## STATUTORY EXTENSION TO INDIVIDUALS UNDER THE RECENT AMENDMENTS TO THE BANKRUPTCY ACT

The passage of the amendments to the bankruptcy act on March 3, 1933, was hailed as likely to bring swift relief to many individual debtors.[1] Its opponents urged that it was perhaps unconstitutional and certainly very harsh towards secured creditors.[2] Whatever the truth of these charges, the bill has been little used by individual debtors, although several prominent railroads are now trying to reorganize their financial structures under the machinery provided by the section of the amendments which applies solely to railroads. In so far as the purpose of the statute was to protect small home-owners from having their homes taken from them by foreclosure of mortgages, this recent statute is now largely obsolete, in view of the more direct means of refinancing available under the statute passed by the extra session just adjourned, providing for direct government loans or the issuance of bonds whose interest (but not principal) is guaranteed by the United States.[3] However, the law may still be utilized to give other classes of individuals, particularly the small business man, considerable benefits. It is the purpose of this note to examine the provisions of the law, in so far as they affect individuals,[4] attempting to point out the changes it has made in the earlier bankruptcy practice and the places in which the law should be clarified in order that it may be consistent with itself or do more perfect justice.

The first change made by the new amendments is the formal permission granted persons not insolvent to avail themselves voluntarily of the benefits of a bankruptcy act. The Act of 1898 defined an insolvent as a person, the aggregate of whose property "exclusive of any property which he may have conveyed, transferred, concealed or removed or permitted to be concealed or removed with intent to defraud, hinder, or delay his creditors, shall

[1] Act of March 3, 1933, 11 U. S. C. 201-205, adding sections 73, 74, 75, 76 and 77 to the Act.

[2] Secured debtor in this paper is used as defined by sec. 1 (23) of the Act of 1898: "Secured creditor shall include a creditor who has security for his debt upon the property of the bankrupt of a nature to be assignable under the provisions of this act, or who owns such a debt for which some indorser, surety, or other person secondarily liable for the bankrupt has such security upon the bankrupt's assets." 39 Stat. 540 (1898), 11 U. S. C. 1.

[3] Cf. the provisions of the Home Owners' Loan Act and the Farm Mortgage Loan Act signed by President Roosevelt in June, 1933.

[4] The essentially different background of the provisions as to railroads precludes their consideration in this note. The railroad provisions are grouped in section 77 of the new amendment.

not, at a fair valuation, be sufficient in amount to pay his debts."[5] The new statute expressly allows a person voluntarily to resort to it who is either "insolvent or unable to meet his debts as they mature."[6] At first glance this seems a great extension of the class of who may be voluntary bankrupts. Actually it is not. Under the Act of 1898 a person might be a voluntary bankrupt even though he was not insolvent.[7] No creditor could object.[8]

Less apparent but in reality far more important is the change in the debts which may be allowed to share in the distribution of the estate which passes into the hands of the bankruptcy court. Under the Act of 1898 only five classes of debts might be proved.[9] It is true that two of the classes were very broad,[10] but nevertheless there were certain common types of claims which could not be proved. The most important of these were claims for future rent[11] and claims for tortious injuries which had not been reduced to judgment at the time the petition was filed.[12] The new amendment expressly provides that debts affected by an extension "shall include all claims of whatever character against the debtor or his property, including a claim for future rent, whether or not such claims would otherwise constitute provable claims under this Act."[13] Under this provision, the debtor need not even be personally liable on the debt, provided it is a lien on his property, e.g. where he has bought land subject to a mortgage, but without assuming the mortgage. This last is entirely novel. Although the Act of 1898 did provide for the allowance of the balance of secured claims after the amount of the security had been determined and deducted, it required that the bankrupt be person-

[5] Sec. 1 (15). All citations are to the sections of the Act as they appear in the Statutes at Large.

[6] Sec. 74 (a). Special provisions are made for agricultural compositions and extensions in sec. 75. These are largely the same as those of sec. 74 except that special commissioners are to be appointed in certain instances. These officials will largely replace the referees. References will be given to the corresponding provisions of both sections and important differences will be pointed out. The corresponding provision is sec. 75 (c).

[7] Hanover Nat. Bank v. Moyses (1902) 186 U. S. 181.

[8] Hanover Nat. Bank v. Moyses, above.

[9] Sec. 63 (a).

[10] Class 1 allowed the proof of all fixed liabilities evidenced by a judgment or instrument in writing absolutely owing at the time of the filing of the petition. Class 5 allowed the proof of claims founded upon an open account or a contract expressed or implied.

[11] Schubacher and Weinstein, Rent Claims in Bankruptcy, (1933) 33 Col. L. Rev. 213.

[12] Remington on Bankruptcy (3rd ed.) sec. 767.

[13] Sec. 74 (a). Unfortunately there is no similar provision in the section dealing with agricultural extensions.

ally liable for the debt.[14] This change will cause no difficulty in cases where the extension agreement is finally confirmed and put into effect, but it may lead to strange results in cases where the extension is refused and the debtor adjudicated a bankrupt. It would seem that this extension of provable debts is only "for the purpose of the extension proposal."[15] If this is refused, then the older test is employed, which may materially lessen the amount of the debts which will share in the distribution. However, this result seems to be the only practical one, because an extension proposal may be filed in an involuntary case even though the debtor is actually insolvent, and it would not be just to vary the proportion that the petitioning creditors shall obtain on their claims by the mere fact whether or not the debtor chose to attempt in vain to secure an extension.

We are now in a position to examine the heart of the new amendment, i.e. the provisions for an extension of certain types of indebtedness. There are two important classes of debts which cannot be extended under this new statute, unless the creditors consent. The money necessary to pay all debts which under the Act of 1898 have priority[16] must be deposited before an extension can be confirmed by the court.[17] However, there is a provision that if the holders of such debts consent to have them extended, they shall not lose their priority. Although there is no express provision, it would seem that each such creditor must act individually in waiving his priority and that a majority may not compel a dissenting minority to join in a general waiver. Secured debts, the security for which is not in the actual or constructive possession of the debtor or the custodian or receiver, may not be extended against the will of the creditor.[18] Indeed, the statute gives no express authority for allowing the extension to extend such debts, even with the consent of creditors. It would seem, however, that such a power should be implied in view of the general remedial purpose of the statute. It is to be regretted that this point is not made clear. This provision was probably necessary to allow banks to realize on the collateral securing loans made by them, which collateral is always in the possession of the bank and not the debtor. It lessens the relief obtainable by the extension, but if banks are to meet the demands of their depositors, they cannot be required to irrevocably extend credit for long periods of time.

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[14] Secs. 63 (a), 57 (h).

[15] Sec. 74 (a).

[16] Sec. 64.

[17] Sec. 74 (e); sec. 75 (g).

[18] Sec. 74 (h). The section as to agricultural extension contains no such limitation. Sec. 75 (j).

There are other limits to the nature of the extension plan designed to protect the interests of creditors. The plan may not, according to the amendment, reduce the amount due to a secured creditor or impair the lien which secures the debt.[19] This protection is not as great as it seems. The new statute specifically allows changes in the time and means of payment. If the time be extended without paying the full market rate of interest, which presumably would be quite high in view of the high risk for which compensation must be made, the creditor actually has suffered a reduction in the present value of the debt, even though he will eventually receive its full face amount. Unsecured creditors have no similar protection and the amounts to be paid them may be less than the face of amount of the debt. Secured creditors may also be given priority.[20] The plan of extension may incorporate other specific guarantees by the debtor, including provisions for payment by installments,[21] a highly desirable provision in cases where a mercantile stock in trade is being liquidated. If the creditors so desire, the extension plan may give a creditor's committee general supervision over the business of the debtor.[22] As a further safeguard the court may after confirmation of the extension still retain jurisdiction over the case.[23] If the court does so, it may adjudicate the debtor a bankrupt and cause the estate to be liquidated according to the normal course of bankruptcy proceedings if "without sufficient reason the debtor defaults in any payment required to be made under the terms of an extension proposal."[24] Thus, it would seem that the limitations of the extension plan are sufficiently flexible so as to allow the preparation of an economically sound plan which will do justice to all, while sufficient safeguards are provided so that a dishonest debtor may not use such a plan as a means to obtain further time in which to defraud his creditors.

There is, however, one limitation upon the extension plan which may make it more difficult for the debtor to obtain the consent of his creditors. The statute requires that the exemptions and allowances of the debtor be set aside and the property so segregated not subjected to the operation of the extension plan.[25] Under

[19] Sec. 74 (i); sec. 75 (k).

[20] Sec. 74 (h); sec. 75 (j).

[21] Sec. 74 (i); sec. 75 (j).

[22] Sec. 74 (h). The section as to agricultural extensions allows the creditors to hire the conciliation commissioner to perform such supervision. Sec. 75 (b).

[23] Sec. 74 (j); sec. 75 (l).

[24] Sec. 74 (l). There is no provision for adjudication for any reason under the section providing for agricultural extensions.

[25] Sec. 74 (h); sec. 75 (j).

the Act of 1898 this was true when the estate was liquidated in bankruptcy, but was not true when compositions were arranged.[26] The amount of these exemptions is regulated by the state statutes,[27] and may amount to a considerable sum. It would seem unwise to deprive a debtor who desires to waive his exemptions of the opportunity to do so as a bait to induce creditors to consent to an extension proposal.

A revolutionary feature of the extension plan is the provision that it shall extend the obligation of any person secondarily liable for prompt payment of any debt extended by the plan.[28] This is not necessary to protect the petitioning debtor. It is essentially a provision for the relief of indorsers. It would seem more in accordance with justice to leave the rights of the creditors unimpaired as against them, so that the creditor might force the indorser to perform as he contracted. The indorser could then prove his claim against the principal debtor, which claim would then become subject to the terms of the extension proposal, following the system now prevailing in the ordinary bankruptcy proceedings.[29] It might perhaps be convenient to allow the creditor if he wished to consent to the extension without this discharging the persons secondarily liable from an obligation to pay at the end of the extension period. It is to be regretted that the statute does not clearly specify the rights of the indorser against the principal debtor who fails to carry out the terms of the plan of extension.

The amendment is poorly drafted in the parts which attempt to describe the jurisdiction which the court acquires over the property of the debtor. It contains a provision that the court in which the petition is filed shall have exclusive jurisdiction over the debtor and his property wherever it is located.[30] This provision standing alone would seem clear, but the amendment apparently recognizes that despite the filing of the petition other courts may have jurisdiction to proceed with cases already before them. Express power is given to the court to enjoin, in its discretion, proceedings in other courts by secured creditors whose claims might be affected by the extension proposal, until the proposal has been acted on.[31] The section dealing specifically with farmers expressly forbids certain types of suits,[32] but says that

[26] Secs. 47 (a), 12.

[27] Sec. 6.

[28] Sec. 76.

[29] Sec. 57 (i).

[30] Sec. 74 (m); sec. 75 (n).

[31] Sec. 74 (n). The section as to agricultural extensions contains no such provision. Cf. sec. 11 of the Act of 1898.

[32] Sec. 75 (o).

this shall not bar the continuance of suits to collect taxes on property not used for farming or in the home, or on land not used as a farm or homestead.[33] If the court had exclusive jurisdiction, such jurisdiction must oust the other courts of their jurisdiction in the pending suits. It would seem that an amendment is necessary to clarify this situation.

It is now necessary to examine briefly the procedural steps by which a desired extension may be obtained. The debtor may file voluntarily a petition asking for such an extension, or if an involuntary petition has been filed against him, the debtor may file a petition for such an extension within the time allowed for filing an answer.[34] It will be noted that this time is considerably more limited than that allowed for the filing of applications for composition which may be proposed even after adjudication.[35] The statute does not contain any provision with reference to the contents of the petition other than that it must contain a statement that the debtor is insolvent or unable to meet his debts as they mature and is desirous of effecting a composition or extension of time in which to pay his debts.[36] The court must at once pass on the legal sufficiency of the petition or answer.[37] If the answer in an involuntary proceeding is legally sufficient, an order of adjudication cannot be entered, unless the debtor fails to comply with the terms which the court may impose to protect the estate.[38] Under the Act of 1898 the court had discretion whether or not to stay adjudication;[39] now it must do so although it may impose conditions. If the proceeding is a voluntary one, a creditor may controvert the facts alleged at or before the first meeting of the creditors.[40] But where the extension proposal is interposed in

[33] Sec. 75 (p). Cf. note (1932) 17 Minn. L. Rev. 47 for a discussion of situation as to suits in other courts by secured creditors under the Act of 1898.

[34] Sec. 74 (a); sec. 75 (c). The time for filing an answer is fixed by sec. 18 (b) to be within five days after the return day of the writ. This time may be extended by the court. Sec. 74 (a).

[35] Under sec. 12 the composition proposal may be filed at any time before or after adjudication.

[36] Sec. 74 (a); sec. 75 (c). It is provided that the petition and answer must be accompanied by the schedules of the debtor. Sec. 74 (a); sec. 75 (c).

[37] Sec. 74 (a). The court also must be satisfied that the proposal is filed in good faith. The section as to agricultural extensions contains no such provisions.

[38] Sec. 74 (a). The section as to agricultural extensions makes the stay absolute "except as provided hereafter in this section". Sec. 75 (c). There are no further provisions in the section.

[39] Sec. 12 (a).

[40] Sec. 74 (c). The truth of the issues thus raised is to be determined by the court. There is no such provision in the section as to agricultural extensions.

an involuntary case, it would seem that no one is allowed to controvert the facts alleged. In either case the creditor cannot apparently question the legal sufficiency of the petition or answer, which has only been passed on by the court ex parte. This would be serious except for the fact that the petition or answer is so simple and need allege so few facts.

If the petition or answer is found legally sufficient, the court may appoint a custodian or receiver to take charge of the property.[41] The amendment does not specify the conditions under which this power can be exercised.[42] This would seem to confer a dangerous power upon the court, for the improvident appointment of such officials would greatly increase the expense of the proceedings. The Act of 1898 limits the power of the court to appoint receivers or marshalls to cases where "the court shall find it absolutely necessary, for the preservation of the estates".[43] This section would seem still to apply to the appointment of receivers even under the new amendment, but unfortunately there is no similar limitation on the power to appoint custodians, for these officers did not exist under the older law.

The court shall promptly call the first meeting of creditors.[44] This provision is far weaker than the old law which required the court to cause the first meeting to be held within a specified short period.[45] Even more remarkable is the requirement that the notice of the call shall contain a summary of the inventory, a brief statement of the debtor's indebtedness as shown by the schedules and a list of the names and addresses of the secured creditors and the fifteen largest unsecured creditors.[46] Unless a receiver or custodian is appointed there is no provision for the taking of the inventory.[47] The new Supreme Court rules are silent upon this subject but the official form contains statements that an inventory and schedule is attached.[48] This would seem necessary for practical administra-

[41] Sec. 74 (c). The section as to agricultural extensions contains no such provision.

[42] The rules adopted by the Supreme Court merely copy this wording.

[43] Sec. 2 (3).

[44] Sec. 74 (c). If a custodian or receiver has been appointed, this officer makes the call. The section as to agricultural extensions provides that the call is to be made by the conciliation commissioner. Sec. 75 (e).

[45] Sec. 55 (a).

[46] Sec. 74 (c); sec. 75 (e). Under the latter section the names of all unsecured creditors must be listed.

[47] The section as to agricultural extensions requires the farmer to file an inventory after he has filed his petition or answer. The rules provide that this must be done in 10 days. Supreme Court General Order 50.

[48] Official form 64.

tion, although it complicates the preparation of the petition or answer. The first meeting seems almost a needless formality. It may examine the debtor and elect a trustee. The only essential thing is that the court shall, after hearing the parties in interest, fix a time within which the application for confirmation of the extension must be filed.[49] The trustee chosen by the meeting only takes control of the property of the bankrupt if an adjudication is subsequently made.[50] Even in such a case, it would seem that the creditors may only recommend rather than bindingly appoint.[51] It will be noted that the examination of the debtor is optional while under the old composition procedure it was a necessary prerequisite to the confirmation of a composition.[52]

The next step is for the debtor to obtain the written consent of a majority in number and amount of the creditors whose debts will be affected by the extension. In the case of unsecured creditors their claims must have been allowed,[53] but in the case of secured creditors there seems to be no requirement that the claims have even been proved, except that all creditors must show that their claim is free from usury as defined by the laws of the state where it was contracted.[54] This provision makes an important change, since usury which did not invalidate the claim, did not bar its proof under the older law. Secured creditors are simply counted with the rest of the creditors; they need not be counted at all if their debts are not affected.[55] Thus, it is possible for the unsecured creditors to force the adoption of a plan against which every secured creditor protests. Furthermore, there is no requirement that the creditors be not closely connected with the debtor by ties of blood or business relations.[56] This is very dangerous as they may be governed by such rather than their interests as creditors and aid in imposing an unfair plan.

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[49] Sec. 74 (d). The section as to agricultural extensions contains no provision for the election of a trustee, but does allow the creditors to name a committee to prepare a supplementary inventory. Sec. 75 (e). The commissioner is then to prepare a final inventory. Sec. 75 (f).

[50] Sec. 74 (l).

[51] Supreme Court General Order 13 dealing with the situation caused by the similar wording of sec. 44 in so far as it conflicts with sec. 2 (17).

[52] Sec. 12 (a).

[53] Sec. 74 (e). The section as to agricultural extensions appears to require that the claims of both secured and unsecured creditors have been allowed. Sec. 74 (g).

[54] Sec. 74 (g); sec. 75 (i).

[55] Sec. 74 (e); sec. 75 (g).

[56] Cf. sec. 59 (e) which provides that such creditors shall not be counted in determining the total number of creditors for the purpose of deciding how many petitioning creditors there must be in an involuntary petition.

After the application for confirmation is filed, the court must set a time for a hearing on it.[57] After this hearing the court shall confirm the extension if satisfied (1) that it includes an equitable and feasible plan for liquidation for the benefit of secured creditors whose claims are affected; (2) it is for the best interests of all the creditors; (3) the debtor would be entitled to a discharge in bankruptcy; and (4) that the plan has been proposed and accepted in good faith, the acceptance not having been procured by fraud or other improper means.[58] Even after confirmation, the court may retain jurisdiction to protect and preserve the estate and enforce the terms of the extension proposal.[59] There was no similar provision under the older law. The confirmation may be set aside within six months after confirmation if it is shown that it was procured by fraud, and that the applicant did not know of the fraud at the time of confirmation.[60] This provision is the same as the older law.[61]

There are only six reasons why a debtor may be adjudged a bankrupt if he asks for an extension by petition or answer. They are: (1) that he has failed to comply with any of the terms required of him for the protection of the estate; (2) he has failed to make the required deposit necessary before the consideration of the application for confirmation; (3) his proposal has not been accepted by the creditors; (4) confirmation has been denied; (5) in cases where the court has retained jurisdiction after confirmation, the debtor has defaulted without sufficient cause in any payment under the extension plan; and (6) if the court is satisfied that he commenced or prolonged the proceedings for the purpose of delaying creditors or avoiding an adjudication in bankruptcy.[62] It would seem that this sixth ground must be narrowly interpreted, for all proposals for extension involve delaying creditors and every time the plan is proposed by answer in an involuntary case, adjudication is delayed. Perhaps the difficulty can be solved by limiting this ground to cases in which delay was the sole purpose of the proposal, or in which there was some fraudulent intent. A clarifying amendment is desirable. If the debtor is a person against whom an involuntary petition could

[57] Sec. 74 (f); sec. 75 (h) (action by conciliation commissioner).

[58] Sec. 74 (g). The section as to agricultural extensions allows confirmation even where the farmer has done or omitted acts which would bar his discharge. Sec. 75 (i).

[59] Note 23 above.

[60] Sec. 74 (k); sec. 75 (m).

[61] Sec. 13.

[62] Sec. 74 (l). There is no provision for adjudication under the section as to agricultural extensions.

not be filed, he cannot be adjudicated without his consent. After adjudication, the normal course of bankruptcy administration is followed.[63]

It is finally necessary to consider the constitutionality of the new statute. It is settled that the power of Congress over the subject of bankruptcy is not limited to the classes which might become bankrupt under the law as it stood at the time the Constitution was framed.[64] A person may be allowed to file as a voluntary bankrupt even though he is not insolvent as the term is used in the Act of 1898.[65] Indeed, the great popular clamor against the Act of 1867 was that it allowed any person who could not pay his debts in full as they matured to be forced into bankruptcy.[66] The plan for extensions is closely analogous in basic principle to the composition agreements sanctioned by the Act of 1898.[67] It is true that secured debtors are now affected by the extension but it would seem that if Congress can force a dissenting minority of unsecured creditors to be bound by a composition agreement that it has power to do the same as to secure creditors. Under the Act of 1898 the liens of such secured creditors may be set aside in many instances.[68]

It would seem to present writer that the new amendment is capable of providing considerable relief to the hard-pressed individual debtor. Perhaps it is the confused drafting of the statute which has prevented more frequent resort to its provisions. Certainly a series of clarifying amendments are desirable.

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## LIMITATIONS AND DEVELOPMENT OF THE ATTRACTIVE NUISANCE DOCTRINE

Even since 1841, when Lord Denham, Chief Justice of the Queen's Bench, laid down the controlling principles of what subsequently has been known as the "attractive nuisance doctrine", there have been divergent interpretations, limitations, and extensions of this rule. *Lynch v. Nurdin*[1] has itself been regarded by some courts as overruled or, at least, seriously impaired by later

[63] Sec. 74 (m).

[64] Hanover Nat. Bank v. Moyses (1902) 186 U. S. 181.

[65] Note 7 above.

[66] Remington on Bankruptcy (2nd ed.) p. 14.

[67] Matter of Reiman (D. C. S. D. N. Y. 1874) Fed. Cas. No. 11,673; In Re Reiman (C. C. S. D. N. Y. 1875) Fed. Cas. No. 11,675.

[68] Sec. 67.

[1] (1841) 1 Q. B. 29, 113 Eng. Rep. 1041.