

Landlords Bankruptcy and 77B

Martin A. Roeder

Follow this and additional works at: <http://scholarship.law.cornell.edu/clr>

 Part of the [Law Commons](#)

Recommended Citation

Martin A. Roeder, *Landlords Bankruptcy and 77B*, 23 Cornell L. Rev. 285 (1938)
Available at: <http://scholarship.law.cornell.edu/clr/vol23/iss2/4>

This Article is brought to you for free and open access by the Journals at Scholarship@Cornell Law: A Digital Repository. It has been accepted for inclusion in Cornell Law Review by an authorized administrator of Scholarship@Cornell Law: A Digital Repository. For more information, please contact jmp8@cornell.edu.

LANDLORDS, BANKRUPTCY, AND 77B

MARTIN A. ROEDER

So much attention has been paid to the power of the Supreme Court to pass on the constitutionality of Congressional legislation, that little interest has been shown in its other activities—some of which have been epoch-making. An example of this is found in the decisions rendered on January 4th, 1937, which brought to a close one phase of protracted litigation engendered by the United Cigar Stores' reorganization.

The United Cigar Stores Company of America, incorporated in 1912, has conducted retail cigar and drug store chains which have grown to huge proportions. These chains served as a basic structure supporting an extensive advertising business and a real estate venture of considerable magnitude. The philosophy of chain store management in boom times prescribed volume of sales rather than dollar profit on sales. Mark-up on sales was required to be sufficient to pay overhead, but low enough to kill competition. The actual profits of the organization were realized from its unique position in the field of distribution. Display advertising revenues and rebates from manufacturers, both of which depended on the amount of volume achieved, were tremendous sources of income which helped swell the chain's profits.

This struggle for volume of, rather than profit on, sales created a situation where the chain store would snatch up an advantageous leasehold regardless of price. They had tremendous bargaining power, could bid for the best leases and seemed to have a monopoly, in the larger cities, of the choice locations. This advantage, however, became, in times of depression, a source of worry and trouble. Most overhead costs are more or less flexible; wages, raw materials and other selling costs are keenly sensitive to the general economic situation. Rent costs, however, are relatively inflexible. This is due, to some extent, to the lack of foresight of most landlords who feel that the signature of a huge corporation on a lease means permanency of tenure and security in the return on their land. But to a large extent this inflexibility is due to other conditions. Taxes on land, interest on mortgages, and depreciation are not easily reduced.

Thus, rentals, which in boom times amounted to 5% of the total gross sales of an organization, became, in a period of depression, 7% or 8%. Over the course of time, the various retail chain stores had found that the ratio of their rentals to gross sales had become standardized depending on the necessity of occupying particularly valuable space. Grocery stores paid about 2½% of gross sales in rental, five and tens 5%, drug stores, candy shops and tobacco stores 7½%, restaurants 10%.

Total sales of the United Chain (in reorganization) for 1936 were \$55,359,286. According to the ratio above, their rentals should have been \$4,150,000. Had their old leases been extant, actual rentals would have been over

\$7,000,000. Thus it was that this huge chain of retail outlets found itself floundering under the tremendous burden of fixed rental charges incurred under long-term leases executed during the halcyon pre-crash days. Over a thousand long-term leases¹ had been optimistically signed involving several millions of dollars in annual rentals. Following the usual procedure,² the

¹See 58 FINANCIAL WORLD 367. Cf. also Representative Cellar's remarks about the pending bankruptcy proceedings of the United Cigar Stores Co. in 76 CONG. REC., Pt. 2, p. 1360. See also (1933) 42 YALE L. J. 1003; (1933) 33 COR. L. R. 231; (1933) 7 UNIV. OF CINN. L. R. 164.

THE LEASE SITUATION IN THIRTY CHAINS (1932)

	Total No. of Stores	No. Owned In Fee	Stores Under Lease	Average Life of Leases (years)
<i>DRUG:</i>				
Drug Inc. (Liggett)	550	6	544	10
Peoples Drug Stores	117	2	115	7
Walgreen Company	471	1	470	*10
<i>GENERAL MERCHANDISE:</i>				
W. T. Grant	438	12	426	*15
S. S. Kresge	722	217	505	*30
S. H. Kress	221	110	111	*25
McCrorry Stores	241	**...	**...	**..
McLellan Stores	274	* 12	*262	***..
J. J. Newberry	379	None	All	***..
J. C. Penney	1,464	None	All	*40
F. W. Woolworth	1,925	192	1,733	10
<i>GROCERY:</i>				
American Stores	2,906	203	2,703	2½
H. C. Bohack	741	***...	***...	*2
Dominion Stores	563	None	All	1½
First National Stores	2,823	***...	***...	***..
Grand Union	708	9	699	..
Great A. & P. Tea	15,670	None	All	1
Kroger Grocery & Baking	4,797	22	4,775	2
National Tea	1,462	***...	***...	***..
Daniel Reeves	775	None	All	**..
Safeway Stores	3,406	50	3,356	4
<i>RESTAURANT:</i>				
Bickford's	76	None	All	21
Childs	109	*50	*59	**..
Exchange Buffet	35	None	All	*11
Loft	145	1	144	8½
Shattuck	47	7	40	***..
John R. Thompson	116	***...	***...	***..
Waldorf System	162	None	All	10
<i>TOBACCO:</i>				
Schulte Retail Stores	296	*170	*126	*45
United Cigar Stores	1,190	None	All	***..

* Partially estimated.

** Information refused.

*** Information not available.

The percentage paid by the United Chain in 1936 was in line with these figures: Cigar Stores 7.1% of total sales and Drug Stores 8.02%.

²The depression was marked by a series of such manoeuvres in the form of bankruptcy proceedings. To mention but a few, F. & W. Grand-Silver Stores, Wallach Brothers, Browning King, Sarnoff Irving and Truly Warner.

corporation filed a voluntary petition in bankruptcy and was adjudged a bankrupt on August 29, 1932. On June 9, 1934, two days after the passage and effective date of § 77B, the Cigar Stores Company filed its petition for reorganization thus taken advantage of the state's mechanism for avoiding the high charges incurred in boom times.³

During the bankruptcy proceedings the trustee for the Company rejected hundreds of leases as too burdensome to be continued. It has long been clear that the trustee may do so.⁴ A long and painful groan, which was soon heard in the courts and before special masters, rose from the ranks of the landlords, who were thus losing their star tenants. But to no avail; the courts were firm that no claim lies against a bankrupt estate for rejection of an unexpired lease.⁵ They refused to deviate from the old and tried rule.

Much excellent material has been written⁶ discussing the plight of the landlord in this situation, and there would be little excuse for another article unless the matter could be somewhat synthesized and the most recent cases, reversing the former doctrine, analyzed. These tasks will be attempted here.

I

The problems presented must be analyzed by the application of the precedents of three different fields of law; that of bankruptcy, of equity receivership, and of landlord and tenant. The solution to the reorganization problem is to be found only by fusing these doctrines in the flame of practical necessity and legal coherence. Investment in land was one of the earliest forms of capital investment,⁷ and the favorite method of determining land value is by capitalizing rentals. In the boom days there was thought to be no sounder means of determining real estate value than by using as evidence the long-term chain store leases; nor was there any surer way of guaranteeing safe income to the landlord. But the depression and its epidemic of chain store bankruptcies taught the too optimistic landlord that he was a much despised creditor,⁸ for the courts have invariably held, in the absence of special statute,

³See *Downtown Investment Assn. v. Boston Metropolitan Bldgs.*, 81 F. (2d) 314, 323 (C. C. A. 1st 1936).

⁴In *re Roth and Appel*, 181 Fed. 667 (C. C. A. 2d 1910); *Manhattan Properties, Inc. v. Irving Trust Co.*, 291 U. S. 320, 54 Sup. Ct. 385 (1934).

⁵*Brown et al. v. Irving Trust Co.*, In *re United Cigar Stores Co.*, 66 F. (2d) 473 (C. C. A. 2d 1933); In *re United Cigar Stores (Otis)*, 83 F. (2d) 202 (C. C. A. 2d 1936); In *re United Cigar Stores (City Bank Farmers Trust Co.)* 83 F. (2d) 209 (C. C. A. 2d 1936).

⁶Too much praise cannot be given to the excellent discussions of various phases of the subject in *Rent Claims in Bankruptcy* by Schwabacher and Weinstein, (1933) 33 COL. L. REV. 213; in *Landlords' Claims in Reorganizations* by Douglas and Frank, (1933) 42 YALE L. J. 1003; in *Claims for Unaccrued Rent in Bankruptcy* by Max Radin, (1933) 21 CALIF. L. REV. 561, 22 CALIF. L. REV. 1 and in *Landlord's Claims under § 77B of the Bankruptcy Act* by J. Mark Jacobson, (1936) 45 YALE L. J. 422.

⁷21 CALIF. L. REV. 561.

⁸This is surprising in view of the privileged position the landlord holds in continental law. The French Code Civil § 1188 and Code de Commerce § 444 allow the landlord's claim. In the German Konkursordnung, § 21 regulates claims for rent and §§ 65, 66 and 67 cause contingent claims to become due or allow the creditor security therefor.

that a landlord could not file a claim for damages caused by his tenant's bankruptcy.⁹

In 1931, *Maynard v. Elliott*,^{9a} had greatly encouraged landlords to believe that their day had come at last. In that case the bankrupt had endorsed some notes not yet matured when the bankruptcy petition was filed. No protest had been made. The Supreme Court, reversing the Circuit Court of Appeals, allowed the claim despite its contingency. The Court reasoned that the purpose of the statute to free the bankrupt from debts necessitated this result. Naturally, a decision like this, where the claim was totally contingent, heartened landlords and made more likely an opinion reversing the former trend of the rent cases which, to a large extent, as will be seen *infra*, had rejected claims for future rent on the ground that they were contingent.

All such hopes, however, were frustrated by *Manhattan Properties, Inc. v. Irving Trust Co.*¹⁰ This was a typical case in which the plaintiff had leased to the bankrupt, the lease containing the usual indemnity clause providing that the landlord could reenter if the tenant becomes bankrupt, the tenant to remain liable for rental losses. After bankruptcy, the plaintiff reentered and then filed a claim for damages resulting from breach of the lease. The opinion reluctantly expunged the plaintiff's claim and decided that, although contingent claims were admissible under *Maynard v. Elliott*, the case of *In re Roth and Appel*¹¹ was too firmly entrenched, in all but two circuits, to be overruled.

The courts, deprived of the argument of contingency, reasoned along historical lines to maintain the doctrine,¹² which was not confined to rent claims by the landlord, but was extended to cover various similar situations.¹³ Thus, claims by a solvent lessee on a rent guarantee made by the bankrupt,¹⁴ sums paid to the bankrupt for the assignment of the lease,¹⁵ sums which the bankrupt contracted to pay in the future for assignment of a lease to it,¹⁶ and sums paid out for repairs¹⁷ have been held unprovable in the bankruptcy proceeding.

The resultant protest among landlords brought about the only remaining solution to the problem—Congressional action. In June, 1934 § 63 (a) of the Bankruptcy Act was amended so as to include claims for future rent,¹⁸ and

⁹See note 6 *supra* and (1933) 33 Col. L. Rev. 213.

^{9a}283 U. S. 273, 51 Sup. Ct. 390, 75 L. ed. 1028 (1931).

¹⁰*Supra* note 4.

¹¹*Supra* note 4.

¹²See *Wright v. Irving Trust Co.*, 70 F. (2d) 245 (C. C. A. 2d 1934).

¹³But see discussion of types of covenants held provable, *infra*.

¹⁴*Marshall and Hsley Bank v. Irving Trust Co.*, 70 F. (2d) 691 (C. C. A. 2d 1934).

¹⁵*Cloudy Realty Corp. v. Irving Trust Co.*, 70 F. (2d) 263 (C. C. A. 2d 1934), *cert. den.* 292 U. S. 653 (1934).

¹⁶*Wright v. Irving Trust Co.*, *supra* note 12.

¹⁷*F. W. Grand 5-10-25 Cent Stores, Inc.*, 69 F. (2d) 807 (C. C. A. 2d 1934). Cf. *In re Metropolitan Chain Stores*, 66 F. (2d) 485 (C. C. A. 2d 1933).

¹⁸L. 1898 c. 541, § 63 a (7) as amended by L. 1934 c. 424, § 4a, 48 STAT. 923, 11 U. S. C. A. 103 a (7):

§ 77B was enacted with a clause allowing such claims¹⁹ under certain circumstances.

It was clear from Congressional discussion that these amendments were designed to make the landlord a creditor of the bankrupt within the terms of the statute, and that he was to receive some measure of relief in reorganization proceedings. H. R. 5884, 73rd Congress, 2nd Session, which ultimately became § 77B of the Bankruptcy Act was under consideration when the decision in the *Manhattan Properties* case was handed down. "The situation of owners of business properties leased to chain store organizations which had resorted to voluntary bankruptcy largely as a lever to force revision of leases was the subject of comment in and out of Congress."²⁰

Litigation under these new statutes was immediate, but still the lower courts refused to extend relief to the landlord in cases based on reentry,²¹ although they did allow claims for damages arising out of rejection by the trustee.²² The statutes, it was said, went merely to the remedy and allowed proof of landlord's claims where the substantive state law created such a claim. The common law, however, unchanged in most states, declared that re-entry by the landlord destroys the landlord-tenant relationship²³ and extinguishes any claim for future rent, since the doctrine of anticipatory breach will not be applied to a lease.²⁴

The appeal from the denial of the claim of the *City Bank Farmers' Trust*

"Debts of the bankrupt may be proved and allowed against his estate which are . . . (7) claims for damages respecting executory contracts including future rents whether the bankrupt be an individual or a corporation, but the claim of a landlord for injury resulting from the rejection by the trustee of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall in no event be allowed in an amount exceeding the rent reserved by the lease, without acceleration, for the year next succeeding the date of the surrender of the premises plus an amount equal to the unpaid rent accrued up to said date."

¹⁹L. 1898 c. 541 § 77B (b) (10) as added by L. 1934 c. 424 § 1, 48 STAT. 912, 11 U. S. C. A. § 207 (b) (10):

"In case an executory contract or unexpired lease of real estate shall be rejected pursuant to direction of the judge given in a proceeding instituted under this section, or shall have been rejected by a trustee or receiver in bankruptcy or receiver in equity, in a proceeding pending prior to the institution of a proceeding under this section any person injured by such rejection shall, for all purposes of this section and of the reorganization plan, its acceptance and confirmation, be deemed to be a creditor. The claim of a landlord for injury resulting from the rejection of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall be treated as a claim ranking on a parity with debts which would be provable under section 103 (a) of this title, but shall be limited to an amount not to exceed the rent, without acceleration, reserved by said lease for the three years next succeeding the date of surrender of the premises to the landlord or the date of reentry of the landlord, whichever first occurs, whether before or after the filing of the petition, plus unpaid rent accrued up to such date of surrender or reentry."

²⁰*City Bank Farmers Trust Co. v. Irving Trust Co.*, 299 U. S. 433, 57 Sup. Ct. 292 (1937).

²¹See note 5 *supra*.

²²In re United Cigar Stores (Picker) 86 F. (2d) 629 (C. C. A. 2d 1936).

²³*Cornwell v. Sanford*, 222 N. Y. 248, 118 N. E. 620 (1918); and see In re R.K.O., 91 F. (2d) 938 (C. C. A. 2d 1937).

²⁴*Hermitage Co. v. Levine*, 248 N. Y. 333, 162 N. E. 97 (1928).

Co. in the United Cigar Stores reorganization, and some few variations on this situation, led to the opinions handed down by the Supreme Court on January 4th, 1937, which we can now proceed to analyze.

II

Of the four decisions only three are of interest; these are *City Bank Farmers' Trust Co. v. Irving Trust Co.*,²⁵ *Schwartz v. Irving Trust Co.*,²⁶ and *Kuehner v. Irving Trust Co.*²⁷

In the *City Bank* case the plaintiff's assignor had leased a building in New Jersey to the United Cigar Co. During the pendency of the lease, which contained no indemnity clause, the lessee filed a voluntary petition in bankruptcy. The trustee, defendant therein, subsequently rejected the lease and the landlord reentered, rebuilt, and relet the premises. In 1934 the bankrupt, as permitted by subsection (p), filed its petition for reorganization in the pending bankruptcy proceeding. In this latter proceeding the plaintiff proved its claim for damages due to loss of the tenant. The claim was expunged below²⁸ as under New Jersey common law the lease had been terminated when the landlord reentered and reconstructed on the premises. The Supreme Court reversed, holding that § 77B (10) clearly makes these claims provable despite reentry.

The *Schwartz* case is particularly interesting in that it shows the extreme reluctance of the lower courts, despite recently enacted legislation, to overturn precedent and change the trend of the cases. In August of 1932 when the United Cigar Stores Company was adjudicated a voluntary bankrupt, the trustee desired in many cases to modify some of the existing leases. In order to do so he presented appropriate forms of agreements to landlords, many of whom executed them. All of these agreements contained releases in paragraph 5, whereby the claims of the landlords were extinguished.²⁹

In nine of the cases, however, a rider, substantially in the following form, was included in the new lease:

"Nothing in this article 5 shall be deemed a waiver by the landlord of the right to prove against the bankrupt's estate any provable claims to which the bankruptcy court may adjudge the landlord is entitled, but this shall not be deemed to render any claim a provable claim which is not otherwise such or to relieve the landlord from the necessity of proving and obtaining the allowance of any such claim or preclude the trustee from contesting such proof or allowance".

Subsequent to the signing of these agreements, Section 77B of the Bank-

²⁵*Supra* note 20.

²⁶299 U. S. 456, 57 Sup. Ct. 303 (1937).

²⁷299 U. S. 445, 57 Sup. Ct. 298 (1937).

²⁸In re United Cigar Stores, 83 F. (2d) 209 (C. C. A. 2d 1936).

²⁹See *Meadows v. Irving Trust Co.*, 299 U. S. 464, 57 Sup. Ct. 307 (1937).

ruptcy Act was enacted. The question was whether these riders were sufficient to save to the landlord the rights given to him by this new legislation. The special master, to whom the matter was referred, conceded that the riders were intended to preserve claims for future rent, but thought them effective to save only claims, the provability of which resulted from a favorable court ruling, and that claims rendered provable by subsequent legislation were not within the reservation. The District Court approved the master's report. A majority of the Circuit Court of Appeals³⁰ held that the agreements constituted surrenders which, according to state law, terminated all rights of the landlords against the tenants, and that no claim was provable under Section 77B unless it was a continuing or subsisting claim against the debtor, recognized by the applicable substantive law of the state. The Supreme Court, however, having already held that surrender by the trustee, acceptance by the landlord, reentry, and the exercise of dominion over the demised premises by the latter after rejection of the lease, did not deprive the landlord of a provable claim in proceedings under Section 77B for injury due to rejection of his lease or upon the covenant of indemnity found in the lease,³¹ ruled that unless a collateral release of the tenant by the landlord existed, the landlord would have a provable claim. In this case the rider which reserved "the right to prove against the bankrupt's estate any provable claims to which the bankruptcy court may adjudge the landlord is entitled", was adjudged by the court to be broad enough to preserve claims made provable under Section 77B. The court said that the language used was not so limited as to save only claims provable as a result of judicial decision, but that it also extended to claims made provable by legislation.³²

The *Kuehner*³³ case arose out of a similar state of facts. The plaintiff's claim was allowed in the lower court only to the extent of three years' full rental, although the plaintiff's total damages were actually more than that. Against the contention that a sum equal to three years' rental be allowed on a parity with other claims and the remainder subordinate to such claims but ahead of stockholders' interests, the Supreme Court affirmed the holding that no constitutional or other objections prevented the statutory limitation of the claim from operating. The rationale of this decision will be discussed later.

Thus, at last, a doctrine rooted in the legal concepts of the feudal period and cuddled and pampered by the courts throughout periods of economic and political expansion was extirpated from our law. American jurisprudence has been brought to conform more closely to modern needs. English law had long since

³⁰83 F. (2d) 202; 85 F. (2d) 11 (C. C. A. 2d 1936).

³¹*Supra* note 20.

³²And see *In re United Cigar Stores, Appeal of Salisbury Inv. Co.*, 88 F. (2d) 621 (C. C. A. 2d 1937).

³³*Supra* note 27.

recognized the necessity of allowing landlords' claims³⁴ although originally the English bankruptcy statutes specifically excluded them.³⁵

The reasons for this harsh treatment of the landlord-creditor in bankruptcy have been three-fold. Two branches of the law are inextricably interwoven here, and each has furnished its rationale for denying the landlord's claim.

In the first place, it might seem that bankruptcy, being a statutory proceeding, would do away with unsubstantial distinctions, the product of history and the common law. But this was not true with regard to those differentiations made by the early courts between personalty and realty. Coke's early words about the "diversity between duties which touch the realty, and the meere personalty"³⁶ have been responsible for the denial of landlords' claims in numerous cases³⁷ and have been cited with approval by the Supreme Court as distinguishing rent claims from all others.³⁸ It has been clearly demonstrated already³⁹ that the Court mis-cited this quotation which, instead of pointing out substantive differences, was only meant by Coke to refer to certain procedural distinctions. Be that as it may, however, many courts have considered the differentiation to be sound and of sufficient weight to deny the same treatment to rent claims as given to other claims in bankruptcy.

Especially important was this type of argument after the decision of *Maynard v. Elliott*, which totally destroyed the old arguments against admission of landlords' claims on the ground that they were contingent;⁴⁰ the only arguments left were those based on historical distinction, mere adherence to precedent,⁴¹ or the speculative uncertainty of damage.

The second and perhaps more important reason for denying landlords' claims in bankruptcy was that which found its source in the nature of the bankruptcy proceeding. It is an old rule in bankruptcy that debts must exist as of a certain date in order to be included in the proceeding and discharged.⁴² Thus where a claim arose against the bankrupt after the filing of the petition it was neither provable nor dischargeable in the proceeding.⁴³ It was early held that most rent claims fell within this category.⁴⁴ These were

³⁴32 and 33 VICT. c. 71 § 25 (1869); 46 and 47 VICT. c. 52 §§ 37, 55 (1883).

³⁵7 GEO. 1, c. 31 (1720) and see (1933) 33 COL. L. REV. 217, 218.

³⁶CO. LIT. p. 292, b §. 513.

³⁷*Wells v. 21st Street Realty Co.*, 12 F. (2d) 237 (C. C. A. 6th 1926); *In re Service Appliance Co.*, 39 F. (2d) 632 (N. D. N. Y. 1930); *In re McAllister Mohler Co.*, 46 F. (2d) 91 (S. D. Ohio 1930); *In re Goldberg*, 52 F. (2d) 156 (S. D. N. Y. 1931); *In re Schulte-United*, 2 Fed. Supp. 285 (S. D. N. Y. 1932); *In re Metropolitan Chain Store, Inc.*, 66 F. (2d) 482 (C. C. A. 2d 1933).

³⁸*Central Trust Co. v. Chicago Auditorium Ass'n*, 240 U. S. 581, 36 Sup. Ct. 412 (1915).

³⁹22 CALIF. L. REV. 1, 11.

⁴⁰See discussion *infra* and (1936) 49 HARV. L. REV. 1111, 1167.

⁴¹*Manhattan Properties v. Irving Trust*, *supra* note 14.

⁴²2 REMINGTON, BANKRUPTCY §§ 774 *et seq.*

⁴³*Davis v. Ham*, 3 Mass. 33 (1807); *Wentworth v. Whittemore*, 1 Mass. 471 (1805).

⁴⁴*Wood v. Partridge*, 11 Mass. 488 (1814).

the first cases in America and most of the subsequent cases relied on this doctrine to prevent the proof of landlords' claims.⁴⁵ On the other hand, rent accruing prior to the petition in bankruptcy⁴⁶ gives rise to provable claims.⁴⁷

Despite the fact that even the very early cases regarded rent as a separate covenant, payment of which was required regardless of the existence of the demised premises, it was gradually asserted that rent was an incident of the land, and accrued periodically while the tenant held the land.⁴⁸ Bankruptcy, therefore, since it did not deprive the tenant of his leasehold, in no way affected the relationship of landlord and tenant. No claim could be made by the landlord; no discharge could release the tenant's duty to pay rent. Rent already due when the bankruptcy occurred was concededly provable;⁴⁹ rent thereafter due, since it was contingent on the continued tenure of the tenant, was not provable. Nor, in the absence of specific agreement, could the landlord retake his land on the tenant's default. His sole remedy was distraint of the tenant's chattels and a separate suit for rent.⁵⁰

In order to avoid the results outlined above, most leases contained a covenant of reentry and indemnity whereby, in case of failure to pay rent, or, sometimes, in case of bankruptcy, the landlord could reenter and the tenant would, nevertheless, indemnify him for loss. Such a clause had no effect on the proof of landlords' claims in bankruptcy, for the claim was still held to be contingent because, at the time of filing of the petition, it was not known whether the landlord would reenter or not.⁵¹

These rules had all been worked out and applied long before the doctrine of bankruptcy as anticipatory breach of a contract was introduced.⁵² The formulation of this latter doctrine and its recognition by the United States Supreme Court⁵³ should have led to a re-examination of the rent cases for it seems clear that if bankruptcy is a repudiation of a contract excusing performance by the promisee and giving him an immediate cause of action, the land-

⁴⁵See (1933) 33 COL. L. REV. 219-221.

⁴⁶In re Sherwoods, Inc., 210 Fed. 754 (C. C. A. 2d 1913); In re Chakos, 24 F. (2d) 483 (C. C. A. 7th 1928); see Schenck v. Lewis, 121 Misc. 370, 201 N. Y. Supp. 282, *aff'd* 210 App. Div. 845 (1923).

⁴⁷It was early thought that breach of a contract to lease or of the lease prior to bankruptcy would likewise create a provable claim, but these doctrines have been overruled. See In re Mullings Clothing Co., 238 Fed. 58 (C. C. A. 2d 1916); Re National Credit Clothing Co., 66 F. (2d) 371 (C. C. A. 7th 1933); Urban Properties Co. v. Irving Trust Co., 74 F. (2d) 654 (C. C. A. 2d 1935); Miller v. Irving Trust Co., 296 U. S. 256, 56 Sup. Ct. 189 (1935); see, however, In re United Cigar Stores, 89 F. (2d) 3 (C. C. A. 2d 1937) which seems to revive the doctrine in the Second Circuit.

⁴⁸Wood v. Partridge, *supra* note 44.

⁴⁹*Supra* note 46.

⁵⁰De Lancey v. Ganong, 9 N. Y. 9 (1853).

⁵¹Watson v. Merrill, 136 Fed. 359 (C. C. A. 8th 1905); Atkins v. Wilcox, 105 Fed. 595 (C. C. A. 5th 1900); In re Roth & Appel, *supra* note 4; In re Hubbard, 57 F. (2) 213 (W. D. N. Y. 1932).

⁵²See cases *supra* note 51.

⁵³Central Trust Company of Illinois v. Chicago Auditorium Ass'n, *supra* note 38. See In re United Cigar Stores, 89 F. (2d) 35 (C. C. A. 2d 1937).

lord should have an immediate cause of action for breach of the rent covenant in a lease. The objection of contingency disappears; the cause accrues with the filing of the bankruptcy petition. Unfortunately the Court did not wish its doctrine to go that far. On page 590 of the opinion, rent claims are expressly distinguished on the basis of Coke's words discussed above. The subsequent decisions seized on this sentence of the *Chicago Auditorium* case as a ground for denying proof of rent claims under the 1898 statute⁵⁴ as claims arising from anticipatory breach of the lease through bankruptcy.

The state courts, likewise, refused to apply the doctrine of anticipatory breach to leases.⁵⁵ This, of course, enabled those federal courts which felt that they had to look to the state substantive law to determine whether the landlord had a claim, to deny the existence of such a claim.

The third reason given by the courts for refusal of the landlords' claims is that even if not barred on historical grounds, nor by the argument of contingency, the claims nevertheless, are too speculative to be allowed in the bankruptcy proceedings.⁵⁶ This phase of the problem is discussed in the *Kuehner* case,⁵⁷ *supra*. The objection is easily dealt with; courts have undertaken much more difficult problems of valuation. The value of an ear, a life, are more difficult of estimation than that of a leasehold.⁵⁸ Nor has the court even hesitated to estimate the value of realty five years in the future.⁵⁹ The original parties to the lease did not deem the task of setting a value for the leasehold an impossible one the court should not hesitate. Difficulty of decision should hardly be a bar to remedy. The better view is expressed in a recent case which distinguishes between provability of claim and allowability. The latter may be impossible because of the claimant's inability to set up a basis for damages, but that does not defeat the provability of the claim.⁶⁰

III

Thus, these doctrines, one born in the feudal law of a lost period and the others out of administrative difficulties inherent in any liquidation process had been responsible for the landlord's predicament. The decisions of the

⁵⁴See note 37 *supra*.

⁵⁵*Hermitage Co. v. Levine*, *supra* note 24. And see *Phoenix National Bank v. Waterbury*, 197 N. Y. 161, 166, 90 N. E. 435 (1910).

⁵⁶*In re Wise Shoes, Inc.*, 2 Fed. Supp. 521, *aff'd* 64 F. (2d) 1023, (C. C. A. 2d 1932); *In re Metropolitan Chain Stores (Malavazos v. Irving Trust)* *supra* note 37; see *Miller v. Irving Trust*, *supra* note 47; see *Maynard v. Elliott*, *supra* note 9a, and *Manhattan Properties, Inc. v. Irving Trust Co.*, *supra* note 4.

⁵⁷*Supra* note 27.

⁵⁸See *Cobb v. Overman*, 109 Fed. 65 (C. C. A. 4th 1901) life expectancy; *Filene Sons Co. v. Weed*, 245 U. S. 597, 38 Sup. Ct. 211 (1917) leasehold; *In re Schultz & Guthrie*, 235 Fed. 907 (D. C. Mass. 1917); *cf.* *In re Portage Rubber Co.*, 296 Fed. 289 (C. C. A. 6th 1924); *cf.* *New York Trust Co. v. Island Oil and T. Co.*, 34 F. (2d) 653, 654 (C. C. A. 2d 1929).

⁵⁹*In re Marshall's Garage*, 63 F. (2d) 759 (C. C. A. 2d 1933).

⁶⁰*In re Wesley Corporation*, 18 Fed. Supp. 347 (E. D. Ky. 1937); REMINGTON, BANKRUPTCY §§ 759, 904.

courts, however, were closely followed by the ingenuity of lawyers and various stipulations were incorporated into leases designed to protect the landlord in case of the tenant's bankruptcy.

These devices must be studied here for it is an open question, under the 1934 amendments to the Bankruptcy Act, whether they would not still be effective to give the landlord something more than the one year's damages or three years' damages allowed in bankruptcy and reorganization proceedings respectively.⁶¹

The usual clause allowing reentry and indemnity on bankruptcy was rendered nugatory in *In re Roth and Appel*.⁶² In order to avoid the objection of contingency set up in that case, some landlords learnt to use the so-called "ipso-facto" clause,⁶³ which provides that on filing the complaint in bankruptcy against the tenant the lease is ipso facto terminated and damages accrued. This procedure, simple on its face, will be nullified by the courts unless the utmost care is taken. Forfeiture or penalty must be avoided,⁶⁴ and the state law will be a factor in determining whether a penalty exists or not.⁶⁵ It seems that the only formula is that used in the *Perry* case.⁶⁶ Attempts to give the landlord both the remainder of the term and accrued damages have been defeated not only as a penalty or forfeiture, but also under the guise of judicial construction.⁶⁷

Landlords' claims based on breaches of covenants of the lease other than rent covenants have frequently held to be provable in bankruptcy. This doctrine originated in *In re Desnoyers Shoe Co.*⁶⁸ where a covenant to repair and return machinery to the lessor was incorporated in a lease of the machinery which was terminable on the lessee's bankruptcy at the will of the lessor. The court uses a strained construction to get around the objection of contingency, saying that when the lessor exercises his option the exercise relates back to the time of bankruptcy.

⁶¹See *In re United Cigar Stores Co.*, 89 F. (2d) 3 (C. C. A. 2d 1937).

⁶²*Supra* note 4.

⁶³*Irving Trust Co. v. Perry*, 293 U. S. 307, 55 Sup. Ct. 150 (1934); see *In re Pittsburgh Drug Co.*, 164 Fed. 482 (W. D. Pa. 1908); *cf. Filene Sons Co. v. Weed*, 245 U. S. 597, 38 Sup. Ct. 211 (1917); (1929) 29 Col. L. Rev. 667.

⁶⁴*Kothe v. Taylor Trust Co.*, 280 U. S. 224, 50 Sup. Ct. 142 (1930).

⁶⁵*In re Barnett*, 12 F. (2d) 73 (C. C. A. 2d 1926); *In re Cushman*, 3 F. (2d) 449 (S. D. N. Y. 1924); 884 West End Ave Corp. v. Pearlman, 201 App. Div. 12, 193 N. Y. Supp. 670, *aff'd* 234 N. Y. 589, 138 N. E. 458 (1922).

⁶⁶*Supra* note 63 at page 310. "... it is agreed as a further condition of this lease that the filing of any petition in bankruptcy or insolvency by or against the Lessee shall be deemed to constitute a breach of this lease, and thereupon, ipso facto and without entry or other action by the Lessor, this lease shall become and be terminated; and, notwithstanding any other provisions of this lease, the Lessor shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof less the fair rental value of the premises for the residue of said term."

⁶⁷See also *Murray Realty Co. v. Regal Shoe Co.*, 265 N. Y. 332, 193 N. E. 164 (1934); *In re Miller Bros. Grocery Co.*, 219 Fed. 851 (C. C. A. 6th 1915).

⁶⁸227 Fed. 401 (C. C. A. 7th 1915).

Whatever we may think of the logic of this case, it was eagerly seized upon as a precedent for allowing damages due to breach of collateral covenants in leases to be proved in bankruptcy.⁶⁹ It is quite possible that by judicious application of this doctrine a clever attorney may so draft a lease as to disguise the rent payments as collateral payments and so avoid the limitations on landlords' claims now incorporated into the Bankruptcy Act.⁷⁰

IV

This review of the law leads to the necessity of a critical appraisal of the situation, and a judgment of what parts of the old doctrines are still relevant.

The first aspect to consider is what is the present standing of the *Boyd* case.⁷¹ The doctrine of the *Boyd* case, that an unsecured creditor whose claim was contingent at the time of an equity receivership, can reach the interest remaining in the hands of the old stockholders when his claim matures, is an outgrowth of the doctrine of fraudulent conveyances originating in the statute of 13 Eliz. ch. 5 (1571). That the doctrine of this case applies to bankruptcy as well as to equity receivership has been established.⁷² Nor is there any doubt that it protects contingent claims such as a landlord's.⁷³

Despite the fact that counsel, in the *Kuehner* case⁷⁴ cited the *Boyd* case in favor of their contention that the landlords were entitled to come ahead of stockholders for the full amount of their claims, the Court did not even mention it.⁷⁵ The *Kuehner* case is not a square holding that this doctrine has no application to corporate reorganization proceedings under 77B, as was baldly stated in *Downton Investment Ass'n. v. Boston Metropolitan Bldgs.*,⁷⁶ but it does seem to decide that where other provisions for the claim are made, which the court deems "reasonable", the doctrine will not be applied to invalidate the mandate of a statute. Of course, the crux of the issue is the meaning of the term "reasonable". Does not the *Boyd* case itself lay down a standard of protection for the creditor, anything less than which is unreasonable? *A*

⁶⁹In re Metropolitan Chain Stores, *supra* note 17; In re Marshall's Garage, *supra* note 59; Trust Co. of Ga. v. Whitehall Holding Co., 53 F. (2d) 635 (C. C. A. 5th 1931); *cf.* In re F. & W. Grand 5-10-25 Cent Stores, 74 F. (2d) 45 (C. C. A. 2d 1934); *cf.* In re Schulte-United, Inc., 2 Fed. Supp. 285 (S. D. N. Y. 1932).

⁷⁰But see limitations, *supra*, at notes 13 through 17. And note the possibility of judicial construction of the lease so as to make sums payable for repairs "additional rent" and therefore subject to the rules regarding rent. In re United Cigar Stores (Picker), *supra* note 22.

⁷¹Northern Pacific Ry. & R.R. v. Boyd, 228 U. S. 482, 33 Sup. Ct. 554 (1912). See (1933) 42 YALE L. J. 1003 for a complete analysis.

⁷²Kingston v. American Car and Foundry Co., 55 F. (2d) 132 (C. C. A. 8th 1932).

⁷³Woodbury v. Sparrell Print, 187 Mass. 426, 73 N. E. 547 (1905); see Hamer v. New York Rys. Co., 244 U. S. 266, 37 Sup. Ct. 511 (1917); Howard v. Maxwell Motor Co., Inc., 269 Fed. 292 (S. D. N. Y. 1920), *aff'd* 275 Fed. 53 (C. C. A. 2d 1921).

⁷⁴*Supra* note 27.

⁷⁵See (1937) 37 COL. L. REV. 489, 490.

⁷⁶*Supra* note 3.

priori, this would seem to be so, but any criticism of the present state of the law must be based on the understanding of the two forces at work in a situation like this. On the one hand, the stockholders must be protected against complete loss of their investment. The purpose of § 77B was to preserve businesses as going concerns, where possible, so that eventually every interested party could be satisfied. On the other hand, creditors, having little interest in the future status of the business, try to recoup as much of their loan as possible. It is hard to balance the equities, but, when it comes to *allowance* of claims, the landlord-creditor should at least be allowed to *claim* all his damages along with other creditors, even at the expense of stockholders who speculated in the company and should be prepared to take losses. To be able to prove full damages is by no means to be able to recoup full loss. Dividends to creditors averaged 5% to 8% between 1928 and 1932.⁷⁷ At best the landlord can recoup little of his actual damage. To limit him further encourages the use of court procedure to evade rightful obligations.

The *Kuehmer* case urges many factors as justifying the limitation of the landlords' claims to three years full rental. An analysis of the decision leaves much to be desired. The Court first insists on a difference between property rights and contract rights, saying that the former may not, but the latter may, be impaired by an exercise of the bankruptcy powers. Criticism of a distinction thus taken is immediate; it is a conceptional nicety but unreal. The line of demarcation between contract rights and property rights is hazy, if existent at all. The test of whether either of such rights has been impaired is the same—the reasonableness of the impairment.⁷⁸ And differentiation is necessarily misleading.

The Court then urges that, since failures are a product of depressions, and since during depressions rental values are very low, the amount of damages claimed by each landlord will be inordinately high. The statement itself seems to justify the landlord's claim. A contract is the legal means of shifting the risk attendant on fluctuation of market. When the lease was made, both parties bargained for a given result, and estimated the value of the leasehold. The very fact that rentals are so depressed at the time of failure is an eloquent appeal for the landlord. At best, he will get a dividend of 6%, and should certainly be allowed to make the most of it.

The Court places some weight on the fact that the land is restored to the landlord. This, it seems, is regarded as a distinguishing characteristic. But it is true of almost every contract not fully executed on one side—the servant whose master files a petition, the seller whose buyer becomes bankrupt before delivery. Both receive something by virtue of the release from the con-

⁷⁷See (1933) 21 CALIF. L. REV. 561, 566.

⁷⁸See note (1930) 30 COL. L. REV. 360; *Home Bld'g and Loan Ass'n v. Blaisdell*, 290 U. S. 398, 54 Sup. Ct. 231 (1933).

tract; the one his services, the other his goods. But no limitation is imposed on their claims. The landlord has lost the benefit of his bargain just as any other type of creditor; the method of computing damages clearly takes this element into account by deducting present rental value from contract price.

It was implicit in the Court's opinion (and emphasized in the respondent's brief) that the reason for the three year limitation in § 77B was that Congress evidently thought that the depression would end after that period and the landlord would have no losses thereafter. Therefore, he should not be allowed to claim for more than that period. But this ignores the fact that if full damages were allowed and the difference between the accelerated reserved rental and the present value of the leasehold were allowed as a claim, the rise in prices accompanying a cyclic boom would be a necessary factor in estimating the present value of the leasehold. Such an estimation could not be exact, but it would be more so than an arbitrary statutory limit.

Finally, the Court finds damages so speculative as to warrant any type of limitation in the interests of certainty and standardization. It has already been demonstrated⁷⁹ that this objection is not valid. Courts have attempted more difficult problems of valuation. In any case, mere difficulty should, at most, be grounds for refusal by the court to allow the claim. Claims may be provable but not allowable.⁸⁰ The plaintiff has the burden of providing the evidence of the value of his claim; failure to do so should affect the amount of the claim, not its provability.⁸¹

There remains the difficult problem of estimating the effect of the prior decisions on the law as it stands today. Will a properly drawn lease, incorporating the "ipso facto" clause, enable the landlord to avoid the limitations on his claim imposed by the new amendments to the Bankruptcy Act? Is the remedy given to the landlord in the Act exclusive or is it merely designed to benefit those landlords who would have received nothing under the old rule? Under the present rulings and decisions, these contentions are both tenable.⁸² It may be urged in favor of the former position that the same arguments favoring the restriction in ordinary cases, and upholding its reasonableness under the circumstances, would lead to the limitations being imposed on all landlords' rent claims. Mere words in a lease should not allow the Congressional intent, based on sound discretion, to be thwarted.

On the other hand, it seems that the weightier arguments favor the recognition of the protective lease clauses as valid avoidances of the limitation. Analytically speaking, the "ipso facto" clause so operates that the landlords' claim is based not on a rent covenant, but on a personal contract which, like

⁷⁹*Supra* note 58.

⁸⁰REMINGTON, BANKRUPTCY §§ 759, 904.

⁸¹In *re Wesley Corporation*, *supra* note 60.

⁸²See In *re United Cigar Stores Co. of America*, *supra* note 61, refusing to answer the question.

any other, is fully provable.⁸³ This applies also to the various covenants of repair which have already been discussed. It would seem that this doctrine should also apply to a guaranty of a lease; but a recent decision holds otherwise⁸⁴ on the ground that any other decision would subject a guarantor in reorganization to a liability greater than his principal in reorganization. One is tempted to question the validity of this objection. The case can be limited to its facts and be construed as having no application to a solvent guarantor. But even so, it is hard to justify it. A statute designed to give a landlord a greater remedy where he had none before, should not be construed to lessen his rights where he has provided himself with an auxiliary and formerly valid remedy.⁸⁵ The curtailment of the landlord's rights against a lessee in bankruptcy or reorganization is no reason for the curtailment of his rights against a guarantor.

Furthermore, the statute by its terms relates only to those cases where the trustee has rejected,⁸⁶ or there is a breach of covenant of indemnity, though there is reason to believe that the courts will construe it liberally.⁸⁷ Even if extended to include those cases where the landlord reentered under the lease, but where there was no rejection or indemnity clause, it would not follow that the amendments included the situations where the leasehold lapsed by its own terms without rejection or reentry,⁸⁸ as is true of a lease containing an "ipso facto" clause.

To hold the statutory limitation applicable to claims provable *in toto* before the enactment of the statute would, furthermore, upset the maxim of statutory construction that already existing rights may not be destroyed except by express repeal.

The unfortunate refusal by the courts to apply the doctrine of bankruptcy as anticipatory breach to a lease still has its repercussions. A recent case⁸⁹ held that where the landlord terminated the landlord-tenant relationship by illegal reentry after the tenant's bankruptcy, but before rejection by the trustee, he has no provable claim whatsoever in the reorganization proceedings of the guarantor of the lease. Had the tenant's bankruptcy been deemed an anticipatory breach of the lease, the landlord would have had no difficulty in proving his claim.

⁸³Irving Trust Co. v. Perry, *supra* note 63.

⁸⁴Hippodrome Bldg. Co. v. Irving Trust Co., *supra* note 76.

⁸⁵Howard v. Maxwell Motor Co., *supra* note 73; but *cf.* In re F. & W. Grand 5-10-25 Cent Stores, Inc., 70 F. (2d) 691 (C. C. A. 2d 1934). Neither of these cases was cited in the Hippodrome case.

⁸⁶Compare Manhattan Properties, Inc. v. Irving Trust Co., *supra* note 4.

⁸⁷(1937) 37 COL. L. REV. 489, 491; Hippodrome Bldg. Co. v. Irving Trust Co., *supra* note 76. But *cf.* In re United Cigar Stores of America (Picker), *supra* note 22.

⁸⁸But see In re United Cigar Stores (Picker), *supra* note 22 for construction of covenant to repair, etc., as part of rent covenant because of agreement to call any sums payable for repairs "additional rent".

⁸⁹In re R.K.O., *supra* note 23.

The problem of the date from which the three years will run may also prove troublesome. It has been held that the amendments to the statute are retroactive so as to allow a claim for rental damages in a bankruptcy where the effective date of the amendments occurred during the period for filing claims.⁹⁰ The court has also decided that where there is a rejection by the trustee the date of rejection marks the beginning of the three year period.⁹¹ The court reasons that if this were not so, the landlord without an indemnity clause might lose his claim altogether. This is no longer cogent, but the decision will probably stand. It is just, for the date of rejection marks the time when the landlord regains the power to use his property. In case of reentry without rejection, pursuant to terms of the lease, the date of reentry will undoubtedly mark the beginning of the three years.⁹²

A final thought occurs regarding a type of lease which is becoming more and more prevalent, the percentage lease. By terms of such a lease the landlord takes either a minimum rental, plus a percentage of the profits of the shop located on the premises or a flat percentage without minimum. Few of these leases envisage the bankruptcy situation. How will damages be estimated? Two methods of dealing with this situation present themselves. It may be argued that the landlord was taking only the risk of the single shop when he contracted and should be allowed damages on the basis of expected profit from the specific shop, figured by means of expert judgment based to a large extent on past averages. On the other hand, in the case of a chain store, it may be argued that the landlord took the risk of insolvency of the chain as a whole and the consequent closing of the shop when he signed the lease. In the absence of authority, the latter seems to be the proper interpretation, especially when a minimum rental has been stipulated giving the landlord some damages in any case.

It is suggested that the statute be amended so as to clearly indicate its scope and eradicate the harshness of the decision binding landlords to one or three years full rent as the amount of their claim.

⁹⁰In re Winn Shoe Co., Inc., 87 F. (2d) 713 (C. C. A. 2d 1937).

⁹¹In re United Cigar Stores (Picker), *supra* note 22.

⁹²In re Benguiat, 20 Fed. Supp. 504 (S. D. Cal. 1937).