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## Constitutional Law-Invalidity of the Frazier-Lemke Amendment to the Bankruptcy Act

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## RECENT CASE NOTES

**CONSTITUTIONAL LAW—INVALIDITY OF THE FRAZIER-LEMKE AMENDMENT TO THE BANKRUPTCY ACT**—The Louisville Joint Stock Land Bank extended a credit of \$9,000 to Radford, secured by a mortgage on a farm of the appraised value of \$18,000. During the thirty four years interim for total amortization, the investment was to carry annual interest at six per centum. Radford defaulted in the payment of taxes, interest, and principal installments. Foreclosure proceedings were instituted by the bank with a request for the appointment of a receiver to collect rents and profits. Following an unsuccessful attempt by Radford to effect a composition, a judgment of foreclosure was entered. Radford then petitioned the federal district court alleging that he failed to obtain a composition, that he was unable to pay his debts as they matured, and, therefore, was entitled to an adjudication as bankrupt with relief under section 75, sub-section s, of the Bankruptcy Act. Held, Sub-section s of section 75 of the Bankruptcy Act is unconstitutional as in deprivation of property rights without due process of law.<sup>1</sup>

The concept of economic value is predicated upon earning power. Potential earning power is the source of credit in the fractional transactions that form the internal credit structure and its counterpart, the internal indebtedness. With an almost blind faith we have permitted an unregulated hypothecation of future earning power. Consequently, when depression impaired the capacity of the economic process, the prospectus for future earnings became impossible of realization. Neither the unsecured creditor nor the secured creditor is invulnerable when the initial premise of credit is undermined. A security res is without value aside from its earning power. The depreciated earning capacity of the security res today with reference to the potential capacity of the res, as judged on the day when credit was extended, becomes a present loss that must be distributed in some equitable manner. While economic and social reformers are contemplating a redistribution of wealth, the courts are dealing with the problem of an equitable distribution of loss.

At least three approaches have been employed by Congress to distribute loss and mitigate its extent. First, a devaluation of the gold content of the dollar was intended to depreciate all intangible assets and indebtedness by forty per centum without regard to an individual ability to pay.<sup>2</sup> A second method for the alleviation of credit tension has operated to shift the credit strain from individual creditors to the government.<sup>3</sup> The third approach is that of bankruptcy, the ramifications of which are now being submitted to judicial trial and error. Through the principle of discharge an orthodox bankruptcy proceeding has extended a possible method for debtor rehabilitation but it has not offered the creditor an opportunity to share in a revival of the debtor's ability to pay. Furthermore, a judicial liquidation and distribution of the debtor's assets often deprived the debtor of the tools of industry necessary to effect the rehabilitation to which the principle of discharge is devoted. A modification of the bankruptcy concept whereby the debtor retains

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<sup>1</sup> Louisville Joint Stock Land Bank v. Radford (1935), 295 U. S. 555.

<sup>2</sup> 48 Stat. 51, 48 Stat. 337, Norman v. Baltimore O. R. Co. (1935), 294 U. S. 240; 10 Ind. L. J. 455, Nebolsine, The Gold Clause in Private Contracts (1933), 42 Yale L. J. 1051.

<sup>3</sup> The Farm Credit Administration has been an integral factor in this program.

the tools of industry and the creditor shares in a possible renaissance of earning power, during a limited period of time and under supervision of the judiciary, promised a mitigation of loss and a rehabilitation of both debtor and creditor. An analysis of the text of the original Frazier-Lemke Amendment will reveal with exactitude its relation to these modified objectives.<sup>4</sup>

The salient portions of section 75, sub-section s, are contained in paragraphs 3 and 7. With the consent of the mortgagee, the bankrupt mortgagor might purchase the property at its present appraised value in compliance with the provisions of paragraph 3 for deferred payments over a six years period. A one per centum interest charge accompanied the arrangement. In effect, paragraph 7 required the bankruptcy court to impose a Congressional scheme for payment of the appraised value of the property in discharge of the mortgage if the mortgagee failed to acquiesce in the private arrangement of paragraph 3. For five years the terms of the mortgage were to be put in abeyance while the debtor retained possession in consideration of a reasonable rental charge which was to result to the creditors as their interests appeared. If the appraised value of the property was paid into court within five years, a discharge of the mortgage was to be decreed. The act was qualified by the mandate that it should operate retroactively, not prospectively.

Whether the original Frazier-Lemke amendment was destructive of the dual form of government in that it exceeded the ambit of the bankruptcy power of Congress went unresolved by the court. That the legislative imagination has not annoyed the judicial conception of bankruptcy escaped only as *inuendo*.<sup>5</sup> Bankruptcy legislation has long since shattered the ramifications of that topic as known to the authors of the Constitution. The states early offered an amenity through release of the person of the insolvent debtor.<sup>6</sup> With the federal bankruptcy statute of 1841, the principle of discharge was established and judicially confirmed in the case, *In re Klein*.<sup>7</sup> Bankruptcy at the debtor's volition supplanted the original devotion of the law to the creditor.<sup>8</sup> The privilege of bankruptcy has been expanded to include persons associated with widely divergent occupations.<sup>9</sup> Composition, both in the brackets of the unsecured<sup>10</sup> and the secured creditors,<sup>11</sup> is a comparatively recent enlargement.

<sup>4</sup> 11 U. S. C. A. 203, sub-section s.

<sup>5</sup> "But, the scope of the bankruptcy power conferred upon Congress is not necessarily limited to that which has been exercised. The discharge of the debts has come to be an object of no less concern than the distribution of his property."

<sup>6</sup> *Sturges v. Crowninshield* (1819), 4 Wheat. 122—"To punish honest insolvency by imprisonment for life would be an excess of inhumanity which will not readily be imputed to the illustrious patriots who framed our constitution, nor to the people who adopted it the State may refuse to inflict this punishment, or may withhold this means, and leave the contract in full force. Imprisonment is no part of the contract, and simply to release the prisoner does not impair its obligations."

<sup>7</sup> (1843) 1 How. 277.

<sup>8</sup> The Bankruptcy Act of 1800, 2 Stat. 19, provided only for involuntary bankruptcy. All subsequent enactments have recognized the voluntary petition.

<sup>9</sup> *Hanover National Bank v. Moyses* (1902), 186 U. S. 181, *Continental Illinois National Bank & Trust Co. v. Chicago, Rock Island & Pacific Ry. Co.* (1935), 294 U. S. 648.

<sup>10</sup> Composition was endorsed in the act of 1867 as amended by the act of 1874, 18 Stat. 178, 182; *In re Reiman* 20 Fed. Cas. 490, 496, 497.

<sup>11</sup> *Continental Illinois Nat. Bk. & Trust Co. v. Chicago, Rock Island & Pacific Ry. Co.* (1935), 294 U. S. 648.

These specific illustrations do not define bankruptcy; they merely reflect a judicial temper that remains amenable to the imaginative processes. Substantiated by a fund of respected opinion, Mr. Justice Story has said, "Perhaps as satisfactory a description of a bankruptcy law as can be framed is that it is a law for the benefit and relief of creditors and their debtors, in cases in which the latter are unable or unwilling to pay their debts."<sup>12</sup> If this descriptive generalization is not a definition, therein resides its value. Only that which is presently known can be reduced to definition. As a concession to convenience definition is justified but definition can too readily preclude a review of that to which the mind later becomes aware. Bankruptcy is not yet a dogma. The secured creditor may well be within its purview. Rehabilitation may become the most important parcel of the concept.

The exercise of every governmental power is subject to the protective restraints of the due process clause.<sup>13</sup> Consequently, the bankruptcy power of the federal government must be exercised in conformity with the judicial conception of that which is due process of law. The conception of due process is the variable which makes for judicial supremacy in the balance of the freedom of the individual as an individual as against the freedom of society in dealing with its component parts. As related to the present investigation, it became incumbent upon the court to evaluate the social interest in the maintenance of the property rights of the individual when in conflict with the interest of society in the economic rehabilitation of an independent, land owning class of farmers and in the reduction of indebtedness to a point commensurate with the earning capacity of our people. In the event that the last named interests prevail in this appraisal, the court then must ascertain whether the legislation appointed to subserve these interests transcends the ambit thereof in wanton and unnecessary demolition or the rights of creditors. In brief, the allocation of loss must be apportioned between debtor and creditor that the latter suffer a deprivation of property only to an extent necessary to sustain the interests given preference in the hierarchy of values.

That society, both through the agencies of state and federal government, is privileged to make a reasonable invasion of property rights for a proper objective is supported by a fund of authority.<sup>14</sup> The social interest in public

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<sup>12</sup> Story, Commentaries on the Constitution (4th Ed., 1873), Ch. 16, p. 50; 33 Mich. L. R. 1210; 44 Yale L. J. 651, *Local Loan Co. v. Hunt* (1934), 292 U. S. 234, *Hanover Nat. Bk. v. Moyses* (1902), 186 U. S. 181, *In re Reiman* (1874), 20 Fed. Cases. 490—"What is the subject of bankruptcies? It is not, properly, anything less than the subject of the relations between an insolvent or non-paying or fraudulent debtor; and his creditors, extending to his and their relief." Mr. Justice Sutherland, in *Continental Ill. Nat. Bk. & Trust Co. v. Chi., R. I. & Pac. Ry. Co.*, affirms the prediction of Mr. Justice Story in this observation, "From the beginning the tendency of legislation and of judicial interpretation has been uniformly in the direction of progressive liberalization in respect of the operation of the bankruptcy power."

<sup>13</sup> *Louisville Joint Stock Land Bk. v. Radford* (1935), 295 U. S. 555, *Hamilton v. Ky. Distilleries Co.* (1919), 251 U. S. 146, *Blodgett v. Holden* (1927), 275 U. S. 142; *United States v. Cress* (1916), 243 U. S. 316.

<sup>14</sup> *Sproles v. Binford* (1931), 286 U. S. 374, *Home Bldg. and Loan Assn. v. Blaisdell* (1934), 290 U. S. 398, *Mangault v. Springs* (1905), 199 U. S. 473, *Hudson County Water Co. v. McCarter* (1908), 209 U. S. 349; *Block v. Hirsh* (1920), 256 U. S. 135, *Atlantic Coast Line Ry. Co. v. Goldsboro* (1913), 232 U. S. 48—"Contract and property rights are held subject to a fair exercise of the police power."

health,<sup>15</sup> safety,<sup>16</sup> morals,<sup>17</sup> economic security and progress<sup>18</sup> social security,<sup>19</sup> and a more or less vague general welfare<sup>20</sup> have individually and in union supported legislative interference with property and contract. The recent decisions, *Worthen Co. v. Thomas*<sup>21</sup> and *Worthen v. Kavanaugh*,<sup>22</sup> sustain a judicial interdiction to thwart legislative efforts that annihilate property rights in excess of the interest sought to be protected.

Mr. Justice Brandeis, in his opinion from the case under investigation, subscribes to an ostensibly untenable position when he states, "Under the bankruptcy power Congress may discharge the debtor's personal obligation, because, unlike the States, it is not prohibited from impairing the obligation of contract." Contract rights are a species of the genus, property, and, as such, are as deserving of the protection of the due process clause as the more tangible mediums of property. If the federal government can impair the obligation of contract with impunity, the decisions of the court in the gold clause cases involving governmental contracts are beyond reconciliation.<sup>23</sup> Therein it was held that the federal government can not impair its own contracts, recovery being denied only because the complainants failed to prove substantial damages. The deduction is that discharge of personal obligations under the approved sections of the bankruptcy law is due process of law in that sufficient social interests sustain the principle; not that contract rights are not protected by the due process clause of the fifth amendment. The cases are multiple in which state legislation has been declared unconstitutional under the contract clause because available remedies as of the date when a mortgage was given were later denied a mortgagee.<sup>24</sup> Why, then, should these remedial rights be construed as property rights in contradistinction to contract rights in the present case?

Having determined that the principle of discharge as applied to personal obligations must conform to the same formula of due process that rendered this legislation, permitting of the discharge of the secured res, unconstitutional, it is instructive to compare the resulting effects of both applications of discharge to the creditor. The original Frazier-Lemke amendment proceeded upon the theory that the secured creditor under ordinary foreclosure sale would realize only the present appraised value of the land. Since the creditor is likely to become the purchaser at the foreclosure sale and thus retain the

<sup>15</sup> *Manigault v. Springs* (1905), 199 U. S. 473, *Fertilizing Co. v. Hyde Park* (1878), 97 U. S. 659.

<sup>16</sup> *Atlantic Coast Line Ry Co. v. Goldsboro* (1913), 232 U. S. 548.

<sup>17</sup> *Stone v. Miss.* (1879), 101 U. S. 814.

<sup>18</sup> *Sproles v. Binford* (1931), 286 U. S. 374, *Manigault v. Springs* (1905), 199 U. S. 473, *Ill. Central Ry. Co. v. Ill.* (1892), 146 U. S. 387, *Brown Holding Co. v. Feldman* (1920), 256 U. S. 170; *Levy Leasing Co. v. Siegel* (1921), 258 U. S. 242; *Block v. Hirsh* (1920), 256 U. S. 135.

<sup>19</sup> *Brown Holding Co. v. Feldman* (1920), 256 U. S. 170; *Levy Leasing Co. v. Siegel* (1921), 258 U. S. 242; *Block v. Hirsh* (1920), 256 U. S. 135.

<sup>20</sup> *Chicago and Alton Ry. Co. v. Tranbarger* (1915), 238 U. S. 67

<sup>21</sup> (1934), 292 U. S. 426.

<sup>22</sup> (1935), 295 U. S. 56.

<sup>23</sup> *Perry v. U. S.* (1935), 294 U. S. 330; *Nortz v. U. S.* (1935), 294 U. S. 317.

<sup>24</sup> *Sturges v. Crowninshield* (1819), 4 Wheat. 122; *W. B. Worthen Co. v. Kavanaugh* (1935), 294 U. S. 555, *Bronson v. Kinzie* (1843), 1 How. 311, *Green v. Biddle* (1823), 8 Wheat. 1, *Howard v. Bugbee* (1860), 24 How. 461, *Edwards v. Kearzey* (1877), 96 U. S. 595, *McCracken v. Hayward* (1844), 2 How. 608.

res in the hope of an eventual restoration of its earning power, the basis of the contention is obviously fallacious. There is, however, no fundamental difference between the property right of the secured creditor here obliterated and the position of the unsecured creditor who has suffered the annihilation of a legal right through discharge of the debtor in bankruptcy. It is within the province of bankruptcy to salvage the man who has hypothecated his industry a life span in advance so that he will not become a peon of his creditors. The Supreme Court has refused to permit bankruptcy to salvage his home and his tools.

Although the objective of the original Frazier-Lemke amendment did not vary from the aim of bankruptcy discharge, the surrounding provisions were in ruthless disregard of the further bankruptcy aim of an equitable distribution of loss. Specifically, the present appraised value of Radford's property amounted to \$4,445. Under the deferred payment plan of paragraph 3 providing for a one per centum interest charge, the present value of this sum at the legal rate of interest was approximately \$3,405. In other words, Radford would have been discharged by the payment of about 38 per centum of his total indebtedness; a price of 76.6 per centum of the present appraised value of the res. The one per centum interest on the appraised value, the only payment to be made under paragraph 3 during the first year, would not satisfy expenditures for taxes and insurance. Furthermore, the protracted period over which the deferred payment plan was to operate did not have the support of precedent. Only nominal discretion was lodged in the courts.

Legislative moratoria have been sustained only in as far as the statute carefully hedged about the security res with protective assurances to the creditor.<sup>25</sup> A ministerial discretion in the application and administration of the law to specific cases was deposited with the courts. Through the operation of the Minnesota mortgage moratorium, it was possible that the mortgagee as well as the debtor might realize from the renaissance of earning power by the continued operation of the res. The institution of credit might thereby be preserved. A reasonable rental charge accompanied the arrangement and the duration of the moratorium was not oppressive. Clearly the original Section 75, sub-section s, does not conform in its incidents to the approved pattern. The principle it sought to propound has suffered from intemperate draftsmanship.

Following this declaration of unconstitutionality, Congress enacted a new sub-section s which, in effect, is a federal moratorium.<sup>26</sup> Its incidents provide for a latitude of judicial discretion, a stay of proceedings for three years, and an application of rental charges, first, to the upkeep and taxes on the property, the residue to result to the creditors. The terms of the former statute for a payment into court of the appraised value of the property is retained subject to this proviso, "That upon request in writing by any secured creditor, the court shall order the property upon which such secured creditor has a lien to be sold at public auction. The debtor shall have ninety days to redeem any property sold at such sale, by paying the amount for which any such property was sold, together with five per centum interest, into court, and he may apply for his discharge." By judicial interpretation in the case, *In re*

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<sup>25</sup> Home Bldg. and Loan Assn. v. Blaisdell (1934), 290 U. S. 398.

<sup>26</sup> 49 Stat. 792; 11 U. S. C. A. 203. The current sub-section s was enacted Aug. 28, 1935.

Young,<sup>27</sup> the proviso is construed to declare that a judicial sale cannot be had "until the debtor might evidence an intention to pay into court the appraised value of the land." A distribution of loss through the reduction of indebtedness to a point commensurate with the earning capacity of the land is rendered nugatory by this provision for judicial sale. At most it offers a scant moment in which other forces may effect a restoration of earning power that will rehabilitate both debtor and creditor. Whether the principle of moratorium is within the conception of bankruptcy necessarily remains conjectural. The evolutionary progress of bankruptcy toward the principle of rehabilitation tempts a belief in the constitutionality of this aspect of the amendment. It is submitted that the balance of social values support this legislation. The preservation of the industry of man in union with the implements of industry alone can fulfill and preserve the credit structure.

J. F. T.

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**JURY—INTENTIONAL EXCLUSION OF WOMEN.**—Appellant was convicted of embezzlement. At the trial, the male defendant challenged the array upon the ground that the jury commissioners had purposely and intentionally excluded the names of women from those selected for jury service. Testimony of the commissioners supported this charge. Held, error to overrule such challenge.<sup>1</sup>

Is a jury selected from a jury box from which the names of women have been intentionally excluded by the jury commissioners a legally drawn jury, and if not, what are the consequences of such actions? Substantially, this was the question which was recently presented to the Indiana Supreme Court. The situation which provoked it is typical. The Lagrange county court house did not facilitate a convenient separation of male and female jurors, should a mixed jury ever be drawn. As a result, the Lagrange Circuit judge and his jury commissioners had reached a tacit understanding that the names of women be omitted from the jury box from which the panel was drawn to avoid complications.

Although there is some conflict,<sup>2</sup> it is now generally settled that women are competent and qualified jurors.<sup>3</sup> Consequently, when the defendant in this proceeding in the Lagrange circuit was to be tried by a jury from which women were excluded, he challenged the array on the above ground. The challenge was overruled, but on appeal the court refused any variance from what it considered the hard and fast lines of statutory instructions to jury

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<sup>27</sup> (1935), 12 Fed. Supp. 30. Although the statute makes provision for a reasonable rental charge, there is to be no payment until the end of the first year of the moratorium. The court declares this to be an unsecured promise "that deprives the mortgagee of an otherwise positive right to income for that period."

In the case, *In re Slaughter* (1935), 12 Fed. Supp. 206, the court apparently interprets the statute to authorize a judicial sale at the insistence of the creditor before the end of the "three years probationary period."

<sup>1</sup> *Walter v. State* (1935), 195 N. E. 268 (Ind.).

<sup>2</sup> 18 *Georgetown L. J.* 393, 394, 16 *A. L. R.* 1154.

<sup>3</sup> *Palmer v. State* (1926), 197 Ind. 625, 150 N. E. 917, *Moore v. State* (1926), 197 Ind. 640, 151 N. E. 689; *Wilkinson v. State* (1926), 197 Ind. 642, 151 N. E. 690; *Jalbert v. State* (1928), 200 Ind. 380, 165 N. E. 522; *Commonwealth v. Maxwell* (1921), 271 Pa. 378, 114 Atl. 825, *People v. Baltz* (1920), 212 Mich. 580, 180 N. W. 423, 4 *A. L. R.* 140.