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The Scope and Effect of the 1926 Amendments to the Bankruptcy Act

James J. Robinson*

"It is the best bill we can pass at this time. It makes for honesty, it makes for economy, it makes for equality among creditors." In these words, on the floor of the House of Representatives, on April 17, 1926, Congressman Earl C. Michener, of Michigan, defended the bill which on August 27, 1926, after subsequent amendments became effective in amendment of the Bankruptcy Act of 1898.¹ Almost the sole opponent of the bill was a "gentleman from Texas," who described himself as "not a bankruptcy lawyer," although, he added, "I may be a bankrupt lawyer."² The vote was—yeas 276, nays 17.

The Amendments are the work of the American Bar Association, the National Association of Credit Men, the Commercial Law League of America, the Judiciary Committees of the House and Senate, and other bodies. The American Bar Association, at its annual meeting in 1923 had followed the recommendation of Chief Justice Taft and others by creating a Special Committee on Practice in Bankruptcy Matters, to recommend amendments to the Bankruptcy Law designed to "bring about a cessation of the frauds and abuses that are complained of under the present practice."³ Mr. Simon Fleischmann, of Buffalo, N. Y., as chairman of that committee, shares with Mr. Michener, of the House Committee on Judiciary, chief individual credit for the present amendments.

The amendments are concerned chiefly with promoting the equal and economical distribution of the debtor's property among his creditors. The other object of bankruptcy legislation, namely, the relief of the honest debtor from his misfortune, was regarded as substantially secured by the original act. The sponsors of the Amendments state that while the amendments strengthen the Act, they still leave the success of the Bankruptcy Act substantially and principally dependent upon its administration, that is, upon the integrity, watchfulness and ability of the judges, referees, trustees, receivers,

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¹(1926) 67 Cong. Rec. 7680.
²(1926) 67 Cong. Rec. 7680.
attorneys, and others upon whom the administration of the Act rests.\textsuperscript{4}

Those who heard the report of Chairman Fleischmann, at Detroit, on September 3, 1925, at the Annual Meeting of the American Bar Association, may remember his summary of the proposed bill, now enacted in largely the same form as it was then presented. We shall here consider the Amendments in substantially the same order in which he summarized them.

"We have increased," said Chairman Fleischmann, "the number and nature and seriousness of objections to discharge in the case of dishonest bankruptcies, including the more serious consequences resulting from failure to keep proper books of account."\textsuperscript{5} Section 14 deals with Discharges,—When Granted. Section 14 (a) is amended so that it ends disagreement among the courts on the question: During what period after adjudication may the bankrupt file his application for discharge? This question is now definitely answered as follows: During the period from the 2d to the 12th month, both inclusive. There is no longer room for the dispute that the bankrupt also has the 13th month after adjudication in which to file his application for discharge.

Sec. 14 (b) is amended to extend the grounds upon which the judge may refuse to discharge the applicant. Subdivision (1) prevents discharge if the applicant has "committed an offense punishable by imprisonment as herein provided." While not amended, this subdivision is enlarged in scope by the amendments to section 29 increasing the number of bankruptcy offenses punishable by imprisonment: Subdivision (2) may prevent discharge if the applicant has destroyed or failed to keep books of account. Before amendment, it required such acts to be done "with intent to conceal his financial condition"; by the amendment, such intent is not specifically mentioned, and the court is given power to disregard such acts or neglect if the facts of the case justify them. Subdivision (3) now denies discharge where the applicant gets money or property or additional credit by publishing or causing to be published, in any manner whatsoever, a materially false statement in writing about his financial condition. Before amendment, this subdivision failed to prevent discharge if the applicant made his false statements through commercial agencies. Subdivision (4) now denies discharge if the applicant during the 12 months preceding the filing of the petition had transferred or concealed any of his property, with intent to hinder, delay or defraud his


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creditors. The former limit was 4 months. That period was found to be too short and was therefore lengthened to 12 months. Subdivision (5) now omits the words "involuntary proceedings," so that now in both voluntary proceedings and involuntary proceedings, no applicant can get a discharge within six years of a previous discharge. This amendment bars the habitual or chronic bankrupt from bringing "involuntary" bankruptcy upon himself to avoid the six-year limitation formerly applicable to voluntary proceedings alone. Subdivision (6) still denies discharge to an applicant who has refused to obey court orders or to answer questions approved by the court. Subdivision (7) is new. By it the judge denies discharge if the applicant has failed to explain satisfactorily any losses of assets or deficiency of assets to meet his liabilities.

To sec. 14 (b) is then added an important proviso which puts upon the applicant the burden of proving that he has not committed any of the seven acts just enumerated, such burden to arise as soon as an objector to the discharge shall show to the satisfaction of the court that there are reasonable grounds for believing that the bankrupt has committed any of the seven acts. The Amended Act retains the further proviso that a trustee shall not object to the discharge except upon authorization of creditors. An effort was made to remove this restriction.

The next statement by the committee's spokesman was: "We have unified the times within which appeals must be taken, and I think in most cases have shortened it, so that bankrupt estates may be more promptly closed." Secs. 24 and 25 deal with appeals. Sec. 24 (b) is amended to end confusion by abolishing petitions to revise or to review, and by making the method of review solely by appeal. A new sub-section, 24 (c), requires that all appeals under sec. 24 shall be taken within 30 days after the judgment, or order, or other matter complained of, has been rendered or entered. Sec. 25 is then correspondingly amended to make the period for appeal 30 days, instead of 10 days. This uniformity is designed to end confusion and conflicts of authority on the subject of the proper time for appeals.5

The Committee's spokesman next emphasized a group of amendments to section 29, saying: "We have increased the number of criminal offenses and the punishments of those directly and indirectly associated with any fraud in connection with going into and through

5For opinion that this has not been accomplished, see Colin, An Analysis of the 1926 Amendments to the Bankruptcy Act. (1926) 26 Col. Law Rev. 789, at 798.
bankruptcy." Subsection (a) of section 29 formerly provided imprisonment not to exceed five years for embezzling the property or secreting the documents of a bankrupt estate by a trustee. By the Amendment, such penalty is also extended to the receiver, custodian or other officer of the court. Subsection (b) of section 29 raises the maximum term of imprisonment from two to five years, for the following enumerated offenses, the number of which is raised from five to eight. Sec. 29 (b) (1) forbids concealment of property belonging to the estate of a bankrupt, and is now so amended that it covers not only concealment by the bankrupt or his agent, as formerly limited, but concealment by anyone; and is now amended so that it covers not only concealment from the trustee, as formerly limited, but also concealment from the receiver, United States Marshal, or other officer of the court in charge of the property, or creditors in composition cases. Section 29 (b) (5) is amended to forbid, not technical "extortion" as formerly, but receiving or attempting to obtain compensation for acting or not acting in bankruptcy proceedings. The three new offenses are: sec. 29 (b) (6) forbids an officer or agent of the debtor to conceal or transfer any of the debtor's property, in contemplation of bankruptcy, or with intent to defeat the Act; section 29 (b) (7) forbids the concealment, after the filing of the petition, or in contemplation of bankruptcy, of any book, etc., relating to the bankrupt's affairs; and section 29 (b) (8) forbids the withholding, from the receiver or trustee, after the filing of the petition, of any book or paper relating to the bankrupt's affairs, and to possession of which he is entitled. Experience is said to have shown the need for the creation of such new offenses.

Criminal prosecutions of bankruptcy offenders are further aided by an extension of the statute of limitations from one year, to three years after the commission of the offense [Sec. 29 (d)]. This extension is expected to discourage the present one-year sojourns, out of the jurisdiction, of fraudulent bankrupts.

Finally, a new subsection (e), directs the referee, receiver, or trustee to report to the proper United States Attorney facts coming to his attention and reasonably indicating that an offense against the Act has been committed. The United States attorney is directed then to present the matter to the Grand Jury, or to the Attorney General for his direction.

And finally, the Committee's spokesman, on the occasion referred to, emphasized one other principal group of amendments, in these

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words: "We have re-arranged, and I believe, improved the regulation of priorities, in the distribution of assets and the payment of taxes, in the interest of creditors. The measures include the abolishing of priority of payment of taxes, (and) of residents, or corporations of a given state, to the prejudice, and as against the claims of, creditors for like claims of other states."

But the Senate amended the bill by striking out that proviso which was designed to abolish the priorities of residents and domestic corporations of a given state.\(^8\) Section 64, of course, fixes the priorities of those getting property from the bankrupt estate ahead of the general creditors. The American Bar Association's Special Bankruptcy Committee recommended that section 64 (b) (7) read as follows: "(7) debts owing to any person who by the laws of the States or the United States is entitled to priority; Provided, however, that priorities granted by any state law to its residents and to domestic corporations over non-residents and foreign corporations shall not be recognized or allowed."\(^9\) The committee said, "The reasons for this amendment grow out of the fact that there is now existing in Tennessee, and, perhaps, in other states, a statute which provides that resident creditors shall have priority in distribution of assets over residents of other states or countries. The U. S. Supreme Court held this act unconstitutional, except in so far as it related to foreign corporations, with the result that a foreign corporation, doing business in Tennessee, is subordinated to all the Tennessee creditors, as was held in Standard Oak Veneer Co., (173 Fed. 103) (1909). Clearly such an unfair discrimination and preferential outcome should not be perpetuated or left possible."\(^10\)

But, the form of section 64 (b) (7) in the Amended Act is as follows:

"(7) debts owing to any person who by the laws of the states or the United States is entitled to priority: Provided, That the term 'person' as used in this section shall include corporations, the United States, and the several states and territories of the United States."

This amended provision is the original clause section 64 (b) (5), plus the proviso. Some of the questions raised by the present amended subdivision and proviso, are: does not this proviso perpetuate, rather than abolish, the home-state discrimination which we may call the "Tennessee evil?" As to making the term "person" include "corporations," why merely repeat the same provision of sec. i (a) (19)? As to making the term "person" include "the United States

\(^8\)(1926) 67 Cong. Rec. 9610.
and the several states," do we not have a conflict with the preceding subdivision, 64 (b) (6), which expressly, and more broadly provides for the priority of taxes due the "United States, state, county, district or municipality?" It has also been suggested that the proviso is an unwarranted legislative repudiation of the law as recently laid down by the United States Supreme Court in *Davis v. Pringle* and *Borland v. United States*, 268 U. S. 315, 45 Sup. Ct. 549 (1925).11

The confusion raised by this Proviso is especially unfortunate, because of the specific abuse being "left possible," and also because the Amendments otherwise bid fair to end the old confusion as to what priority was due taxes owing by the bankrupt estate.

Sec. 64 (a) is amended to show clearly that taxes are payable, under subsection (b), after expenses of the proceedings and wages. The amendment also exempts real estate of the bankrupt estate from taxes in excess of the actual interest, or equity, of the bankrupt estate in such real estate. This makes for fairness to the general creditors. Sec. 64 (b) (3) now allows an attorney's fee to the involuntary bankrupt, as well as to the voluntary bankrupt as heretofore. Sec. 64 (b) (4) is a new subdivision, empowering the court in its discretion to allow reasonable expenses to creditors who have successfully opposed a composition. The Committee's reason for this priority was to encourage the defeat of dishonest compositions. But the amendment fails to indicate that dishonest compositions particularly are meant. Perhaps the courts will exercise their discretion so as to limit such relief to such cases, so that this provision will not become a "two-edged sword," as some critics fear.12 Sec. 64 (b) (5) increases the maximum priority for wages from three hundred dollars to six hundred dollars, as maintaining relative proportions between the values of 1898 and of 1926.

Important procedural changes also include the reduction of the time for proving claims against a bankrupt estate from the former limit of one year after the adjudication, to six months after the adjudication. [Sec. 57 (n).] The object of this amendment is simply to hasten the closing up of the proceeding.

Another procedural change is that the voluntary bankrupt is no longer required to file with his petition a schedule of his property and a list of his creditors. He now has 10 days after filing his petition within which to file such schedule and list, just as the involuntary bankrupt has 10 days after adjudication to do the same. Sec. 7 (a) (8).

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Some of the other changes in the Act made by the 1926 Amendments, are the following: The definition of "corporations" in sec. 1 (a) (6) is expanded to include common-law trusts and unincorporated companies and associations. Changes in territorial status, or in the federal system of courts, are provided for in sec. 1 (a) (8), (24); sec. 2; sec. 23; sec. 24, and sec. 25. Changes as to patents appear in sec. 70.

A new Act of bankruptcy is created in sec. 3 (a) (4), to overcome the effect of the decision of the Supreme Court in Citizens Banking Co. v. Ravenna National Bank, which held that a creditor might get a lien and do nothing toward sale under it until it had ripened into a preference.

As to expenses, such as stenographic help, more discretion is placed in the court, and an arbitrary and outgrown price limit is abolished in sec. 38 (a) (5).

Sec. 21 (h) establishes a privilege and immunity for good-faith communications between creditors, receivers, and trustees concerning the conduct, acts or property of the bankrupt. Its object is to facilitate full investigation and conference.

Another provision designed to speed up the proceedings is the Amendment of sec. 12 (a). The old law required that if an offer of composition was filed, action on the petition for adjudication should automatically be delayed until the composition was acted upon. This led to delay, waste and to the filing of "sham" offers of composition. The 1926 amendment provides that the filing of such offers before adjudication shall not delay action on the petition for adjudication, subject to the discretion of the court.

One difficult question remains. In case the bankrupt or prospective bankrupt makes a preferential transfer of his property, and the transferee delays in recording such transfer, should the power of the creditor or of the trustee to proceed to recover part or all of such property be limited by the time of the transfer, or by the time of the recording of the transfer? And what difference does it make whether the statute of the particular state requires recording or merely permits recording of such transfers? If the actual recording of the transfer is the first notice which the creditor or trustee has received of the preferential transfer, as may often be the case, should not the four months' statute of limitations begin to run against the creditor or trustee from the recording, rather than from the theretofore unknown transfer?

These questions have been dealt with somewhat inconsistently by the Bankruptcy Act, and it is not easily determined how much the

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234 U. S. 360 (1914).
Amendment of section 60 (a) has cleared up the matter. By sec. 3 (b) where such transfer is an act of bankruptcy, the creditor may file his petition at any time within four months after the recording of the transfer "if by law such recording or registering is required or permitted." But after the bankrupt has thereby been thrown into bankruptcy, the trustee, under sec. 60 (b), has had no power to recover the property so transferred if he sought to proceed within four months of the recording in a jurisdiction where such recording was not required but was merely permitted.14 The Bankruptcy Committee believed that the four months' period during which the trustee might recover the preference should begin to run when such recording is permitted as well as when it is required.15 They, therefore, added the words, "or permitted" to sec. 60 (a), which defines a preference. They did not add the words "or permitted" after the word "required" in sec. 60 (b) which is the section from which the trustee gets his power to recover property transferred by way of such preference. Does this omission leave the Committee's object largely unrealized, for the reason that it merely enlarges the definition of a preference, without enlarging correspondingly the power of the trustee to set aside such a preference? It is sometimes stated that sec. 60 (a) and sec. 60 (b) are to be read together, but it would be difficult to say that such an interpretation on this point is supported by the weight of authority.

The Amendatory Act was approved May 27, 1926, and by its terms went into effect on August 27, 1926. It readily appears that many of the amendments are improvements of the Bankruptcy Act. Some of the amendments proposed by the American Bar Association committee which deserved enactment as proposed, did not pass. And some of the Amendments will require interpretation by the courts before we know their effect.

The 1926 Amendments are remarkable in several respects. They check the under-current in Congress in favor of repealing the entire Bankruptcy Act.17 And for the first time in the history of proposed extensive bankruptcy amendments, a united front was presented by national legal and commercial organizations.18 Their success in Congress is a valuable precedent. And finally, both the bench and the bar are encouraged now to continue their concerted efforts in improving the administration of the Bankruptcy Act.

16See Carey v. Donohue, supra note 14; Martin v. Commercial Nat'l. Bank, 245 U. S. 513 (1918); REMINGTON ON BANKRUPTCY, (3d ed. 1923) §§ 1790, 1791, S. C. et seq. Also see §57 (g) of the Act, which bases voidability of such preferences upon subdiv. b. of section 60.