339, 37 Sup. Ct. 256 (1911).

<sup>4</sup>30 STAT. 550 (1898), 11 U. S. C. A. §32 (1926), BANKRUPTCY ACT §14.

<sup>5</sup>30 STAT. 554 (1898), 11 U. S. C. A. §52 (1926), BANKRUPTCY ACT §29.

D. There is a popular fallacy that the cost of administration of a bankrupt estate is exorbitant. That is not true. Compared with the cost of administering an estate under the State Court practice, the expenses of the bankruptcy administration are modest. Records show that eighty cents of every dollar of assets that comes into the Bankruptcy Court goes to creditors. Creditors delay in enforcing their rights, with the result that when the bankruptcy proceeding is actually instituted in the United States Court, liabilities are large and the assets to be administered small.

K. Professor, I also have a feeling that it is generally believed that all bankrupts are not straightforward—that they are dishonest and crooked. What has your experience been in this connection?

D. That is also a popular misconception. While it is true that there are several instances of crookedness on the part of some merchants, it also is a known fact that honest merchants have sought relief through the Bankruptcy Courts because of economic conditions beyond their control, more particularly in recent years by reason of the world-wide depression which has affected almost every individual in the country.

K. Professor, you have made some reference to bankruptcy finding its origin in the Bible—at least to the discharge of the debtors finding its origin there. Does bankruptcy also relate back to any other important document?

D. The framers of our Constitution realized the importance of assisting unfortunate but honest debtors and included in our Constitution under Article 1, Section 8, Clause 4, authority for Bankruptcy Legislation which provides that "The Congress shall have power \* \* \* to establish \* \* \* uniform laws on the subject of bankruptcies throughout the United States." The first bankruptcy law was enacted during the presidency of John Adams in 1800. Champions of states' rights were jealous of federal control and shortly thereafter this law was repealed. We also had a bankruptcy law enacted in 1841 which was repealed two years later.

Shortly after the Civil War, owing to the general depression then existing, another bankruptcy law was enacted in 1867, but because of the exorbitant charges of administration, that law was repealed in 1878. It is within the memory of many present-day merchants, who recall the unfortunate and unsettled business conditions of 1893, when it was impossible for men to resume normal activity owing to the tremendous financial burdens they were obliged to carry. Agitation seeking justifiable relief bore fruit in the enactment of a law known as the "Bankruptcy Act of 1898." This law is the one under which we are operating, modified only to the extent of about twelve or thirteen amendments that have been made since 1898 and up to the present time.

K. There has been, I am told, a recent amendment that is quite far-reaching in its scope. When did that take effect?

D. It would be more correct to say that there were several recent amendments. They provide for readjustment of the debt burden through the Individual Debtor Extension or Compromise Act,<sup>6</sup> the Municipal Bankruptcy Act,<sup>7</sup> the Railroad Reorganization Acts,<sup>8</sup> the Farmer Relief Act<sup>9</sup> and the Corporation Reorganization Act.<sup>10</sup> On the last day of President Hoover's administration Congress passed an amendment to the Bankruptcy Act which made provision for the institution of proceedings in the United States Court for the relief of the individual debtor.<sup>11</sup> In it the debtor avoids the name of "bankrupt." Unfortunately, at that time Congress failed to provide relief for the corporation debtor. Business organizations today are mainly in corporate form. With the failure of some very large business concerns, Congress turned to passing legislation looking towards the amendment of the Bankruptcy Act so as to provide for corporate reorganization. Previously there was no provision

<sup>6</sup> 47 STAT. —, 11 U. S. C. A. §202 (1933), BANKRUPTCY ACT §74.

<sup>7</sup> 48 STAT. 798, 11 U. S. C. A. §301 (1934), BANKRUPTCY ACT §78; 48 STAT. 798, 11 U. S. C. A. §302 (1934), BANKRUPTCY ACT §79; 48 STAT. 798, 11 U. S. C. A. §303 (1934), BANKRUPTCY ACT §80.

<sup>8</sup> 47 STAT. 1474, 11 U. S. C. A. §205 (1933), BANKRUPTCY ACT §77.

<sup>9</sup> 47 STAT. —, 11 U. S. C. A. §203 (1933), BANKRUPTCY ACT §75.

<sup>10</sup> 48 STAT. —, 11 U. S. C. A. §207 (1934), BANKRUPTCY ACT §77 B.

<sup>11</sup> *Supra* note 6.

for such debtors being relieved of the burden imposed by obligations held by secured creditors or of various issues of corporate stock. The only method by which a readjustment then could be worked out was by a foreclosure of such security by a bondholders' committee usually in conjunction with a form of equity receivership, the administration of which was not alone cumbersome, but also expensive. All of this gave rise to the enactment of the recent amendment to the Bankruptcy Act in June, 1934, known as the "Corporation Reorganization Law"<sup>12</sup> which is considered a major achievement of the Roosevelt "New Deal program." It is to be noted that this "New Deal" legislation gives relief without the government being required to make any advances or contributions of money of any kind, and so differs from other phases of the Roosevelt program.

K. Do you believe that this legislation will become a permanent part of the law of our land?

D. The Municipal Debt Adjustment Act indicates emergency relief for municipalities for a period of only two years.<sup>13</sup> The Frazier Lemke Farm Bankruptcy Act<sup>14</sup>—which grants a virtual five-year moratorium—will undoubtedly be modified. It is certainly contrary to the philosophy back of the recovery program of the "New Deal" which is to push up prices alongside debts. While the recent amendments were primarily enacted because of the national emergency, yet it is believed that the provisions for reorganization of business concerns—whether in corporate or individual form—which find their assets frozen or non-liquid—will become a permanent part of our legal structure. As the law stands today, one can answer in the affirmative the question which our President mentioned in a radio address following the close of the 73d Session of Congress, when he asked, "Are your debts less burdensome?"

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<sup>12</sup> *Supra* note 10.

<sup>13</sup> *Supra* note 7.

<sup>14</sup> 48 STAT. —, 11 U. S. C. A. §203 (1934), BANKRUPTCY ACT §75 (s); *In re Bradford*, 7 F. Supp. 665, 26 Am. B. R. (N. S.) 1 (D. Md. 1934) (court holding law unconstitutional).

K. Will you give us some of the high spots wherein there were changes or reforms or additional new matter in the recent Bankruptcy Law.

D. (1) It will no longer be necessary in Corporate Reorganization cases to appoint ancillary receivers in the different districts where a debtor's assets may be located. All will now be under the immediate jurisdiction and guidance of the Court of original jurisdiction where the petition for reorganization is filed.<sup>15</sup>

(2) No Trust Company, or for that matter, no individual, can have a monopoly of receiverships or trusteeships. Thus ends the virtual Irving Trust Company monopoly in New York.<sup>16</sup>

(3) The new bankruptcy legislation refers to a distinct labor policy by which the Court, the Trustee and debtor are forbidden to interfere with the right of employees or those seeking employment, to join labor organizations of their own choice.<sup>17</sup>

(4) The former method of judicial sale of corporate property to fix the amount to be paid to dissenting creditors is now unnecessary.<sup>18</sup>

(5) On approving the petition for reorganization, the Judge may name Trustees for such period as he may decide or may have the debtor corporation continue its business, in which event the salaries of the officers must be reasonable and approved by the Judge.<sup>19</sup>

(6) The reorganization plan may include the transfer, merger, or consolidation of all or any part of the property of the debtor to or with another corporation.<sup>20</sup>

<sup>15</sup> *Supra* note 10, BANKRUPTCY ACT §77 (B) (a); see also GENERAL ORDER 51 limiting ancillary receivership in ordinary bankruptcy proceedings.

<sup>16</sup> *Supra* note 10; 48 STAT. —, 11 U. S. C. A. §76 a (1934), BANKRUPTCY ACT §3.

<sup>17</sup> *Supra* note 10, BANKRUPTCY ACT §77 B (1) (m).

<sup>18</sup> *Supra* note 10, BANKRUPTCY ACT §77 B (b) (e) (f).

<sup>19</sup> *Supra* note 10, BANKRUPTCY ACT §77 B (c).

<sup>20</sup> *Supra* note 10, BANKRUPTCY ACT §77 B (b).

(7) Running of time under bankruptcy laws or Statute of Limitations is suspended during reorganization proceedings.<sup>21</sup>

(8) If no plan is proposed or approved, the Court may either dismiss the proceedings or order liquidation.<sup>22</sup>

(9) The stigma or odium of "bankruptcy" is avoided.<sup>23</sup>

(10) Proceedings may be voluntary or involuntary.<sup>24</sup>

(11) Good faith in filing proceedings must be alleged or proved.<sup>25</sup>

K. Have any of the large corporations who have had financial difficulties taken advantage of this new legislation?

D. Yes. Within twenty minutes after President Roosevelt affixed his signature to this law, the National Press Building Corporation of Washington, D. C., filed the first petition to reorganize under this law which is known as Section 77B of the Bankruptcy Act. In the Southern District of New York we find the Radio-Keith-Orpheum Corporation the first corporation seeking such relief, and the Lehrenkrauss Corporation in the Eastern District of New York.

K. Are the benefits of this corporate reorganization bill available to all classes of corporations?

D. No. Banking corporations, building and loan associations, insurance corporations,<sup>26</sup> and certain railroad corporations are excluded.<sup>27</sup> With respect to municipalities, owing to the National Emergency, the President in May,

<sup>21</sup> *Ibid.*

<sup>22</sup> *Supra* note 10, BANKRUPTCY ACT §77 B (c. 8).

<sup>23</sup> 48 STAT. —, 11 U. S. C. A. §207 (1934), BANKRUPTCY ACT §77 A.

<sup>24</sup> *Supra* note 10, BANKRUPTCY ACT §77 B (a).

<sup>25</sup> *In re* Laclede Gas Light Co. (D. Mo.) June 25, 1934; *In re* Coronado Co. (D. Mo.) July 5, 1934; *In re* Texas Gas Utilities Co. (D. Texas) Aug. 20, 1934; *In re* South Coast Co. (D. Del.) Sept. 12, 1934; *In re* Philadelphia Rapid Transit Co. (D. Pa.) Sept. 12, 1934.

<sup>26</sup> *In re* National Surety Co., 7 F. Supp. 959 (D. — 1934); *In re* Union Guaranty & Mortgage Co., 26 Am. B. R. (n. s.) 113 (1934).

<sup>27</sup> *Supra* note 10, BANKRUPTCY ACT §77 B (a) (n).

1934, approved an amendment to the Bankruptcy Act by which municipal debt readjustments may be effectuated during the next two years.<sup>28</sup>

K. Will you explain the effect that the recent bankruptcy amendments have on landlords' claims.

D. Prior to the March 3, 1933, amendment, a landlord's claim for rent for the unexpired term of a lease was not provable—not dischargeable—and could not participate in the distribution of dividends.<sup>29</sup> Under the Act of March 3, 1933, which only made provision for an individual debtor to obtain an extension or settlement, rent to accrue could be proven in any amount.<sup>30</sup> But under the amendments of June, 1934, in ordinary bankruptcy cases (whether the bankrupt is an individual, partnership or corporation) the landlord may prove his claim for rent up to the equivalent of one year's rent plus an amount equal to the unpaid rent which accrued up to the date of the surrender of the premises.<sup>31</sup> In corporate reorganization cases landlords may now prove their claim for rent up to the equivalent of three years' rent plus an amount equal to the unpaid rent which accrued up to the date of the surrender of the premises.<sup>32</sup>

K. By whom may a corporate reorganization plan be proposed?

D. Either by debtor,<sup>33</sup> creditors,<sup>34</sup> or stockholders.<sup>35</sup> The proposed plan if offered by creditors must have been approved by not less than 25% in amount of any class of creditors affected by the plan and not less than 10% in amount of all claims against the debtor.<sup>36</sup> If the corporate

<sup>28</sup> *Supra* note 7.

<sup>29</sup> *Manhattan Properties, Inc. v. Irving Trust Co.*, 291 U. S. 320, 54 Sup. Ct. 385, 24 Am. B. R. (N. S.) 187 (1934).

<sup>30</sup> *Supra* note 6, BANKRUPTCY ACT §74 (a).

<sup>31</sup> 48 STAT. —, 11 U. S. C. A. §103 (1934), BANKRUPTCY ACT §63 (7).

<sup>32</sup> *Supra* note 10, BANKRUPTCY ACT §77 B (b).

<sup>33</sup> *Supra* note 10, BANKRUPTCY ACT §77 B (a).

<sup>34</sup> *Supra* note 10, BANKRUPTCY ACT §77 B (a) (d).

<sup>35</sup> *Supra* note 10, BANKRUPTCY ACT §77 B (d).

<sup>36</sup> *Ibid.*

debtor is solvent, but is found unable to pay its debts as they mature, a proposed plan may be offered by stockholders having not less than 10% of any class of stock and not less than 5% of the total number of all classes of stock.<sup>37</sup>

K. Can you tell me what is necessary for the court to confirm a plan of reorganization?

D. Generally speaking, the plan must be accepted in writing by creditors holding at least two-thirds in amount of the claims of each class affected by the plan, and if the debtor is solvent, by stockholders holding the majority of the stock of each class. Acceptance is not necessary by creditors whose claims are not affected by the plan or such claims are to be paid in cash in full, or if provision is made for the protection of such claims in manner provided by statute. It is also a fact that the acceptance is not necessary by any stockholder if the corporate debtor is insolvent or if the interests of such stockholder will not be affected by the plan, or if provision is made for the protection of said interest in the manner provided by law.<sup>38</sup>

In the event that the corporate debtor is a utility, the plan of reorganization must be submitted to such regulatory commission and an opportunity afforded such commission or authority to be heard. In the event that the corporate debtor is a public utility corporation doing intra-state business only, the plan of reorganization will not be approved unless the regulatory commission approves thereof. If such commission fails to certify within thirty days that the public interest is affected by the plan, the court may approve of such plan of reorganization.<sup>39</sup>

K. Does the law apply to any municipally owned railroad?

D. Railroads owned in whole or in part by any munic-

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<sup>37</sup> *Ibid.*

<sup>38</sup> *Supra* note 10, BANKRUPTCY ACT §77 B (e).

<sup>39</sup> *Supra* note 10, BANKRUPTCY ACT §77 B (e. 2).

pality or in which a municipality has an operating interest, are not affected by the Corporation Reorganization Act.<sup>40</sup>

K. On the whole, what do you think of our Bankruptcy Law as presently constituted?

D. It is a most humane piece of legislation. It is constructive. It solves social and financial problems. It will dovetail perfectly with other phases of the nation-wide recovery program in granting relief to unfortunate debtors, and it is an answer to the question "Am I my brother's keeper?"

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<sup>40</sup> *Supra* note 10, BANKRUPTCY ACT §77 B (n).