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## RE-ESTABLISHING THE AVAILABILITY OF FARMER-DEBTOR RELIEF UNDER THE BANKRUPTCY ACT

FRED H. KRUSE\*

### INTRODUCTION

The Frazier-Lemke Act, which became Section 75 of the Bankruptcy Act, was passed as a temporary or emergency measure, to be effective until March 3, 1938, that being the time limit fixed in the Act within which cases under it could be filed. This limit was extended by successive acts of Congress to March 1, 1949, when it expired.

In the meantime bills were introduced by Mr. Lemke, and others, to amend and make Section 75 a part of the permanent Bankruptcy Act. None of these efforts succeeded.

At a hearing before the special Subcommittee on Bankruptcy and Reorganization of the Committee on the Judiciary of the House, on H. R. 7528, sponsored by Mr. Lemke, and S. 1935, which was identical to H. R. 7528, on January 29, 1940, the writer suggested the law be redrafted to conform to the other arrangement chapters of the Act. At a subsequent hearing, the suggestion was made by a member of the Subcommittee that a combined effort be made to prepare a bill providing for farmer-debtor relief which could be made permanent bankruptcy law. A number of conferences were had and Mr. Lemke agreed to modify his bill in a number of particulars. A committee of the National Bankruptcy Conference experts on bankruptcy law was appointed,<sup>1</sup> which did an outstanding job of drafting and prepared the bill which was introduced in the 82d Congress, 1st Session, as H. R. 1745, and became known as the N. B. C. draft. It followed along the lines of the other arrangement chapters of the Act. Its procedural provisions were largely incorporated in bills subsequently introduced to amend Section 75.<sup>2</sup>

At the previous session of Congress there were introduced four bills<sup>3</sup> to amend Section 75 and to add a new Chapter XVI to

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1. This committee consisted of Mr. Olney, Referee in Bankruptcy, New York City, and then Chairman of the National Bankruptcy Conference; Mr. Jacob I. Weinstein, of Philadelphia, Chairman of the Drafting Committee of the N. B. C.; Mr. Robert S. Oglebay, co-author of Collier on Bankruptcy; and Mr. Charles A. Horsky, of Washington, D. C., now Chairman of the N. B. C.

2. It should be stated that the National Bankruptcy Conference takes no position with reference to the wisdom or expediency of such legislation, and that its sole purpose is to assist in perfecting the structural form of the proposed Act and to make it conform, as far as practicable to the other arrangement chapters of the Bankruptcy Act.

3. H. R. 1068 (the same as the previous Reed bill, H. R. 1745); H. R. 447, introduced by Mr. Hillings; H. R. 3584, introduced by Mr. Hunter; and S. 25, introduced by Mr. McCarran. The latter three bills are similar.

the Bankruptcy Act in its place. One of these, S. 25, as amended, passed the Senate on June 8, 1953, and a hearing was had upon it and the other bills before the Subcommittee on Bankruptcy and Reorganization of the Committee on the Judiciary of the House on May 21, 1954, but the session adjourned without further action in the matter.

As of this writing there are pending in the present Congress two bills to amend Section 75 and adopt a complete revision as Chapter XVI: S. 689 and H. R. 670, both being similar to S. 25 of the previous session. There has also been introduced S. 316, to extend the time for filing under Section 75 to March 1, 1956.

#### FARMER-DEBTOR RELIEF LEGISLATION

Farmer-Debtor relief under the Bankruptcy Act originated with the Frazier-Lemke Act of June 28, 1934, which became Section 75 of the Act. This law was declared unconstitutional under the Fifth Amendment in *Louisville Bank v. Radford*.<sup>4</sup> But the law was amended August 28, 1935, to conform to the opinion of the Supreme Court, and as amended held constitutional in *Wright v. Vinton Branch*.<sup>5</sup>

A large amount of litigation arose under the law and a considerable number of cases reached the Supreme Court. For example, the Court defined a "farmer" under the law;<sup>6</sup> held expenses for harvesting a crop were properly payable out of its proceeds as against a lien;<sup>7</sup> held that a farmer-debtor's case should not be dismissed because he had no reasonable hope of rehabilitation before the end of the three year moratorium;<sup>8</sup> held the farmer-debtor is entitled to a 3 year stay, which can be terminated prior to the end of that period only if he fails to comply with the provisions of the law or with the orders of the court;<sup>9</sup> held the farmer-debtor had the right to redeem within 90 days at the sale price;<sup>10</sup> held the bankruptcy court has exclusive jurisdiction and that state foreclosure proceedings were superseded under Section 75.<sup>11</sup> These cases and others construed and settled the law and to a large extent established the rights, duties and liabilities of the farmer-debtor and creditors under the law.

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4. 295 U. S. 555 (1935).

5. 300 U. S. 440 (1937).

6. *Bank v. Beach*, 301 U. S. 435 (1937).

7. *Adair v. Bank*, 303 U. S. 350 (1938).

8. *John Hancock Mut. Life Ins. Co. v. Bartels*, 308 U. S. 180 (1939).

9. *Borchard v. Bank*, 310 U. S. 311 (1940).

10. *Wright v. Union Central Life Ins. Co.*, 311 U. S. 273 (1940).

11. *Kalb v. Feuerstein*, 308 U. S. 433 (1940).

## THE PURPOSE AND EFFECT OF THE ACT

On this subject, Mr. Justice Douglas said, in *Wright v. Union Central Life Ins. Co.*:

"This Act provided a procedure to effectuate a broad program of rehabilitation of distressed farmers faced with the disaster of forced sales and an oppressive burden of debt. (Citing cases.) Safeguards were provided to protect the rights of secured creditors, throughout the proceedings, to the extent of the value of the property. (Citing cases.) There is no constitutional claim of the creditor to more than that."<sup>12</sup>

In *John Hancock Mutual Life Ins. Co. v. Bartels*, Mr. Chief

Justice Hughes said:

"The scheme of the statute is designed to provide an orderly procedure so as to give whatever relief may properly be afforded to the distressed farmer-debtor, while protecting the interests of his creditors by assuring the fair application of whatever property the debtor has to the payment of their claims, the priorities and liens of secured creditors being preserved."<sup>13</sup>

The Act was designed to give the farmer an opportunity to scale down his secured debts to the value of his property and to keep the farmer the owner of his farm. It was, in effect, "bankruptcy reorganization for farmers," somewhat along the lines of debt relief for other financially depressed debtors.<sup>14</sup> As stated by Senator Borah, on the floor of the Senate, when the second Frazier-Lemke Bill was under discussion:

"I see nothing in this bill which in principle has not been given to business, to municipal corporations, and to all lines of industry."<sup>15</sup>

The provisions of Section 75, permitting the farmer-debtor to redeem at the appraised value of his farm, together with the moratorium, were the heart of the Act. According to Mr. Lemke, hundreds of thousands of farms were saved from foreclosure by the presence of the law on the books. A great many cases were adjusted outside the law as the result of its existence, as shown by the following excerpt from a report published by the Department of Agriculture, Bureau of Agricultural Economics:

"In 1937 there was a total of 27,011 cases adjusted under this supervision of the Farm Security Administration. In 1938 this had dropped to 16,663, and in 1939 it had increased again to 24,776 cases that were adjusted."

12. 311 U. S. 273, 278 (1940).

13. 308 U. S. 180, 187 (1939).

14. See § 77(e)(c) (Railroad reorganization); C. X, § 216(7)(c) (Corporate reorganization); C. XI (Arrangements); C. XII, § 461(11)(c) (Real Estate Arrangements); C. XIII (Wage earner composition or extension).

15. 79 Cong. Rec. 13637 (1935).

The purpose and effect of S. 689, one of the bills now pending, are not the same as those of Section 75. That is made clear by the Senate Report accompanying its predecessor, S. 25, and the statement by Senator Magnuson on the floor when the bill was under discussion. In the report it is stated:

"It is undesirable for debtor assistance to go so far as to protect incompetent or negligent borrowers. There will, of course, be cases where farmers are so overburdened with debt that a scale-down settlement or foreclosure is the only solution. This proposed moratorium law is not designed to serve such cases."<sup>16</sup>

It has been urged that the Frazier-Lemke Act would close off the farmer from private credit sources, and this was given as a reason for requiring payment in full of secured debts in S. 25. As stated in the Senate report:

"It is believed that permanent legislation on this subject providing for scaling of debts secured by farmer property would adversely affect farmers in obtaining adequate loans on which to efficiently operate. . . . For the foregoing reasons there is no provision in this bill which would effect a scaling of secured debts. It is believed that to include provisions in that regard, at this time, would tend to restrict, limit, or dry up agricultural credit."<sup>17</sup>

The proportion of farm mortgages held by private lenders was markedly reduced between 1930 and 1938, but the ratio progressively increased between 1938 and 1945, when close to 66 per cent of farm mortgage debt was held by private lenders. This would seem to indicate private credit extension in the farm mortgage field has not been deterred.<sup>18</sup> It was testified by the Land Bank Commissioner at a hearing before the Subcommittee of the Committee on the Judiciary of the House, that in the previous four or five years private capital, including Federal Land Banks, made 80 to 90 per cent of the loans, and that the Federal Land Banks made about 12 per cent of the loans, individuals being the largest single group.<sup>19</sup>

#### PENDING LEGISLATION

S. 689 and H. R. 670, the two bills now pending, are similar to S. 25 (83d Congress), which passed the Senate on June 8, 1953, and on which hearing was had in the House before a Subcommittee of the Committee on the Judiciary.<sup>20</sup> For practical purposes, we will

16. Sen. Rep. No. 1303, 82d Cong., 2d Sess. 4 (1952).

17. *Id.* at 3.

18. See Comment, 56 Yale L. J. 982, 983 n. 3 (1947).

19. See *Hearings before Subcommittee of Committee on the Judiciary on S. 25*, 82d Cong., 1st and 2d Sess. 69 (1952).

20. See *Hearings, supra* note 19.

discuss only S. 689, although our comments apply equally to H. R. 670.

S. 689 introduces some new concepts into farmer-debtor relief legislation, as did S. 25. For instance:

1. *Unlimited Moratorium.* It provides for an unlimited moratorium "for the duration of the emergency, without expressly limiting the moratorium to a term of years." (Sec. 938.) Section 75 provides for a three year moratorium.

The idea of an unlimited moratorium is new and seems to be alien to the provisions of the other arrangement and reorganization chapters of the Bankruptcy Act, in none of which is there such a provision.

The termination of the moratorium with the end of the emergency would probably be difficult to enforce, notwithstanding it is provided in Section 942 that the court may upon hearing determine that the emergency has ceased and terminate the moratorium. In Section 75(s)(6) it states:

"This Act is hereby declared to be an emergency measure and if in the judgment of the court such emergency ceases to exist in its locality, then the court, in its discretion, may shorten the stay of proceedings herein provided for and proceed to liquidate the estate."

Yet, notwithstanding the resurgence of farm prices and prosperity after the commencement of the Second World War, in no reported case where that question has been raised has the court held that the emergency ceased to exist in its locality.

An unlimited moratorium would likely cause farmer-debtor cases to encumber the bankruptcy courts and the administrative offices for an indeterminate number of years and clog the dockets of the district courts. While there would generally be more efficient administration by Referees in Bankruptcy under the pending bills than occurred in many cases administered by Conciliation Commissioners under Section 75, the administrative work involved in the offices of Referees in a large number of pending farmer-debtor cases would be very great. Cases involving review of decisions of Referees would also increase the work of the district judges.

2. *Availability of Relief Dependent upon Cause of Farmer's Financial Distress.* S. 689 makes the availability of relief by way of moratorium dependent upon the cause of the farmer's financial distress. This idea is likewise alien to the provisions of the present Bankruptcy Act. In no chapter of the Act providing for reorganization, composition or extension of debts by a financially distressed corporation or individual debtor is the relief conditioned upon the

cause. All that the unfortunate debtor need state in his petition for relief is that he is "insolvent or unable to pay his debts as they mature."

S. 689, Section 938, provides on this subject as follows :

"At such meeting of creditors, or any adjournment thereof, the court shall determine whether the debtor's distress is due to causes beyond his control, or is due to causes within his control, such as *bad personal habits, failure to attend to business, diverting farm income to nonagricultural expenditures, and extravagant operations*. . . . If the cause is determined by the court to be within the debtor's control, the court shall proceed as provided in section 1016 of this Act."

Under Section 1016 the court may direct that bankruptcy be proceeded with, or adjudicate the farmer, or dismiss the petition.

The question naturally presents itself of why a farmer in financial distress from whatever cause should be deprived of an opportunity to make a composition or extension agreement with his creditors, secured and unsecured, and to rehabilitate himself. Under the present Bankruptcy Act, the only time the cause of the debtor's bankruptcy becomes important is when the matter of his discharge comes up, and then he may be denied a discharge if he is guilty of an act or conduct which is ground for objection to his discharge. No such determination is provided for in the case of a business man who files under Chapter XI or Chapter XII, or a wage earner who files under Chapter XIII, and petitions for a composition or extension under a plan or arrangement.

According to testimony before the Subcommittee of the Committee on the Judiciary of the Senate on S. 25,<sup>21</sup> the idea of an unlimited moratorium and making its availability depend on the conduct of the farmer originated with the board of directors of the Land Bank of Berkeley, California. The writer has no information as to the extent of experience of the members of that board, or of the draftsman who prepared the bill, but in the handling of hundreds of cases filed under Section 75, as Conciliation Commissioner and as Referee in Bankruptcy, he does not recall a single case where the debtor's distress was developed to have been due to causes entirely within the control of the debtor.

3. *No provision for Adjustment; Secured Creditor must be Paid in Full.* S. 689 has no provision for adjustment or scaling down of the farmer's secured indebtedness, such as is provided in Section 75. It provides<sup>22</sup> that, after a final determination that the emergency has ceased to exist, the debtor may elect an extension (as to which the

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21. *Ibid.*

22. §§ 986, 987.

secured creditor has nothing to say), which "shall provide for *full payment* of his secured claims," amortized over a term of years "not exceeding the greater of *ten years* or the original term of years." As to unsecured debts, the proposal may provide for payment "to the extent and on the terms which the debtor *believes* he will have the ability to pay from his future income." It would seem the secured creditors are to be protected in full, while unsecured creditors, who may have large claims, are to be limited to what the farmer believes he can pay them from his future income, notwithstanding the farmer may have a large amount of unmortgaged property or there is a large equity in his real property. This is a novel and unprecedented concept in bankruptcy legislation, to say the least.

At the hearing before the Senate Subcommittee on S. 25, a representative of the Farmers' Union favored a provision for scaling down of the farmer's debts. Mr. J. R. Isleib, Land Bank Commissioner, also favored a provision for adjustment, as well as for appraisal and reappraisal, not included in S. 689. The representative of the Equitable Life Assurance Society testified in favor of permitting the farmer to work out a settlement with the majority of his unsecured creditors. A representative of the American Bankers Association testified that the law should protect the debtor and deal fairly with his secured and unsecured creditors; that the unsecured creditors may have an equity in the real property, and that the debtor should be empowered to negotiate a settlement with the majority of his unsecured creditors. The following from the testimony of Mr. Isleib is pertinent on this subject:

"Senator MAGNUSON: But you believe, from your experience, in the farm loan bank, the land bank, which is in the nature of, as you say, a quasi-public lending institution, that the question of adjustments becomes almost necessary in order to effect the basic intent of the bill; is that correct?"

"Mr. ISLEIB: Yes, sir; and those relatively few cases where that is the only answer."

"Senator MAGNUSON: And that the court should have that discretion in making the adjustments?"

"Mr. ISLEIB: Yes, sir."<sup>23</sup>

Section 75 permits the scaling down of secured debts to the actual value of the property, which the courts have pointed out is all the secured creditor could obtain on foreclosure and all that he is constitutionally entitled to.

It seems that a financially distressed farmer should be entitled to the same opportunity for relief as is accorded by the Bankruptcy

23. *Hearings, supra* note 19, at 69.

Act to a financially distressed railroad, corporation, municipal organization, business man, real estate owner or wage earner, under Section 77 and Chapters IX, X, XI, XII, XIII and XV, and to make an offer of composition or extension to his creditors, secured and unsecured, which would become binding when it had been accepted by creditors of each class holding a majority in number and amount of claims. This was provided for in H. R. 1068, one of the bills introduced in the 83d Congress.

4. *No Provision for Appraisalment.* S. 689, if enacted, would be the only arrangement chapter of the Act without provision for appraisalment of the debtor's property. Appraisalment is required in all cases under the present Bankruptcy Act. It is useful in determining the amount, kind and value of property to be administered, in fixing the bond of the trustee, in determining the debtor's claim to exemptions, and, in the case of a farmer, in fixing a reasonable rent, and for purposes of sale, if necessary.

#### CONCLUSION

It seems probable that this Congress will pass some bill for farmer-debtor relief. Conditions in certain parts of the country have greatly depressed farm income. A recent newspaper item stated that a town in Aroostook County, Maine, ordered its schools closed because there was not enough money in the town treasury to pay the teachers, and that was caused by the people there having had a poor potato season and not being able to pay their taxes. If a complete revision of Section 75 is not passed, then it seems likely that the bill of Senator Watkins, S. 316, to amend Section 75 by extending the filing date for new cases to March 1, 1956, will pass. No bill incorporating the provisions of H. R. 1068, 83d Congress, known as the N. B. C. draft, has been re-introduced in the present Congress to date.