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# A New Understanding of the Bankruptcy Clause

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# A NEW UNDERSTANDING OF THE BANKRUPTCY CLAUSE

*Stephen J. Lubben*<sup>†</sup>

*“The Congress shall have Power . . . [t]o establish . . . uniform Laws on the subject of Bankruptcies throughout the United States . . . .”*<sup>1</sup>

## ABSTRACT

In the contest for least-studied part of Article I, Section 8 of the Constitution, the Bankruptcy Clause—Clause 4—certainly might win. Although we have lived with a permanent bankruptcy law since the end of the nineteenth century, efforts to understand the Clause typically extend little further than an assumption that the Clause is the bankruptcy counterpart to the much better-known Commerce Clause. To the extent the Bankruptcy Clause is given any thought at all, the modern conception is to assume it part of a larger Hamiltonian effort to federalize the economy: the Commerce Clause, the Bankruptcy Clause, and the Contracts Clause—combined perhaps with the Supremacy Clause and the Necessary and Proper Clause—work together to provide that the most important aspects of commerce are federalized and kept from piecemeal regulation by the states. Indeed, this conception has probably been the most common understanding for almost a century.

That may have been the Framers’ intent, and it works well in explaining the recent past, particularly since the New Deal, but it struggles as an explanation once we remember that Congress only rarely exercised its powers under the Bankruptcy Clause for almost a century after the nation’s founding. It also neglects the understanding of the Bankruptcy Clause that developed shortly after ratification: namely, that Congress’s powers regarding insolvency were simply to impose uniformity, and that the states continued to enjoy full power to enact bankruptcy legislation that would apply to debtors within their realm.

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† Harvey Washington Wiley Chair in Corporate Governance & Business Ethics, Seton Hall University School of Law. This Article is all the better because Michelle Harner, Eddie Hartnett, Emily Kadens, Rich Levin, Troy McKenzie, Daniel Pines, John Pottow, Mark Roe, David Skeel, Charles Tabb, and Jay Westbrook took the time to read early drafts and provide their comments, and it also benefited from exceptional research assistance by Amanda E. McKinlay and Sarah B. Chopnick and historical discussions with Monty Waller.

1. U.S. CONST. art. I, § 8, cl. 4.

In this Article, I argue that the only way to really understand the Bankruptcy Clause is to relearn its history. Thus, I begin with the ways in which American bankruptcy—as enacted by the colonies and the states—diverged from that of England. This divergence helps to explain why the federal 1800 Bankruptcy Act, which was heavily reflective of English bankruptcy practice, was so ill received. From there, the Article traces the long era of state bankruptcy regulation, consistent with the poststratification understanding of the Clause. It was only after interstate commerce began to grow and, following the Civil War, the Fourteenth Amendment changed the state-federal dynamic that a long-term federal Bankruptcy Act was considered needed and palatable. In short, I view the enactment of permanent bankruptcy legislation more as the result of external factors and less the result of the cyclical process that Charles Warren famously described.

The Article concludes with a revised understanding of the Bankruptcy Clause, one that I argue is more faithful to the history and evolving understanding of the Clause. I argue that the Bankruptcy Clause, as currently understood, is not the limited thing it once was, but that the current understanding is the process of an evolution that was far from inevitable.

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## INTRODUCTION

The Bankruptcy Clause—Article I, Section 8, Clause 4—is something of an oddball. After all, Congress was already granted the power to regulate interstate commerce in the preceding clause,<sup>2</sup> so why single out bankruptcy for separate treatment?<sup>3</sup> And why lump bankruptcy with nationalization?<sup>4</sup> Purists might note that the Bankruptcy Clause is not limited to interstate activities, both by its terms<sup>5</sup> and by the requirement that laws passed thereunder operate uniformly.<sup>6</sup> But that suggests consideration of the Bankruptcy Clause in the first place, which might be a bit of a stretch because it is so often overlooked.

To the extent the Bankruptcy Clause is given any thought at all,<sup>7</sup> the modern conception considers it part of a larger Hamiltonian effort to federalize the economy: the Commerce Clause, the Bankruptcy Clause, and the Contracts Clause—combined perhaps with the Supremacy Clause and the Necessary and Proper Clause—work together, ensuring that the most important aspects of commerce are federalized and kept from piecemeal state regulation.<sup>8</sup> Indeed, this conception has probably been the most common understanding for

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2. U.S. CONST. art. I, § 8, cl. 3.
  3. See generally James Monroe Olmstead, *Bankruptcy a Commercial Regulation*, 15 HARV. L. REV. 829, 831 (1902) (discussing the origin of the Bankruptcy Clause at the Constitutional Convention).
  4. U.S. CONST. art. I, § 8, cl. 4 (“The Congress shall have Power . . . [t]o establish a uniform Rule of Naturalization, and uniform Laws on the subject of Bankruptcies throughout the United States . . .”).
  5. Compare *id.* (covering “bankruptcies throughout the United States”), with U.S. CONST. art. I, § 8, cl. 3 (authorizing regulation of “commerce . . . among the several states”).
  6. See *Cent. Va. Cmty. Coll. v. Katz*, 546 U.S. 356, 376 n.13 (2006) (rejecting an argument that the uniformity requirement “cannot be interpreted to confer upon Congress any greater authority . . . than is conferred, for example, by the Commerce Clause”).
  7. For example, Professor Tribe spends not quite two pages in total on it in his treatise. 1 LAURENCE H. TRIBE, *AMERICAN CONSTITUTIONAL LAW* 846–48 (3d ed. 2000).
  8. See DAVID A. SKEEL, JR., *DEBT’S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA* 23 (2001) (noting James Madison’s belief that the federal dominion embodied in the Bankruptcy Clause was “necessary to prevent debtors from fleeing to another state” to avoid their debts); cf. Emory Speer, *Alexander Hamilton*, 16 YALE L.J. 94, 106–07 (1906) (discussing the importance of Hamilton’s views on the federal government and its powers, particularly regarding the nation’s banking system).

almost a century.<sup>9</sup> That may have been the framers' intention, and it works well in explaining the recent past, particularly since the New Deal, but it struggles as an explanation once we remember that Congress only rarely exercised its powers under the Bankruptcy Clause for almost a century after the nation's founding.<sup>10</sup> Typically this inconvenient fact is explained away by reference to Charles Warren's history of, as he calls it in his opening line, the "gloomy and depressing subject."<sup>11</sup>

Although that opening line says much about Warren's writing style, ultimately it is Warren's argument that the early bankruptcy laws were responses to financial crises—which fell away once the crises had passed—that lingers as our understanding of the Clause. In essence, Warren argues that the country's Jeffersonian and Jacksonian impulses largely won the argument, until they didn't. This interpretation has been widely influential ever since, but it is itself the product of its New Deal heritage.<sup>12</sup> Additionally, Warren's argument neglects the understanding of the Bankruptcy Clause that developed shortly after ratification—namely, that Congress's powers regarding insolvency were simply to impose uniformity and that the states continued to enjoy full authority to enact bankruptcy laws applying to debtors within their jurisdictions.<sup>13</sup>

The Supreme Court's 1819 decision in *Sturges v. Crowninshield*,<sup>14</sup> striking down a New York bankruptcy law under the Contracts Clause,<sup>15</sup> upended this post-ratification understanding that states enjoyed nearly unfettered authority with regard to bankruptcy. But the issue remained contested—and thus the need for a national bankruptcy law debated—until the Gilded Age.<sup>16</sup> By this time,

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9. See F. REGIS NOEL, A HISTORY OF THE BANKRUPTCY CLAUSE OF THE CONSTITUTION OF THE UNITED STATES OF AMERICA 98 (1918) (published dissertation, Catholic University of America) (stating that "uniformity of the laws" was a concern during the drafting of the Constitution).
  10. See *infra* Parts II–III.
  11. CHARLES WARREN, BANKRUPTCY IN UNITED STATES HISTORY 3 (1935). Warren's opening is similar to an earlier one on the same topic. H.H. Shelton, *Bankruptcy Law, Its History and Purpose*, 44 AM. L. REV. 394, 394 (1910) ("I am aware of the fact that my subject is an unpopular one. It is neither a cheerful nor a pleasing theme, because it deals with financial disaster, and we dislike the gloom attending ruin.").
  12. The first chapter of David A. Skeel, Jr.'s *Debt's Dominion* can be seen as a better-written version of the Warren story. SKEEL, *supra* note 8, at 23–47.
  13. See *infra* Part II.
  14. 17 U.S. (4 Wheat.) 122 (1819).
  15. *Id.* at 196–208.
  16. In some sense, *Sturges* and the resulting continual debate relegated the Bankruptcy Clause to an obscure corner of the larger notion of constitutional protectionism.

relations between the states and the federal government had been hugely revamped by the Fourteenth Amendment, making the original Hamiltonian project more consistent with the overall conception of the Constitution.<sup>17</sup>

In this Article I argue that the only way to really understand the Bankruptcy Clause is to relearn its history, free from Warren's influence. Thus, I begin by sketching the pre-*Crowninshield* era. Central to my suggested view of the Bankruptcy Clause is understanding the ways in which American bankruptcy law—as first enacted by the colonies and the states—diverged from that of England. This divergence was well established by the time of the American Revolution and helps to explain why the federal 1800 Bankruptcy Act,<sup>18</sup> which was heavily reflective of English bankruptcy practice, was so ill received. Thus, Part I looks at the colonial understanding of bankruptcy and insolvency, and Part II looks at the early years under the Constitution. Part III then examines the contest over *Crowninshield* from 1819 until 1898. This was an era of two temporary bankruptcy laws, much state innovation in the area, and even some attempts to reverse the holding of *Crowninshield* through constitutional amendment.

At adoption of the Constitution, there were several possible interpretations of the Bankruptcy Clause. First, for a Federalist, the Clause might have been seen as an insolvency counterpart to the Commerce Clause, preempting state action in the field of bankruptcy, whether or not Congress exercised its power. At the other extreme, the Jeffersonian or Jacksonian view of the Clause (along with a certain understanding of the Contracts Clause) might have been read to permit state bankruptcy laws, at least to the degree such laws were a part of general debtor-creditor law before the adoption of the Constitution.

Instead, the Supreme Court adopted a kind of muddled, middle-ground position in a series of cases beginning with *Crowninshield* and extending at least through *Ogden v. Saunders*,<sup>19</sup> which held that a state bankruptcy law was permissible, under certain conditions.<sup>20</sup> Namely, the law could only operate prospectively and apparently could only apply to citizens of the state of enactment.<sup>21</sup> This holding seemingly constitutionalized the issue more than it needed to, perhaps

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17. Slaughter-House Cases, 83 U.S. (16 Wall.) 36, 125 (1873) (Swayne, J., dissenting) (“These amendments are a new departure, and mark an important epoch in the constitutional history of the country.”).

18. Act of Apr. 4, 1800, ch. 19, 2 Stat. 19 (repealed 1803).

19. 25 U.S. (12 Wheat.) 213 (1827).

20. *Id.* at 369.

21. *Id.*

because of the Court's limited ability to affect state laws at the time; overrode extant law regarding enforcement of contracts across jurisdictions; and left both Federalists and Jeffersonians confused. As a result, both continued to argue their original positions, despite the Supreme Court's decisions.

Part IV then examines the modern era, which nominally features two bankruptcy laws—the 1898 Bankruptcy Act<sup>22</sup> and the 1978 Bankruptcy Code<sup>23</sup>—but I submit these were extensively amended so many times that the United States has actually had about a half dozen bankruptcy laws during this period. This period began to embrace something closer to the Federalist understanding of the Bankruptcy Clause, but I argue that this is more a result of a new, post-Civil War understanding of the federal government combined with the increased nationalization of credit markets. In short, I view the enactment of permanent bankruptcy legislation more as the result of external factors and less the result of the cyclical process that Warren described in his famous book.

The Article concludes with a revised understanding of the Bankruptcy Clause, one that I argue is more faithful to the history and evolving understanding of the clause. I argue that the Bankruptcy Clause, as currently understood, is not the limited thing it once was, but that the current understanding is the process of an evolution that was far from inevitable.

## I. THE COLONIAL YEARS

By the time the Constitution was enacted, England had several centuries of experience with bankruptcy laws. This experience naturally influenced practice in the colonies and in the early years under the Articles of Confederation. What follows is a necessarily abbreviated history of English debtor-creditor law, focusing in particular on those aspects of the law that have had special salience in the discussion of American bankruptcy law. It should not be mistaken for a comprehensive account of the history of English debtor-creditor law, which is far more complex and worthy of separate treatment.

Ultimately, the American colonists knew English bankruptcy law as a collective collection remedy for business debts more than a device for the relief of honest but unfortunate debtors.<sup>24</sup> And they knew

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22. Act of July 1, 1898, ch. 541. 30 Stat. 544 (repealed 1978).

23. Act of Nov. 6, 1978, Pub. L. 95-598, 92 Stat. 2549 (codified as amended at 11 U.S.C.).

24. An account of one debtor's experience in the English bankruptcy system in the early nineteenth century can be found in EDMUND TOWNSEND, AN EXTRAORDINARY HISTORY OF A BANKRUPTCY (1811).



English bankruptcy as a process that could result in severe penalties that were erratic in application.<sup>25</sup>

A. *Early Influences on English Bankruptcy*

It is common to date bankruptcy to either the Old Testament and Mosaic Law or Roman Law.<sup>26</sup> The principle outlined in Deuteronomy<sup>27</sup> is an early example of the law in the books not corresponding to the law in practice—the development of the *prosbul*, a kind of early waiver of the biblical forgiveness rule, avoided the obvious effects routine forgiveness would have on the development of early credit markets.<sup>28</sup> Eventually, the rule of Deuteronomy was simply ignored by the Jewish community.<sup>29</sup> As for the Roman antecedents, while they may have had indirect influence by way of neighboring countries like France and the area we now know as Belgium, which in turn

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25. See 2 WILLIAM BLACKSTONE, COMMENTARIES \*482 (“The bankrupt, upon this examination, is bound upon pain of death to make a full discovery of all his estate . . .”).
26. See, e.g., 3 J. STORY, COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES ch. XVI, §§ 1107–1108 (Boston & Cambridge 1833) (dating bankruptcy and its system of discharging persons to Roman law); R.P. Hobson, *Federal Bankruptcy Act—Its History and Operation*, 21 KY. L.J. 86, 86 (1932) (transcript of a radio lecture) (tracing bankruptcy law “back more than three thousand years to the Mosaic law” but tracing the more modern law of “assignment for the benefit of creditors” to Roman law); see also Rhett Frimet, *The Birth of Bankruptcy in the United States*, 96 COM. L.J. 160, 162 (1991) (Code of Hammurabi, Islamic, and Jewish law); Andrew J. Duncan, *From Dismemberment to Discharge: The Origins of Modern American Bankruptcy Law*, 100 COM L.J. 191, 191 (1995) (Roman law). The myth of the “broken bench”—whereby an insolvent merchant’s debtors would come to the marketplace and break the bench on which he conducted business over his head—appears to have been just that, a myth with little basis in actual practice. Sandor E. Schick, *Globalization, Bankruptcy and the Myth of the Broken Bench*, 80 AM. BANKR. L.J. 219, 222, 251–52 (2006).
27. *Deuteronomy* 15:1–3 (New English) (“At the end of every seventh year you shall make a remission of debts. This is how the remission shall be made: everyone who holds a pledge shall remit the pledge of anyone indebted to him. He shall not press a fellow-countryman for repayment, for the LORD’s year of remission has been declared.”).
28. 10 THE JEWISH ENCYCLOPEDIA 219–20 (Isidore Singer et al. eds., 1912) (discussing the *prosbul*’s amelioration of creditor concerns and the resultant stabilization of liquidity in ancient credit markets). Procedurally, the *prosbul* was “a declaration made in court, before the execution of a loan, to the effect that the law requiring the release of debts upon the entrance of the Sabbatical year shall not apply to the loan,” which was “attested by witnesses or by the judges of the court.” *Id.* at 219.
29. See *id.* at 220.

influenced English law, it is hard to find a direct connection between Roman law and late medieval England.<sup>30</sup>

*B. Methods Available to Early Creditors*

In England and in colonial and early independence America, creditors began with two basic means of collecting unpaid debts; the creditor could proceed against the debtor's assets or against the debtor's person.<sup>31</sup> Sometimes a creditor might pursue both means of collection. Asset-based collection obviously was more likely to result in actual payment, but for a variety of reasons—including limitations on collection against real estate, the difficulty of finding assets, and the broader risk of fraudulent transfers—it seems to have been slightly used, at least when compared to modern practice.

Instead, defaulting debtors were often thrown in debtor's prison, which was only likely to result in actual collection if the debtor had secreted away assets, had substantial exempt assets, or had wealthy friends willing to help out.<sup>32</sup> Otherwise, prison mostly vindicated the moral aspects of the debtor-creditor relationship.<sup>33</sup>

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30. See Shelton, *supra* note 11, at 396 (noting that in parts of Continental Europe at the turn of the last century, the requirement that a bankrupt person or entity must still pay debts in entirety or face criminal punishment was still prevalent); cf. Israel Treiman, *Acts of Bankruptcy: A Medieval Concept in Modern Bankruptcy Law*, 52 HARV. L. REV. 189, 192–97 (1938) (discussing the harshness of Continental Europe's bankruptcy laws as perhaps reflective of the relative ease with which a debtor could abscond outside the territory over which his creditors had political influence).
31. See PETER J. COLEMAN, DEBTORS AND CREDITORS IN AMERICA: INSOLVENCY, IMPRISONMENT FOR DEBT, AND BANKRUPTCY, 1607–1900, at 3–5 (1974) (describing the colonial procedural mechanisms of writ of execution against debtors); see also *Imprisonment for Debt*, 11 AM. JURIST & L. MAG. 289 (1834) (reviewing the arguments for and against imprisonment for debt).
32. See COLEMAN, *supra* note 31, at 5 (noting that insolvent debtors could be held until family or friends paid their debts for them).
33. This is perhaps most vividly illustrated by reference to the specific example of William Marvell, the hangman in London from 1715 to 1717. He was arrested for unpaid debts, and thus unable to perform his job. Since he was paid by the execution, his financial picture became ever bleaker the longer he remained in prison, until he was eventually replaced as hangman and thus lived the remainder of his life in poverty. HORACE BLEACKLEY, *THE HANGMEN OF ENGLAND* 23–35 (1929).

Creditors also developed a variety of tools that allowed for monitoring defaulting debtors and even distributing the debtor's assets through compositions and assignments, which were short of the formal collection mechanisms. But these tools suffered from problems that remain familiar today. Most importantly, some creditors preferred to become holdouts and some debtors were uncooperative. Thus, while

[l]etters of licence, deeds of inspectorship and assignments were available to all and provided the mainstay of unofficial ways of dealing with insolvency and failure . . . [i]t was often easier for creditors to move from haranguing their debtors for repayment to official forms of debt collection . . . Bankruptcy put all creditors upon an equal footing [and] allowed the bankrupt to be questioned closely about his estate . . . .<sup>34</sup>

### C. *First English Bankruptcy Laws*

The first bankruptcy law is often said to be a statute passed in the final years of Henry VIII's long reign, entitled "An Act againste suche persones as doo make Bankrupte."<sup>35</sup> The first Henry VIII statute was unlike traditional common law debtor-creditor law in that it provided for a collective collection process.<sup>36</sup> Essentially, various high officials from the Privy Counsel were tasked with arresting the debtor, selling his assets, and distributing the proceeds to creditors. There was no discharge under this law.<sup>37</sup>

As Lord Coke noted, the concept of a debtor absconding to avoid payment was not newly minted in the sixteenth century, but the problem had previously been addressed by narrowly tailored statutes

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34. JULIAN HOPBIT, *RISK AND FAILURE IN ENGLISH BUSINESS, 1700–1800*, at 31 (1987).
35. 34 & 35 Hen. 8, c. 4 (1542–43) (Eng.); *see also* 2 WILLIAM BLACKSTONE, *COMMENTARIES* \*474 (indicating that this was "the first statute made concerning any English bankrupts"). Note that the dating of these statutes is somewhat imprecise, given differences in calendars and citation conventions. Emily Kadens, *The Last Bankrupt Hanged: Balancing Incentives in the Development of Bankruptcy Law*, 59 DUKE L.J. 1229, 1236–37 (2010). Until the mid-1700s, England marked the new year as beginning on Lady Day (March 25th). JOHN SUGDEN, SIR FRANCES DRAKE 288 (1990).
36. 4 W.F. FINLASON, *REEVES' HISTORY OF ENGLISH LAW, FROM THE TIME OF THE ROMANS TO THE END OF THE REIGN OF ELIZABETH* 382 (New Amer. ed. 1880). *See generally* Louis Edward Levinthal, *The Early History of Bankruptcy Law*, 66 U. PA. L. REV. 223, 225–26 (1917) (describing the collective collection process in detail).
37. An Acte Againste Suche Persones as Doo Make Bankrupte, 34 & 35 Hen. 8, c. 4, § 6 (1542–43) (Eng.) ("Such Debtors shall remain liable for Amount of Debts not satisfied.").

that did not invoke the term “bankruptcy” for the problem at hand.<sup>38</sup> For example, under Henry VII, a statute had been enacted that penalized debtors that tried to avoid creditors while fraudulently transferring goods.<sup>39</sup> That statute is less known, because it did not use the magic word “bankruptcy.”<sup>40</sup> It has been noted that it shares the same preamble as its more famous and newer counterpart, suggesting a similarity of purpose.<sup>41</sup>

From the enactment of the statute in Henry VIII’s reign through the restoration of the House of Stuart,<sup>42</sup> Parliament enacted a series of similar laws designed to address the problems of absconding or hiding debtors.<sup>43</sup> It was these statutes that adopted the notion that bankruptcy was something that only applied to “traders,”<sup>44</sup> and began

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38. EDWARD COKE, *THE FOURTH PART OF THE INSTITUTES OF THE LAWS OF ENGLAND: CONCERNING THE JURISDICTION OF COURTS* 277 (1669); *see also* Schick, *supra* note 26, at 252–55 (discussing the influence of medieval Italian laws on the English system).
  39. An Acte Agaynst Fraudulent Deede of Gyft, 3 Hen. 7, c. 4 (1487) (Eng.); *see also* FINLASON, *supra* note 36, at 193–94 (discussing the statute).
  40. Max Radin traces the term to 1533. Max Radin, *The Nature of Bankruptcy*, 89 U. PA. L. REV. 1, 1 n.2 (1940). By 1600, the word was apparently in common use, as Shakespeare used the phrase “Upon that poor and broken bankrupt there?” in his play, *As You Like It*. WILLIAM SHAKESPEARE, *AS YOU LIKE IT* act 2, sc.1 (H. J. Oliver ed., Penguin Books 1968) (c. 1600).
  41. FINLASON, *supra* note 36, at 381 n.(a).
  42. The requirement that the debtor be a merchant or trader was suspended during the Commonwealth period, when the focus was expanded to include all imprisoned for debt. C.P. COOPER, *A BRIEF ACCOUNT OF SOME OF THE MOST IMPORTANT PROCEEDINGS IN PARLIAMENT* 243 n.† (1828).
  43. An Acte Touchyng Orders for Bankruptes, 13 Eliz., c. 7 (1571) (Eng.); An Acte for the Better Reliefe of the Creditors Againste Suche as Shall Become Bankrupte, 1 Jac., c. 15 (1603–04) (Eng.); An Acte for the Discrificeon of a Bankrupt and Reliefe of Credytors, 21 Jac., c. 19 (1623–24) (Eng.).
  44. *See* 13 Eliz., c. 7, § 1 (applying to “any Merchaunte or other pson using or exercysinge the Trade of Marchaundize by way of Bargaynyng Exchange Rechaunge Bartrie Chevisaunce or otherwyse, in Grosse or by Ratayle, or seeking his or her Trade of lvyng by buyinge and selling”); *Alexander v. Vaughan*, 98 Eng. Rep. 1151, 1151–52 (K.B. 1776) (foreigner who was a trader, was subject to 21 Jac., c. 19 (1623–24)); *see also* Richard Brown, *Comparative Legislation in Bankruptcy*, 2 J. SOC. COMP. LEGIS. 251, 251–52 (1900) (discussing English bankruptcy law as it applied to traders); Louis Edward Levinthal, *The Early History of English Bankruptcy*, 67 U. PA. L. REV. 1, 16 (1919) (noting that bankruptcy statutes after Henry VIII’s reign were subsequently limited to traders); *cf. Lavie v. Phillips*, 97 Eng. Rep. 1094 (K.B. 1765) (holding that a married woman, trading as part of her individual business, could be subject of bankruptcy commission).

to list specific acts of bankruptcy, rather than the general idea of “fraud” contained in the first statute.<sup>45</sup>

1. Limited Application to Merchants and Traders

The limitation of bankruptcy to merchants or traders is often seen today as stinginess: why shouldn't others have the benefit of a discharge too? But this is anachronistic thinking.

First, it's not clear that the statute of Henry VIII did not contain an implicit condition to be a merchant, simply by using the term “bankrupt.”<sup>46</sup> Moreover, in a world where penalties for bankruptcy were severe and quite random in application, as discussed below, bankruptcy was connected with great shame. Further, because the bankruptcy system was typically involuntarily imposed on debtors, it was seen as something of a benefit to not be deemed a trader.<sup>47</sup>

Thus, a statute passed during the reign of Charles II expressly protected the “divers noblemen, gentlemen, and persons of quality” who owned and traded stock in the East India Company or the Guiney Company and participants in the royal fishing trade from being subjected to the bankruptcy laws on that basis alone.<sup>48</sup>

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45. The statute from Henry VIII's reign did implicitly provide that fleeing or keeping house was an offense. 34 & 35 Hen. 8, c. 4, § 6 (1542–43) (Eng.) (providing remedies for creditors of “any souche offendour or offendoures whiche shall keepe his or theyre house or houses, or whiche shall absent or withdrawe themselves into places unknowne”); *see also* 13 Eliz., c. 7, § 1 (Those who “hathe or at any tyme hereafter shall departe the Realme, or begyn to kepe his or her House or Houses, or otherwyse to absent hym or her self, or take Sanctuary, or suffer hym or her self wyllingly to be arrested for any Debt or other Thinge not growen or due for Monye delyved Wares sold or any other just or lawfull cause or good consideration or purposes, hath or will suffer hym or her self to be outlawed, or yeld hym or her self to prysion, or depte from his or her Dwellyng House or Houses, to thentent or purpose to defraude or hynder any of his or her Credytors, being also a Subject borne as is aforesaid, of the just Debt . . . shalbe . . . taken for a Banckrupt”). *See generally* 2 WILLIAM BLACKSTONE, COMMENTARIES \*477–79 (outlining to whom the bankruptcy law applies); Israel Treiman, *Escaping the Creditor in the Middle Ages*, 43 L.Q. REV. 230, 233–36 (1927) (describing the practice of “keeping house,” where debtors used the English “rule against breaking into a man's house for the purpose of executing civil process” to their advantage).

46. I'm grateful to Emily Kadens for pointing this out.

47. *Cf.* W. J. JONES, THE FOUNDATIONS OF ENGLISH BANKRUPTCY: STATUES AND COMMISSIONS IN THE EARLY MODERN PERIOD, 58–59 (1979) (published as Volume 69, Part 3 of the July 1979 Transactions of the American Philosophical Society Held at Philadelphia for Promoting Useful Knowledge) (discussing the nuanced but important social distinctions that existed between various economic classes in England at the time).

48. An Act Declaratory Concerning Bankrupts, 14 Car. 2 c. 24, § 1 (1662) (Eng.).

Similarly, the law establishing the Bank of England protected its members from being subject to the bankruptcy laws.<sup>49</sup> Landowners, farmers, and “gentlemen” actively wanted to keep the threat of bankruptcy away.<sup>50</sup>

## 2. Procedural Devices and Commissions

Through the years, the statutes explicitly adopted the procedural devices originally developed for administrative convenience. It was never very likely that the Lord Privy Seal, the Keeper of the Great Seal, or any of the other high officials listed in the original 1544 statute would personally preside over the arrest of a debtor and the sale of his assets, even if the literal language of the statute seemed to so provide. One treatise writer explained:

[The statute of Henry VIII] merely provided generally that the chancellor, etc., should “take order” in the matter. What should be done in the matter appears to have been left wholly uncertain, and especially as to who should be the authorities practically to execute or carry out the law and what powers they should exercise. Probably for this reason the act does not seem to have been of much practical effect . . . .<sup>51</sup>

Eventually the daily work of the bankruptcy process was typically delegated to commissions, and increasingly the Lord Chancellor was given the sole responsibility for appointing the commissions.<sup>52</sup> Professor W.J. Jones described this English bankruptcy process:

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49. An Act for Making Good the Deficiencies of Several Funde Therein Mentioned and for Enlargeing the Capital Stock of the Bank of England and for Rasing the Publick Credit, 8 & 9 Will. 3 c. 20, § 47 (1696–97) (Eng.).
  50. See HOPBIT, *supra* note 34, at 24–25, 145, 147–48 (noting that the bankruptcy laws at the time only applied to merchants and traders, to the exclusion of other professions and classes, due to what was commonly viewed as the inherent uncertainty of overseas commerce). Such distinctions were common in other areas of the law too; for example, only gentlemen were exempt from the press gangs that staffed Royal Navy warships. See generally An Act for the Increase and Encouragement of Seamen, 7 & 8 Will. 3, c. 21, § 13 (1695–96) (Eng.) (offering some protection for “Landmen” from impressment).
  51. FINLASON, *supra* note 36, at 381–82 n.(a); see also 1 EDWARD CHRISTIAN, THE ORIGIN, PROGRESS, AND PRESENT PRACTICE OF THE BANKRUPT LAW, BOTH IN ENGLAND AND IN IRELAND 9 (2d ed. 1818) (“This statute continued alone for twenty-eight years, but I have not found a single case in the books upon the construction of any part of it”). But see JONES, *supra* note 47, at 18 (noting several specific commissions where the statute of Henry VIII was used, even after the enactment of newer statutes, since the prior statute was not explicitly repealed).
  52. 13 Eliz., c. 7, §§ 2, 4, 5 (1571). An early form of commission can be found in THOMAS GOODINGE, THE LAW AGAINST BANKRUPTS 7–9 (1695).

[Under the process the] lord chancellor alone was authorized to issue commissions of bankruptcy under the Great Seal and to appoint “such wise and honest discreet persons as to him shall seem good.” He would do this on receiving a complaint or petition in writing. The practice developed, certainly during the Stuart period, that this must be accompanied by an affidavit that debts were owed—from 1624 the specific sum of £100 or more had to be mentioned—and that an act of bankruptcy had been committed. The petitioning creditors would suggest the names of possible commissioners in a separate document . . . .<sup>53</sup>

The commissions handled the work of today’s bankruptcy judges but were unlike the judges in their informality and in the fact that they were comprised of multiple members, somewhat like many early American trial courts.<sup>54</sup> As one writer explained,

although it is usual to speak of the Court of the Commissioners of Bankrupt, and to name the Commissioners judges, yet it has been frequently decided, that the Commissioners have none of the requisites of a court of justice; that their authority, although nearly approach to the judicial, is not judicial, but executory and ministerial . . . .<sup>55</sup>

Thus, while it is often said that modern bankruptcy courts are “court[s] of equity,”<sup>56</sup> this reflects a misunderstanding of a process

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53. JONES, *supra* note 47, at 25 (footnotes omitted). Strictly speaking, despite this, the Chancellor would not “do” anything. There was an office of bankruptcy which handled the appointment of commissioners; the process was fully bureaucratic. See 2 WILLIAM BLACKSTONE, COMMENTARIES \*479–85. See generally EDWARD CHRISTIAN, PRACTICAL INSTRUCTIONS FOR Suing OUT AND PROSECUTING A COMMISSION OF BANKRUPT (1816) (describing the requirements for suing out a commission of bankruptcy).
54. Stephen C. Hicks & Clay Ramsay, *Law, Order and the Bankruptcy Commissions of Early Nineteenth Century England*, 55 TIJDSCHRIFT VOOR RECHTSGESCHIEDENIS 123, 133 (1987). And the connection between the commissions and today’s bankruptcy judges is anything but linear. Cf. Thomas E. Plank, *Why Bankruptcy Judges Need Not and Should Not Be Article III Judges*, 72 AM. BANKR. L.J. 567, 575–78, 587–89 (1998) (arguing that bankruptcy’s early chancery setting indicates it should proceed differently than Article III courts and their common law predecessors).
55. COOPER, *supra* note 42, at 256. For a blistering critique of the bankruptcy commissions, see Francis Vesey, Jr., *Regulations in Bankruptcy*, 31 Eng. Rep. 908, 908 (1801) (“The Lord Chancellor took the first occasion of expressing strong indignation at the frauds committed under cover of the Bankrupt laws, and his determination to repress such practices.”).
56. NLRB v. Bildisco & Bildisco, 465 U.S. 513, 527 (1984); Local Loan Co. v. Hunt, 292 U.S. 234, 240 (1934); see also Heiser v. Woodruff, 327 U.S. 726, 732 (1946) (“It is true that a bankruptcy court is also a court of

that has from inception been statutory and bureaucratic.<sup>57</sup> As Chancellor Kent recognized, bankruptcy commissions happened to be overseen by the same official that oversaw English chancery courts, but that did not create any equitable jurisdiction in the commissions.<sup>58</sup> As one early nineteenth century writer noted, “[an] order of the Lord Chancellor in bankruptcy is *analogous* to a decree of the Court of Chancery.”<sup>59</sup>

Indeed, actions of the commissions initially could be challenged in either equitable or common-law courts.<sup>60</sup> And once the commissions were appointed, they were subject to only limited Chancery oversight of their routine operation.<sup>61</sup>

Commissions typically assigned the debtor’s assets to an “assignee”—who in the early days was also a creditor—and who actually marshaled and liquidated them.<sup>62</sup> As one contemporary

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equity.”); *Pepper v. Litton*, 308 U.S. 295, 304 (1939) (“[F]or many purposes ‘courts of bankruptcy are essentially courts of equity . . . .’”); *cf.* Marcia S. Krieger, “*The Bankruptcy Court Is a Court of Equity*”: *What Does That Mean?*, 50 S.C. L. REV. 275, 278 (1999) (examining the technical differences between actions at law and actions at equity); Adam J. Levitin, *Toward a Federal Common Law of Bankruptcy: Judicial Lawmaking in a Statutory Regime*, 80 AM. BANKR. L.J. 1, 24 (2006) (discussing the importance of a statutory authorization of equity powers). Admittedly, what is likely going on here is that equity is being used in a loose sense, to mean a court that is somewhat informal, rather than in its historical and technical sense.

57. See 1 EDWARD E. DEACON, *THE LAW AND PRACTICE OF BANKRUPTCY* 9 (1827) (“The jurisdiction of the Lord Chancellor in Bankruptcy is both legal and equitable; but this arises more from long practice, perhaps, than from any precise authority on the subject.”).
58. 1 JAMES KENT, *COMMENTARIES ON AMERICAN LAW* 382 (6th ed. 1848) (“This [bankruptcy] jurisdiction of the English chancellor is not in the court of chancery, but in the individual who holds the great seal . . . .”).
59. FRANCIS WHITMARSH, *A TREATISE ON THE BANKRUPT LAWS* 3 (1817) (emphasis added).
60. *E.g.*, *Martin v. Sharopin*, 125 Eng. Rep. 960 (C.P., 1731) (concerning an action brought in common pleas court); see also COOPER, *supra* note 42, at 253 (describing common law courts as having “concurrent jurisdiction with the Chancellor”).
61. 1 W.S. HOLDSWORTH, *A HISTORY OF ENGLISH LAW* 257–58 (1903) (“These acts gave no jurisdiction in Bankruptcy to the court of Chancery. The act gave the Chancellor no control over the commissioners.”); see also LORD NOTTINGHAM’S ‘MANUAL OF CHANCERY PRACTICE’ AND ‘PROLEGOMENA OF CHANCERY AND EQUITY’ 162 (D.E.C. Yale ed., 1965) (describing the difficulty regulating the commissioners, “because they think they have authority by Act of Parliament”).
62. 2 WILLIAM BLACKSTONE, *COMMENTARIES* \*485. For more detail on the role of assignees, see COMMISSIONER OF BANKRUPTS, *THE LAW FOR AND AGAINST BANKRUPTS: CONTAINING ALL THE STATUTES, CASES AT LARGE*,



source explained: “[The debtor’s] affairs having unfortunately gone wrong, a commission of bankruptcy was issued against him upon the 12th January 1757, and upon the 15th of the same month, his effects were as usual conveyed to assignees under that commission.”<sup>63</sup> Eventually this practice was formally recognized in the statutes, and the power to appoint assignees was given to the creditors.<sup>64</sup> The assignees then began to be regulated and subject to removal by the Lord Chancellor.<sup>65</sup>

### 3. Severe Penalties and Erratic Application

This was an era of increasing commerce and increasing financial fragility. Credit markets were thin and obligors were highly interconnected.<sup>66</sup> One default could lead to a chain of systemic failure. Thus, Parliament increasingly sought to ensure debtors’ compliance with their obligations through the use of sticks rather than carrots. Thus, debtors in part of this period faced the possibility of time in the pillory and removal of an ear.<sup>67</sup>

All of this reached a head during Queen Anne’s tenure, following the Pitkin Affair—a scandal involving fraud in the London cloth industry that exceeded \$150 million in modern terms.<sup>68</sup> Most notably, the penalty for obstinate debtors was increased to death without benefit of clergy,<sup>69</sup> a fate that befell a small but not insignificant number of debtors.<sup>70</sup>

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ARGUMENTS, RESOLUTIONS, JUDGMENTS AND DECREES, UNDER THE HEAD OF BANKRUPTCY, DOWN TO THE PRESENT TIME 81–95 (1743).

63. Petition of Robert Stevenson, and Others, Assignees Under the Commission of Bankruptcy, Issued Against George Forbes of London, Merchant, at 2 (July 10, 1765).
64. An Act to Prevent the Committing of Frauds by Bankrupts, 5 Geo. 2, c. 30, § 30 (1731–32) (Eng.).
65. 1 WILLIAM COOKE, *THE BANKRUPT LAWS* 338–39 (2d ed. 1788).
66. Kadens, *supra* note 35, at 1238 (“[T]he insolvency of one person who owed significant debts could lead to the failure of many others.”).
67. 21 Jac., c. 19, § 6 (1623–24) (“[Debtors convicted of fraud] shalbe sett upon the Pillory in some publique Place, for the space of Two Houres, and have one of his or her Eares nayled to the Pillory and cutt off.”); Garrard Glenn, *Essentials of Bankruptcy: Prevention of Fraud, and Control of Debtor*, 23 VA. L. REV. 373, 381 (1937) (noting that these punishments were considered mild by contemporary standards).
68. Emily Kadens, *The Pitkin Affair: A Study of Fraud in Early English Bankruptcy*, 84 AM. BANKR. L.J. 483, 484 (2010). Many contemporary sources reference the Pitkin Affair and assume familiarity with it; Kadens’s article is the only complete exposition of the Affair that I have discovered.
69. The “benefit of clergy” originally allowed priests to avoid the harsh penalties (like death) associated with the secular courts, but then almost anyone who could read a Bible verse, or recite one from memory, could

For example, in 1759 John Perrott<sup>71</sup> followed the Pitkin model: he suddenly started to expand his business by purchasing goods on credit that he immediately turned around and sold at a discount.<sup>72</sup> Eventually he announced to his creditors his inability to pay for the goods purchased because the cash was gone, and a commission was given the task of sorting out his affairs.<sup>73</sup> The commissioners found Perrott evasive in several depositions and kept him in Newgate prison; meanwhile he made an unsuccessful attempt to get a writ of habeas corpus from King's Bench.<sup>74</sup>

Then the commission learned of a woman who might be considerably referred to as Perrott's girlfriend.<sup>75</sup> She had possession of several halves of bank notes—Perrott turned out to have the other halves hidden in his belongings in debtor's prison—and some larger notes, which she had received after an attorney had exchanged many bank notes at her request.<sup>76</sup> Until a few years before, the woman in question had been a fellow lodger with the woman who was to become her maid, at which time she “had *no money*, and was in *great want of cloaths*, and *all other necessaries*.”<sup>77</sup>

In September of 1761 the assignees indicted Perrott for bankruptcy fraud, and he was found guilty by the jury in the following October:

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avoid the harshest penalties as members of the “clergy,” unless the statute specifically excluded this right. *See generally* FINLASON, *supra* note 36, at 216 (discussing the benefit of clergy in capital cases).

70. *See An Act to Prevent Frauds Frequently Committed by Bankrupts 4 & 5 Ann., c. 4 (1705) (Eng.)* (enacted because “many Persons have and do daily become Bankrupt”); John Paul Tribe, *Bankruptcy and Capital Punishment in the 18th and 19th Centuries* (Jan. 16, 2009) (unpublished manuscript), available at <http://ssrn.com/abstract=1329067>. There is some debate in the literature as to how to properly count the number of debtors hung.
71. For a fuller account of Perrott, see Kadens, *supra* note 35, at 1272–85.
72. 1 AN AUTHENTIC NARRATIVE OF THE PROCEEDINGS UNDER A COMMISSION OF BANKRUPTCY AGAINST JOHN PERROTT 4–5 (1761).
73. *Id.* at 1. Most of the proceedings in the commission, including the depositions mentioned in the text, took place at the Half-Moon tavern on Cheapside. *Id.* at 2, 11, 20, 23. This was typical of the practice of the times, and there were often complaints about the size of the commissioners' bills for food and drink.
74. *Id.* at 27–28.
75. 2 AN AUTHENTIC NARRATIVE OF THE PROCEEDINGS UNDER A COMMISSION OF BANKRUPTCY AGAINST JOHN PERROTT 8 (1761) (recounting how the woman's maid testified that her employer said that she always made her “fellows . . . pay for favors received”).
76. *Id.* at 11–15; *see also* 1 PERROTT, *supra* note 72, at 21.
77. 2 PERROTT, *supra* note 75, at 8.

In his subsequent behavior, to the time of his execution, this unhappy criminal is reported to have evinced great penitence; and it would almost border on inhumanity to doubt his sincerity: but certain it is, that he could not, by any means, be prevailed on, to make any further retribution to his injured creditors, though there is the utmost reason to believe it to have been in his power. The deficiency in his affairs amounts to at least 17000£ [about £3 million today<sup>78</sup>].<sup>79</sup>

#### 4. Limited Relief: Discharge

The Statute of Anne<sup>80</sup> is quite often portrayed as the beginning of modern, enlightened bankruptcy practice because it introduced a discharge.<sup>81</sup> Such a view obviously overlooks its rather draconian penalty.<sup>82</sup> The discharge was an innovation,<sup>83</sup> but it was exceedingly hard to get a discharge under this law, especially following amendments to the statute shortly after enactment.<sup>84</sup>

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78. For the calculation of present value, see Inflation Calculator, BANK OF ENGLAND, <http://www.bankofengland.co.uk/education/Pages/inflation/calculator/flash/default.aspx> (calculate the value of £17000 in 1761 compared to 2012).
79. 2 PERROTT, *supra* note 75, at 42.
80. 4 Ann, ch. 17 (1705).
81. *See, e.g.*, HOPBIT, *supra* note 34, at 20–23 (“With the certificate of discharge, freeing the bankrupt from his debts, the businessman was offered an escape from his unsuccessful spirit of adventure. . . . [T]he past would not hang round his neck like an albatross.”); CHARLES JORDAN TABB, *THE LAW OF BANKRUPTCY* 40 (2d ed. 2009) (“While the quasi-criminal nature of bankruptcy remained, the Statute of Anne established the roots of a more humanitarian legislative attitude toward honest but unfortunate debtors.”).
82. *See* COOKE, *supra* note 65, at 479 (“This is a penal law and a severe one, for it reaches to the life of the bankrupt . . .”).
83. Ian P.H. Duffy, *English Bankrupts, 1571–1861*, 24 AM. J. LEGAL HIST. 283, 287–88 (1980) ([T]he [discharge] reforms were clearly revolutionary and aroused understandable anxiety that bankrupts would be able to escape their liabilities too easily.”); *see also* Douglass G. Boshkoff, *Limited, Conditional, and Suspended Discharges in Anglo-American Bankruptcy Proceedings*, 131 U. PA. L. REV. 69, 70 n.7 (1982) (describing the discharge provision as originally enacted to be quite “generous,” which triggered subsequent legislative constraints).
84. *See* Kadens, *supra* note 35, at 1289–93 (arguing that the lack of a realistic discharge, combined with the outrageous penalty for non-cooperative debtors, actually increased corruption in the English bankruptcy system); *see also* John C. McCoid, II, *Discharge: The Most Important Development in Bankruptcy History*, 70 AM. BANKR. L.J. 163, 167–68 (1996) (detailing the additional restrictive conditions upon debtors seeking a discharge).

This statute would remain in place, with minor changes, during the reigns of Georges I through III—the remainder of the colonies’ attachment to the home country.<sup>85</sup> Contemporaneous treatises referred to one as being “liable” to bankruptcy, rather than benefiting from it, under the law of this period.<sup>86</sup> The “benefit” of the discharge was still restricted to “traders” and, more generally, the concept of bankruptcy in England at the time by definition only applied to traders, and despite the lax definition of what constituted “trading” as the century progressed, getting a discharge remained difficult but the risk of draconian penalties, although slight, remained real.<sup>87</sup>

*D. First Colonial Bankruptcy Laws*

Through a hodgepodge of general bankruptcy laws, often not titled as such, and private bills, the American colonies managed to provide a system of bankruptcy relief. In the early years, this system was heavily influenced by English practice, but it was never the case that English practice applied directly in the colonies. Moreover, the laws of the time broadly centered on the plight of imprisoned debtors, with somewhat lesser emphasis on the issue of insolvent traders (to the exclusion of other debtors) than found in the home country.

In the American colonies, many early debtor-creditor laws lacked the collective nature of bankruptcy as it had already developed in England. For example, the Charter of Philadelphia, granted in 1701, contained its own debtor-creditor law, including provisions for what we would now term debt slavery.<sup>88</sup> The practice seems to have been a

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85. *E.g.*, 5 Geo. 2, c. 30, § 1 (1732) (providing that bankrupts who fail to surrender to the commission “shall suffer as felons, without benefit of clergy”). This was the statute in effect during the Revolution, through the passage of America’s first bankruptcy statute in 1800. The progression after 4 & 5 Ann., c. 17 (1705) was 6 Ann., c. 22 (1706) and 5 Geo. 1, c. 24 (1718). These acts were all then consolidated in 5 Geo. 2, c. 30 (1732), which was amended by 46 Geo. 3, c. 135 (1806) and 49 Geo 3, c. 121 (1809). All were eventually repealed and replaced with 6 Geo. 4, c. 16 (1825), but by then the United States had long obtained its independence. Note it was only this latter act that formally repealed the old statutes, which remained in force, if underused. COOPER, *supra* note 42, at 243 n.\*.

86. THE SPIRIT OF THE BANKRUPT LAWS 2 (4th ed., corr., enl., Edward Green, comp., 1780); THOMAS DAVIES, THE LAWS RELATING TO BANKRUPTS, BROUGHT HOME TO THE PRESENT TIME 1 (1744).

87. On the definition of what constituted “trading,” see 2 CHARLES PETERSDORFF, A PRACTICAL AND ELEMENTARY ABRIDGMENT OF THE COMMON LAW AS ALTERED AND ESTABLISHED BY THE RECENT STATUTES, RULES OF COURT, AND MODERN DECISIONS 16–20 (1842) (collected cases); *see also* 2 WILLIAM BLACKSTONE, COMMENTARIES \*475–77 (discussing who qualifies as a “trader”).

88. Debt bondage was common in the colonies, especially in Virginia before the introduction of African slaves. *See generally* EDMUND S. MORGAN,

feature of the debtor-creditor law in Pennsylvania until at least 1729, as the Commonwealth revisited the vexing problem of unpaid debts every few years.<sup>89</sup>

Noel credits Maryland with the “first formulated bankruptcy law on the American continent,” a statute passed in 1638<sup>90</sup> that tracked then-existing English law, without using the term “bankruptcy.”<sup>91</sup> Likewise, in 1714 Massachusetts enacted a statute<sup>92</sup> modeled on a decade-old English statute,<sup>93</sup> and Pennsylvania also enacted a bankruptcy statute<sup>94</sup> that followed English practice, including provisions for putting the uncooperative debtor into the pillory and removing bits of the debtor’s ear.<sup>95</sup>

Massachusetts then followed its original statute with two others—one in 1757 and another in 1765 after the Crown had struck down the first—of more local origin.<sup>96</sup> Similarly, from 1755 to 1770, New York

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AMERICAN SLAVERY, AMERICAN FREEDOM: THE ORDEAL OF COLONIAL VIRGINIA 381–84 (1975) (explaining Jefferson’s aversion to debt bondage, which he felt was contrary to the republican ideal of self-support and left the nation susceptible to tyranny). Following the introduction of African slaves in the South, debt servitude became a Northern phenomenon. And unlike African slavery and some modern examples of debt slavery, debt servitude in the colonies was subject to legal limitations on applicability—for example, several states limited it to unmarried men, although some border states like Delaware used racial categories for applicability—and was generally not hereditary, although fathers could sometimes bind their sons to satisfy the claims. COLEMAN, *supra* note 31, at 40–41, 210–11, 253.

89. F. REGIS NOEL, *A HISTORY OF THE BANKRUPTCY LAW* 54–66 (William S. Hein & Co. 2003) (1919).
90. Act of March, 1638 (Md.).
91. NOEL, *supra* note 89, at 43–44. Notably, Coleman describes this period of bankruptcy law in Maryland’s history somewhat differently, despite citing Noel among his sources. COLEMAN, *supra* note 31, at 162–63 (“Maryland modified creditor rights more fundamentally than did most communities in the region, but its relief system was also highly unstable and confused.”). It should also be noted that Noel would heartily disagree with the thesis of this Article. Noel’s book reflects a typically Progressive Era, Hamiltonian view of federal power, and thus he argues (based on reviewing Maryland and Pennsylvania) that states were largely incompetent in the bankruptcy area, and that the states enacted little more than “transcript[s] of the British statutes.” NOEL, *supra* note 89, at 83.
92. Act of 1714 726–29 Mass. Bay Acts and Resolves.
93. COLEMAN, *supra* note 31, at 45.
94. *The Statutes of Pennsylvania from 1682 to 1801*, at 129–30, 249–51.
95. In all cases, the assumption that the extant English statutes did not apply directly in the colonies has interesting implications for latter, Revolutionary era disputes about Parliament’s efforts to impose statutes on the colonists.
96. COLEMAN, *supra* note 31, at 45–47.

expanded an existing system for release of impoverished debtors from prison to include the ability to bind holdout creditors to a workout agreed to by the majority of creditors.<sup>97</sup> In doing so, New York effectively backed itself into a bankruptcy system, but one that was unlike the English ones of the time.

Maryland did a similar thing with a 1774 law—passed in the last legislative session before the American Revolution—that released debtors from prison and was later interpreted by a court to protect the debtor’s future earnings from past creditors.<sup>98</sup> This law stayed in effect until repeal in 1817.<sup>99</sup>

A common problem throughout most of the colonies was the requirement that any commercial legislation, including bankruptcy statutes, obtain the approval of the Privy Counsel and its Lords of Trade. Quite often, colonies enacted statutes only to have them revoked by officials in London. For example, in 1771 New York attempted to expand its original impoverished-debtor-release law to protect the debtor’s property acquired following release from prison. London said no.<sup>100</sup>

But the process worked the other way too: Massachusetts attempted to repeal its bankruptcy statute in 1766, only to have the Board of Trade revive the statute.<sup>101</sup> As might be expected, dueling authority did not make for stability in bankruptcy legislation during this period. A solution was to proceed by way of private bill, discharging specified debtors.<sup>102</sup> London often explained that it preferred general acts that made clear to creditors *ex ante* the potential for discharge, yet a substantial number of private bills from multiple colonies managed to slip through the Privy Counsel.<sup>103</sup>

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97. *See id.* at 108–09 (noting that by 1756 statutes extended relief to debtors throughout the colony).

98. *Id.* at 164–65.

99. *E.g.*, A General Act for the Relief of Prisoners, ch. 28, 1774 Md. Laws 5 (1776), *repealed by* Supplement to An Act for the Relief of Sundry Insolvent Debtors, ch. 183, 1817 Md. Laws 191.

100. COLEMAN, *supra* note 31, at 113.

101. *Id.* at 48.

102. Kurt H. Nadelmann, *On the Origin of the Bankruptcy Clause*, 1 AM. J. LEGAL HIST. 215, 222–23 (1957).

103. *See, e.g., id.* at 222–24 (discussing the special acts of Connecticut and Pennsylvania).

## II. BANKRUPTCY IN THE UNITED STATES BEFORE CROWNINSHIELD

### A. *Differing Views of the Bankruptcy Clause*

While some merchants apparently hoped for a national bankruptcy law, the Articles of Confederation never provided one. Indeed, enacting such a law would have required unanimous consent of all the colonies, something that was not apt to happen with regard to the divisive issues of whether there should be such a law and what such a law might look like. But with the adoption of the Constitution in 1787, the Bankruptcy Clause gave the federal government the power to enact “uniform Laws on the subject of Bankruptcies throughout the United States.”<sup>104</sup> Despite this seeming progress toward uniform bankruptcy laws, views of the Bankruptcy Clause’s purpose and grant of authority differed greatly.

In the *Federalist*, Madison argued that the federal bankruptcy power was intimately connected with the interstate commerce power,<sup>105</sup> an argument Hamilton would echo with even greater force when he pointed to the federal government’s power to override state bankruptcy laws as indicative of a larger federal supremacy in economic matters, which supported the creation of a national bank.<sup>106</sup>

Others, most notably the late Kurt Nadelmann, have argued that the Bankruptcy Clause was actually connected to the Full Faith and Credit Clause. Specifically, he traces the origins of the Bankruptcy Clause to an effort to amend the Full Faith and Credit provision to provide equal weight to private bills passed by state legislatures, especially those that were used in the colonies and states to discharge specific debtors.<sup>107</sup> He notes that it was unclear whether these acts, or discharges granted under general state bankruptcy laws, were valid in other states.<sup>108</sup> He attributes the Bankruptcy Clause’s ultimate location in the Constitution to the Committee on Style, rather than any clear connection to the Commerce Clause.<sup>109</sup>

Under Nadelmann’s reading of the Bankruptcy Clause, its purpose was to ensure that state-granted discharges would be valid

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104. U.S. CONST. art. I, § 8, cl. 4.

105. THE FEDERALIST NO. 42, at 221 (James Madison) (The Gideon ed., 2001); see also THE FEDERALIST NO. 10, at 44 (James Madison) (The Gideon ed. 2001) (discussing the inherent tension between debtors and creditors).

106. Alexander Hamilton, *Opinion on the Constitutionality of an Act to Establish a Bank* (Feb. 23, 1791), in 8 THE PAPERS OF ALEXANDER HAMILTON 97, 109 (Harold C. Syrett et al. eds., 1965).

107. Nadelmann, *supra* note 102, at 219–20.

108. *Id.* at 224.

109. *Id.* at 226–27.

nationwide. The Supreme Court's failure to understand this—which he excuses since Madison's notes were not yet available to the Court—lead to a much different reading of the Clause than originally intended.<sup>110</sup> Of course, all of this turns on acceptance of a secret meaning of the Bankruptcy Clause, known only to the Founders, that was not apt to be apparent to those at any of the ratifying conventions, which then begs the question of whether, even if true, it really matters.

Or, more generally, we might note the possibility that some members of the convention may have favored a Hamiltonian reading of the Clause, while others, particularly early Jeffersonian-Republicans, likely favored the one proffered by Nadelmann.<sup>111</sup> It was not really necessary for these two interpretations to be reconciled, since both lead to support for inclusion of the Clause in the final document.<sup>112</sup>

And ultimately the Bankruptcy Clause's most important role in the first decades of the United States was its use, by analogy, in Hamilton's *Opinion on the Constitutionality of an Act to Establish a Bank*. Otherwise, the federal government largely ignored the Clause, leaving the states free to act.<sup>113</sup>

#### *B. State-Based Regulation Following Constitutional Adoption*

Some early opinions held that the states remained free to address insolvency despite the Constitution.<sup>114</sup> And certainly the legislatures of

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110. *Id.* at 228.

111. On the broader Hamiltonian-Jeffersonian split, see STANLEY ELKINS & ERIC MCKITRICK, *THE AGE OF FEDERALISM* 4 (1993) (discussing the “enmity that arose” between Hamilton and Jefferson).

112. See Thomas E. Plank, *The Constitutional Limits of Bankruptcy*, 63 TENN. L. REV. 487, 527 (1996) (noting the Constitutional Convention adopted the proposed clause with little debate to indicate legislative intent).

113. *E.g.*, *Wall v. Court of Wardens*, 1 S.C.L. (1 Bay) 434, 436 (S.C.C.P. 1795) (describing the purposes of, and ultimately applying, the South Carolina Insolvent Debtor's Act); see also 1 ALEXIS DE TOCQUEVILLE, *DEMOCRACY IN AMERICA* 107 n.\* (Henry Reeve trans., 3d Amer. ed., rev. and corr. 1839) (explaining that Congress neglects its right to make a general law of bankruptcy, and instead each state makes such law for itself).

114. *E.g.*, *Blanchard v. Russell*, 13 Mass. (12 Tyng) 1, 12 (1816); *Clarke v. Ray*, 1 H. & J. 318, 320 (Md. 1802) (“The legislatures of the several states have competent authority to pass laws for the relief of all persons who are not comprehended within the act of Congress. That part of the constitution of the United States relating to bankrupts, is carried into operation by the law of Congress, as far as that body thought it was politic and expedient; and the law of Congress constitutes the only restriction which is imposed on the state legislatures in the case of insolvent debtors.”); *Pettit v. Seaman*, 2 Root 178, 180 (Conn. Super. Ct. 1795) (“As to the objection made to the constitutionality of the act of the state of New York, respecting insolvency, drawn from the Constitution of the federal government having vested



the several states that enacted legislation at least implicitly expressed the belief that such power remained with the states.<sup>115</sup> Moreover, beginning in 1790 and then several times thereafter, Congress enacted legislation that gave the federal government a priority in bankruptcy proceedings, which necessarily referenced state insolvency proceedings since there was no federal law; therefore, these enactments could be seen as a kind of congressional acquiescence in the development of state statutory schemes.<sup>116</sup> Chief Justice Marshall upheld a version of this priority statute, arguing more than a decade before *McCulloch v. Maryland*<sup>17</sup> that such a law could be supported under the Necessary and Proper clause, as “it would be incorrect and would produce endless difficulties, if the opinion should be maintained that no law was authorised which was not indispensably necessary to give effect to a specified power.”<sup>118</sup>

Thus, the primary means of resolving financial distress remained with the individual states. For example, a 1788 New York law<sup>119</sup> provided for the general discharge of all debts upon agreement of three-quarters of the creditors, and an 1813 New York law,<sup>120</sup> in effect through the end of the nineteenth century, reduced the requirement from requiring three-fourths of creditors in agreement to two-thirds.<sup>121</sup>

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Congress with the sole power of making general laws of bankruptcy, that never can be understood and construed, to supersede the power of the state governments, to make and to continue in force and exercise their respective insolvent laws, until Congress shall exercise the powers vested in them, by making and promulgating general laws of bankruptcy through the states, which will be the supreme law of the land. This not having been done at this time, the law of the state of New York is in force.”).

115. See Hollis R. Bailey, *A Discharge in Insolvency, and Its Effect on Non-Residents*, 6 HARV. L. REV. 349, 351 (1893) (listing New York, Pennsylvania, Maryland, and Louisiana as states that enacted insolvency laws, and rendered judicial decisions based on those laws, after 1789).
116. *Priority of Payment, Given to the United States in Cases of Bankruptcy, Insolvency, &c.*, 1 U.S. L. INTELLIGENCER & REV. 219, 220 (1829); see also *United States v. Fisher*, 6 U.S. (2 Cranch) 358, 384 (1805) (noting that it was necessary for the federal government to claim priority of payment in order to protect government revenue from fraud by debtors who absconded across state lines).
117. 17 U.S. (4 Wheat.) 316 (1819).
118. *Fisher*, 6 U.S. (2 Cranch) at 396.
119. Act of March 21, 1788, ch. 92, 1788 N.Y. Laws 823.
120. Act of April 12, 1813, ch. 98 (R.L.), 1813 N.Y. Laws 450.
121. COLEMAN, *supra* note 31, at 123–24. New York financial distress laws predate these 1788 and 1813 acts. See *Bankruptcy and Insolvency*, 21 ALB. L.J. 106, 106–07 (1880) (discussing the early history of New York law as it applied to the discharge of debt and dating such laws to 1755); see also Act of Apr. 13, 1786, ch. 34, 1786 N.Y. Laws 242 (providing relief of insolvent debtors); *Billings v. Skutt*, 1 Johns. Cas. 105, 105–06 (N.Y. Sup. Ct. 1799)

It was one of these series of statutes—an 1811 New York Act<sup>122</sup>—that the Supreme Court would take up in *Crowninshield*,<sup>123</sup> and a version of the three-fourths act was the subject of *Saunders*.<sup>124</sup> But until then, thousands of debtors obtained a discharge of the debts under the statute, and several hundred were released from prison.

In addition to states like New York, which already had extensive experience with bankruptcy laws that were not called bankruptcy laws, many other states responded to the general economic decline after the war and enacted legislation.<sup>125</sup> As explained by Lawrence Friedman: “The colonies had constantly tinkered with this or that law for the relief of debtors, and the Revolution did not interrupt the process; indeed, the dislocations of the war, and the economic misery that followed, gave a strong push to debtor relief.”<sup>126</sup>

Some other Federalist-leaning states, like Rhode Island, initially refrained from enacting any new bankruptcy legislation, with the expectation that the Congress would act.<sup>127</sup> But eventually they too would return to the task of addressing financial distress at the state level.<sup>128</sup>

*C. The Bankruptcy Act of 1800: Short-Lived  
Exception to State Regulation*

The obvious exception to the larger story of federal indifference in the early years is the Bankruptcy Act of 1800,<sup>129</sup> which was drafted

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(finding that a pre-discharge confession of judgment was unenforceable due to the defendant’s discharge under the 1786 insolvency law).

122. Act of April 3, 1811, ch. 123, 1811 N.Y. Laws 200 (benefitting Insolvent Debtors and their Creditors).
123. COLEMAN, *supra* note 31, at 125.
124. *Ogden v. Saunders*, 25 U.S. (12 Wheat.) 213 (1827). The three-fourths acts date back to 1761. *Bankruptcy and Insolvency*, *supra* note 121, at 106–07. The specific three-fourths law at issue in *Saunders* was enacted in 1801. Act of April 3, 1801, ch. 131, 1801 N.Y. Laws 316 (providing relief in cases of insolvency) (commonly referred to as the three-fourths act). This was a revision of the 1788 Act. *Bankruptcy and Insolvency*, *supra* note 121, at 107.
125. *An Analysis of the Insolvent Laws of Pennsylvania*, 2 AMER. L.J. 242, 242 (1809) (describing the 1808 insolvency law, which was a reenactment of the 1798 statute).
126. LAWRENCE H. FRIEDMAN, A HISTORY OF AMERICAN LAW 201 (rev. 3d ed., Touchstone Books 2005) (1973).
127. *See* COLEMAN, *supra* note 31, at 276 (noting that “Rhode Island abandoned its relief system in 1819 when the Supreme Court declared state bankruptcy laws unconstitutional”).
128. However, Rhode Island did wait to act for more than fifty years after *Saunders* in 1827. *Id.*
129. Act of Apr. 4, 1800, ch. 19, 2 Stat. 19 (repealed 1803).

and shepherded through Congress by John Marshall.<sup>130</sup> This first attempt at a federal bankruptcy law<sup>131</sup> came after more than a decade of indecision and tortured debate.<sup>132</sup> The 1800 Act “was by its terms limited to a five years’ operation, but it only lasted three years.”<sup>133</sup>

#### 1. Similarity to English Bankruptcy Law

The statute closely tracked the English practice that had developed throughout the eighteenth century,<sup>134</sup> and the leading treatise on the Act is peppered with cross-references to English statutes and cases.<sup>135</sup> Bankruptcy petitions were filed against traders who had committed specified acts of bankruptcy,<sup>136</sup> and, as initially drafted, the district courts appointed a commission to handle the proceedings.<sup>137</sup>

As with all bankruptcy laws, the end result was a common collection for creditors and by “the 36th section of the Bankrupt Law, Congress has given the district Judge the same authority in allowing the certificate [of discharge], as is by the English statutes lodged in

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130. See JEAN EDWARD SMITH, JOHN MARSHALL: DEFINER OF A NATION 256–58, 348 (1996) (noting that Marshall was a principal author of the Act in the House of Representatives and discussing his calculated efforts to ensure the measure would pass).

131. Act of Apr. 4, 1800, ch. 19, 2 Stat. 19 (repealed 1803).

132. See BRUCE H. MANN, REPUBLIC OF DEBTORS: BANKRUPTCY IN THE AGE OF AMERICAN INDEPENDENCE 254–63 (2002) (discussing the ideological debate that led to the Act, namely whether bankruptcy should primarily be a process for creditors to seize the debtor’s assets “in a more orderly fashion” or instead a “social safety net” to allow debtors a second chance to become productive economic contributors).

133. WARREN, *supra* note 11, at 19; see also 2 GEORGE TUCKER, THE LIFE OF THOMAS JEFFERSON, THIRD PRESIDENT OF THE UNITED STATES 157–58 (1837) (discussing the factors that led to Jefferson’s repeal of the 1800 Act, especially downsizing the federal government).

134. *Roosevelt v. Mark*, 6 Johns. Ch. 266, 285 (N.Y. Ch. 1822) (“The bankrupt act of the *United States*, of *April*, 1800, was a consolidation of the previous provisions in the *English* statutes of bankruptcy; and the *English* decisions on their statutes prior to that date, properly apply as rules of construction to this act of Congress.”).

135. See THOMAS COOPER, THE BANKRUPT LAW OF AMERICA, COMPARED WITH THE BANKRUPT LAW OF ENGLAND (1801) (comparing a number of English statutes and cases with their American counterparts).

136. See, e.g., *Barnes v. Billington*, 2 F. Cas. 858, 859 (C.C.D. Pa. 1803) (finding that the party in question was “a trader within the meaning of the bankrupt law”).

137. Karen Gross et al., *Ladies in Red: Learning from America’s First Female Bankrupts*, 40 AM. J. LEGAL HIST. 1, 9–10 (1996); see also *Maxim v. Morse*, 8 Mass. (7 Tyng) 127, 127–28 (1811) (describing a defendant pleading his case to a bankruptcy commission under the 1800 Act).

the hands of the Chancellor.”<sup>138</sup> In short, this statute ignored the ways in which American insolvency law had already drifted away from English practice in the decades before the American Revolution.<sup>139</sup> It was limited by its terms to merchants or traders, meaning that it applied to but a small sliver of the potential debtors.<sup>140</sup> And it provided the kind of limited discharge that the states had already found unworkable.<sup>141</sup>

## 2. Amendment

Shortly after Jefferson’s inauguration in 1801, the Bankruptcy Act of 1800 was amended to take the power to name commissioners away from the district courts, which were seen as Federalist, and give the power to the President.<sup>142</sup> Among the commissioners thus removed from office was future President John Quincy Adams, attempting to restart his law practice after many years abroad as a minister during his father’s administration.<sup>143</sup> Shortly thereafter, continued Democratic hostility to the bankruptcy law resulted in its complete repeal.<sup>144</sup>

## 3. Federal-State Balance

Notably, the 1800 Act itself acknowledged the existence of state bankruptcy statutes and provided that enactment of the Act did not

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138. 1 GEORGE CAINES, AN ENQUIRY INTO THE LAW MERCHANT OF THE UNITED STATES 588 (1802).

139. See NOEL, *supra* note 89, at 132 (discussing the view that the English system of commercial insolvency laws could not be properly applied in the largely agricultural United States).

140. Act of Apr. 4, 1800, ch. 19, § 1, 2 Stat. 19, 20 (repealed 1803); see also Wood v. Owings, 5 U.S. (1 Cranch) 239, 250–51 (1803) (noting that the Act applies to “any merchant”); CAINES, *supra* note 138 at 483 (describing a bankrupt under the 1800 Act as “a person [who is] a resident within the United States, actually using the trade of merchandise, by buying and selling in gross or retail, or dealing in exchange, as a banker, broker, factor, underwriter, or marine insurer”).

141. See COLEMAN, *supra* note 31, at 274 (noting that the Bankruptcy Act of 1800 was abandoned in part because it embodied the English bankruptcy style).

142. Act of Apr. 29, 1802, ch. 31, § 14, 2 Stat. 156, 164.

143. See Morris Weisman, *Of Jefferson and Adams and a Commissioner in Bankruptcy*, 48 COM. L.J. 248, 249 (1943) (discussing John Adams’s appointment of his son, John Quincy Adams, as a bankruptcy commissioner and the latter’s removal by Thomas Jefferson).

144. Act of Dec. 19, 1803, ch. 6, 2 Stat. 248 (repealing the 1800 Act); see also David A. Skeel, Jr., *The Genius of the 1898 Bankruptcy Act*, 15 BANKR. DEV. J. 321, 323–24 (1999) (discussing the political struggle between Federalists and Jeffersonian Democrats that led to the repeal of the 1800 Act).

supersede such statutes “except so far as the same may respect persons, who are, or may be clearly within the purview of this act.”<sup>145</sup>

Maryland’s response to the enactment of the 1800 Act is quite telling. Its legislature proclaimed that the Constitution did not take away the power of the states to enact bankruptcy laws, and then proceeded to enact the 1800 Act as another option for debtors at the state level.<sup>146</sup> Given the scarcity of federal district courts at the time, this was probably more useful than the 1800 Act itself.

Indeed, the 1800 Act was but a flash in the pan compared with the serious, longer-term efforts at addressing bankruptcy at the state level. Thus, an 1805 Maryland insolvency statute is described in a long-forgotten opinion in terms that would be familiar to any contemporary bankruptcy lawyer:

[T]he great principal upon which it is founded, is, that the debtor shall surrender *all* his property for the common benefit of *all* his creditors. He can only obtain his discharge on complying with this requisite, and some others of an inferior nature. When he *has* complied, then he is entitled to his discharge.<sup>147</sup>

Within a few short years, dozens had applied to the Baltimore court to obtain a fresh start under this law.<sup>148</sup>

A review of the case law during this period suggests a fairly vibrant insolvency system was at work, albeit one that comprised many parts instead of a single whole as some of the Framers may have envisioned.<sup>149</sup> Private bills likewise continued to discharge specific debtors.<sup>150</sup>

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145. Act of Apr. 4, 1800 § 61.

146. COLEMAN, *supra* note 31, at 176 n.30.

147. *In re Stewart*, 2 AM. L.J. 184, 186 (Md. Ch. 1809).

148. *See Insolvents*, 1 AM. L.J. 393, 393–95 (1808) (listing those who had been discharged, and those for whom petitions were pending, based on the records of the Baltimore County Court).

149. *See, e.g., Reily v. Lamar*, 6 U.S. (2 Cranch) 344, 353 (1805) (finding that a Maryland insolvency statute only applies to residents of Maryland); *Packwood v. Foelckell*, 1 Mart. (o.s.) 60, 60 (Orleans 1809) (looking to the construction of the Louisiana Territory insolvency statute); *Hale v. Ross*, 3 N.J.L. 807, 809 (N.J. 1811) (applying a New York insolvency statute to litigants in New Jersey) *overruled by* *Wood v. Malin*, 10 N.J.L. 208 (N.J. 1828); *Baker v. JJ. of Ulster Com. Pl.*, 4 Johns. 191, 191 (N.Y. Sup. Ct. 1809) (per curiam) (holding defendant could not plead discharge under a New York insolvency act); *Cross v. Hobson*, 2 Cai. 102, 102–03 (N.Y. Sup. Ct. 1804) (per curiam) (denying defendant’s application to be discharged under a New York insolvency statute); *Miller v. Hunter*, 5 N.C. (1 Mur.) 394, 395 (1810) (interpreting a North Carolina insolvency statute from 1773); *Anonymous*, 2 N.C. (1 Hayw.) 481, 481 (1797) (per curiam) (holding defendant must separate good debts from bad debts); *Wilt v. Schreiner*, 4 Yeates 352, 352 (Pa. 1807) (applying the Pennsylvania acts of

There was also a degree of comity at work during this period, with states and even some federal courts<sup>151</sup> honoring discharges granted by sister jurisdictions,<sup>152</sup> while protecting the due process rights of distant creditors who were without notice of the proceedings.<sup>153</sup> The aim in all cases was to provide relief to the “*honest and unfortunate debtor*.”<sup>154</sup>

But throughout the system, there lingered important Constitutional questions. Namely, did the Bankruptcy Clause, like the Commerce Clause,<sup>155</sup> contain an implicit preemption of most state

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- insolvency); *Fabre v. Zylstra*, 2 S.C.L. (2 Bay) 147, 150 (S.C. Ct. App. 1798) (remanding to determine the issue of fraud under the state’s insolvent debtor’s act); *Hunt v. Simons*, 2 S.C.L. (2 Bay) 104, 105 (S.C. Ct. App. 1797) (granting defendant’s discharge under the state’s insolvent debtor’s act); *Commonwealth v. Chapman*, 3 Va. (1 Va. Cas.) 137, 139 (1803) (noting a state act allowing persons imprisoned for fines to take the oath of insolvency).
150. *See, e.g.*, ch. 36, 1807-8 Md. Laws (relieving *James West*, an insolvent debtor), *reprinted in* 1 AM. L.J. 87, 89 (1808); *see also* *Barber v. Minturn*, 1 Day 136, 137 (Conn. 1803) (finding that the assembly passed “a special act of insolvency” to discharge each defendant); *Jeffries v. Thompson*, 2 Yeates 482, 482 (Pa. 1799) (describing Maryland legislation that discharged several named debtors); COLEMAN, *supra* note 31, at 69 (noting that for private bills enacted in Vermont between 1785 and 1821, the vast majority merely provided a stay of execution rather than a full discharge).
151. *See* *Wray v. Reily*, 30 F. Cas. 653 (C.C.D.C. 1808) (recognizing a state insolvency law in federal court).
152. *See* *McKim v. Marshall*, 1 H. & J. 101, 102 (Md. 1800) (honoring defendant’s discharge under Pennsylvania insolvency law); *Baker v. Wheaton*, 5 Mass. (4 Tyng) 509, 512 (1809) (honoring defendant’s discharge under Rhode Island insolvency law) *overruled by* *Marsh v. Putnam*, 69 Mass. (3 Gray) 551, 567 (1854); *Hare v. Moultrie*, 2 Yeates 435 (Pa. 1799) (honoring defendant’s discharge under South Carolina insolvency law); *see also* *Haddon v. Chambers*, 1 Yeates. 529, 531 (Pa. 1795) (suggesting that a Maryland discharge would have been honored, but for the specific facts of the case).
153. *See* *Hayton v. Wilkinson*, 11 F. Cas. 917, 918 (C.C.D. Md. 1808) (Chase, J.) (questioning whether a British creditor could be discharged under Maryland insolvency law, when the creditor had not be listed by the debtor); *Webster v. Massey*, 29 F. Cas. 553, 553-54 (C.C.D. Pa. 1808) (discharge under Pennsylvania law released debtor from prison when contract was governed by non-Pennsylvania law, but left the contract between debtor and creditor still in force).
154. *In re Brown*, 1 Mart.(o.s.) 158, 159 (Orleans 1810). This is one of the earliest references to the famous phrase; *see also* *Stellwagen v. Clum*, 245 U.S. 605, 617 (1918) (stating that the federal system of bankruptcy, in part, “intends to aid the unfortunate debtor”).
155. While it is beyond the scope of this Article, nothing in this Article should suggest that the Court’s development of its dormant Commerce Clause jurisprudence has been any clearer than its Bankruptcy Clause

legislation in the field, even when the bankruptcy power went unexercised?<sup>156</sup> And, if not, as some state courts had already suggested, did the Contracts Clause to the Constitution nonetheless limit the states' ability to discharge debts?<sup>157</sup>

Indeed, during the antebellum period, any consideration of bankruptcy and the Bankruptcy Clause necessarily involved consideration of two, and sometimes three, competing issues. First, what meaning should be given to the Bankruptcy Clause itself? Second, if the Bankruptcy Clause did not preclude state laws entirely what role did the Contracts Clause play with regard to state laws? And third, in cases involving federal appeals, the Court at this time might also apply general constitutional law, incorporating a kind of common law of due process into the analysis.<sup>158</sup> In such cases, the Venn diagram includes three overlapping circles of constitutional considerations. Quite often it becomes impossible to discern precisely which piece of constitutional law was at play in a particular case.

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jurisprudence. *Cf.* FELIX FRANKFURTER, *THE COMMERCE CLAUSE UNDER MARSHALL, TANEY AND WAITE* 28–29, 50–51, 96–101 (1937) (discussing the varied views of three influential Chief Justices on the proper role of the dormant Commerce Clause). But the existence of a dormant Commerce Clause is presumed; whereas the dormant Bankruptcy Clause is, at most, implied. Undoubtedly, this is partly the result of the narrower focus of the Bankruptcy Clause: it is much easier for Congress to occupy a greater part of the field with regard to bankruptcy.

156. See Malcolm P. Sharp, *Movement in Supreme Court Adjudication—A Study of Modified and Overruled Decisions*, 46 HARV. L. REV. 593, 595–96 (1933) (discussing contemporary arguments that existed for a bankruptcy companion case to *Gibbons v. Ogden*, 22 U.S. 1 (1824)); see also Norman R. Williams, *Gibbons*, 79 N.Y.U. L. REV. 1398 (2004) (discussing the early debate surrounding the Dormant Commerce Clause); David P. Currie, *The Constitution in the Supreme Court: State and Congressional Powers, 1801–1835*, 49 U. CHI. L. REV. 887, 916 (1982) (discussing Justice Marshall's dictum "that the commerce power might be exclusive").
157. See Stephen A. Siegel, *Understanding the Nineteenth Century Contract Clause: The Role of the Property-Privilege Distinction and "Takings" Clause Jurisprudence*, 60 S. CAL. L. REV. 1, 12 (1986) (discussing the disputes over the application of the Contract Clause raised by the bankruptcy controversy).
158. See Michael G. Collins, *October Term, 1896—Embracing Due Process*, 45 AM. J. LEGAL HIST. 71, 74–76 (2001) (discussing the "public purpose" limitation on state taxation as an early application of due process from general constitutional law); Michael G. Collins, *Before Lochner—Diversity Jurisdiction and the Development of General Constitutional Law*, 74 TUL. L. REV. 1263, 1304–15 (2000) (discussing the application of general constitutional law in federal jurisdiction for assessing whether state tax rates for businesses are confiscatory and allow a fair return).

D. Courts Weigh in on the Bankruptcy Clause Debate

1. Early Cases and Disagreement

It was not until 1812 that the Hamiltonian, or Federalist, view of the Bankruptcy Clause that undergirds these questions began to appear in federal court litigation.<sup>159</sup> And by then, although Hamilton had been dead eight years since his encounter in Weehawken,<sup>160</sup> his legacy lived on at the Supreme Court in the form of Chief Justice Marshall.<sup>161</sup>

But it took a while for the cases to reach the Chief Justice.<sup>162</sup> In the interim, some courts felt that the issue had been resolved. For example, in an 1817 opinion the Chief Justice of the Pennsylvania Supreme Court observed that

all the states have passed insolvent laws, and Congress has passed one, for the district of Columbia, the validity of which has never been questioned. This act was not made under the express power given to Congress to pass a bankrupt law, (because that was to be *general* and *uniform*, throughout the Union), but under the power vested in them, to legislate for the district of Columbia. Had it been thought that an insolvent law, was the *impairing of a contract*, within the meaning of the constitution, we can hardly suppose, that Congress would have passed one for Columbia, although not prohibited expressly by

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159. See COLEMAN, *supra* note 31, at 31 (“[N]o one challenged the constitutionality of state relief laws until after 1812.”).

160. See James D. Myers, *Bringing the Vice President into the Fold: Executive Immunity and the Vice Presidency*, 50 B.C. L. REV. 897, 923 (2009); RON CHERNOW, ALEXANDER HAMILTON 650–55, 680–709 (2004).

161. See BENJAMIN FLETCHER WRIGHT, JR., THE CONTRACT CLAUSE OF THE CONSTITUTION 27–28 (1938) (referring to Marshall as the “greatest of [Hamilton’s] disciples,” and heralding the importance of his appointment to the development of a broader conception of the Contract Clause for protection of private property rights); see also William E. Nelson, *The Eighteenth-Century Background of John Marshall’s Constitutional Jurisprudence*, 76 MICH. L. REV. 893, 894–95 (1978) (noting that Marshall “consciously furthered the political goals of the Federalist Party”).

162. As early as 1809, the Chief Justice heard a case involving a discharge granted under Virginia’s insolvency statute, but it appears that the issue of the statute’s constitutionality was never raised. *Slacum v. Simms*, 9 U.S. (5 Cranch) 363 (1809). An even earlier opinion, to a similar effect, can be found in *Turner v. Fendall*. 5 U.S. (1 Cranch) 117 (1801). The issue that the Court ultimately considered in *Saunders* was nearly addressed before Chief Justice Marshall’s tenure in *Emory v. Grenough*, 3 U.S. (3 Dall.) 369 (1797), but the case was ultimately dismissed for lack of diversity.



the constitution; because, to say the least of it, it would have been setting a very bad example.<sup>163</sup>

The Pennsylvania court was likely weighing in on a dispute that was then percolating amongst the Supreme Court Justices.<sup>164</sup>

The issue was also splitting the state courts. For example, the New Jersey high court held that Congress had exclusive control over bankruptcy and that “a law discharging a debtor from his debts, without payment, if not a bankrupt law, is a law impairing the obligation of contracts, the power of making which is, by the said constitution, expressly forbidden to the individual states.”<sup>165</sup> The New Jersey court thus held the New York insolvency statute unconstitutional before the Supreme Court reached the same result in *Crowninshield*.

In 1812, Justice Story, while riding circuit in Rhode Island, considered whether that state’s colonial era insolvency law discharged a foreign creditor on a contract made in a foreign jurisdiction.<sup>166</sup> Justice Story acknowledged doubts about the true meaning of the Bankruptcy Clause before finding a way to elide the dispute on procedural grounds that suggested the discharge was not binding.<sup>167</sup>

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163. *Farmers’ & Mechs.’ Bank v. Smith*, 3 Serg. & Rawle 63, 71 (Pa. 1817) *rev’d sub nom. Farmers’ & Mechs.’ Bank of Pa. v. Smith*, 19 U.S. (6 Wheat.) 131 (1821).

164. See Gerald T. Dunne, *Joseph Story: The Great Term*, 79 HARV. L. REV. 877, 896–97 (1966) (discussing the tactical aspects surrounding the difference in opinion among Supreme Court Justices regarding the construction of the Contract Clause).

165. *Olden v. Hallet*, 5 N.J.L. 466, 469 (N.J. 1819).

166. See *Babcock v. Weston*, 2 F. Cas. 306, 306 (C.C.D.R.I. 1812) (doubting whether private bill by legislature could discharge Massachusetts creditor’s claim); see also Gerald T. Dunne, *Joseph Story: 1812 Overture*, 77 HARV. L. REV. 240, 253 (1963) (noting that the *Babcock* case was where Justice Story “began his work in structuring the American law of bankruptcy”). The reporting on some of these early cases leaves much to be desired—for example, in the *Babcock* opinion as it appears on Westlaw and in *Federal Cases*, Justice Story is alleged to have cited not only *Crowninshield*, which was decided in 1819, but also *Saunders*, from 1823, a neat trick in an 1812 decision. It appears that *Federal Cases* used the second edition of the original Gallison reporter. This edition, produced in 1845, adds a footnote that contains the offending citations. *Babcock v. Weston*, 1 Gall 168, 169 (C.C.D.R.I. 1812). Somehow the footnote was moved to the text when *Federal Cases* was produced late in the nineteenth century.

167. See *Van Reimsdyk v. Kane*, 28 F. Cas. 1062, 1065 (C.C.D.R.I. 1812) (suggesting that state insolvency law cannot apply to “controversies affecting citizens of other states”).

In 1814, Justice Washington had ruled that a Pennsylvania insolvency statute was unconstitutional.<sup>168</sup> In short:

[Justice Washington] reasoned that the grant of a power to the federal government without any mention of the states suggested that the grant was complete and therefore exclusive. In addition, the concept of a uniform bankruptcy system logically demanded a single regulation applicable throughout the Union; such a system necessarily depended on congressional action and an exclusive constitutional grant of power for that purpose. Finally, he suggested that it would be incorrect to restore to the states, by implication, a power that the Constitution specifically assigned to the federal government. The parallel inclusion of the naturalization and bankruptcy provisions in the same constitutional section added weight to the view that in both areas a concurrent power would violate the framers' intent.<sup>169</sup>

This was followed by an 1816 decision, in which the South Carolina Circuit Court followed Justice Washington's reasoning, and held:

[B]y the constitution of the United States the individual states have given up their rights of legislating as to commerce and bankruptcy; that this right is now solely in possession of the United States government . . . ; that no bankrupt law existing at this time does not affect the main question, because the right in government still remains to enact one.<sup>170</sup>

To the modern reader, the decision in this case seems something of a reach, inasmuch as the complaining creditor was without notice of the South Carolina proceedings, providing an obvious basis for finding the discharge inoperative that avoided the Constitutional question. But this naive counterargument forgets that the states were not yet subject to the Due Process Clause.<sup>171</sup>

Then, in 1817, Justice Livingston rejected Justice Washington's analysis in an opinion regarding the retroactive application of New York's insolvency statute.<sup>172</sup>

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168. *Golden v. Prince*, 10 F. Cas. 542, (C.C.D. Pa. 1814).

169. Herbert A. Johnson, *Bushrod Washington*, 62 VAND. L. REV. 447, 465 (2009) (footnotes omitted).

170. *Gill v. Jacobs*, 10 F. Cas. 373, 375 (C.C.D.S.C. 1816).

171. *Cf. Barron v. Mayor of Baltimore*, 32 U.S. (7 Pet.) 243, 250–51 (1833) (holding that the Fifth Amendment's Takings Clause was only a limitation on the federal government's power).

172. *See Adams v. Storey*, 1 Fed. Cas. 141, 143–44 (C.C.D.N.Y. 1817) (holding that Congress does not have exclusive power to create

Justice Livingston argued that while the precise statute at issue had been enacted after the contract in question was signed, New York had long had similar insolvency statutes—the present one differed but in detail—and thus the contract law of New York and most other states had long included the possibility that contracts might be discharged as part of the debtor’s insolvency proceedings.<sup>173</sup> Livingston also took a thoroughly modern view of insolvency legislation, arguing that the inability of debtors to obtain a “fresh start” would produce a drag on economic activity.<sup>174</sup>

2. *Sturges v. Crowninshield* Affirms State Authority to Regulate Bankruptcy

Shortly thereafter, Justice Story, who was riding circuit in Boston, was faced with a challenge to the very same New York statute that Justice Livingston had previously upheld. Story took a third course: he accelerated Richard Crowninshield’s case to the full Supreme Court, on the basis of the courts’ apparent division.<sup>175</sup>

Crowninshield had defaulted on two loans worth approximately \$1,500, and sought relief under New York’s insolvency statute.<sup>176</sup> His creditor argued that because of the Bankruptcy Clause, only Congress had the power to pass bankruptcy laws, and moreover state insolvency laws violated the Contracts Clause.<sup>177</sup>

The majority hinted at a broader reading of the Bankruptcy Clause, noting:

Congress is expressly vested with the power of passing bankrupt laws, and is not prohibited from passing laws impairing the obligation of contracts, and may, consequently, pass a bankrupt law which does impair it; whilst the states have not reserved the power of passing bankrupt laws, and are expressly prohibited from passing laws impairing the obligation of contracts.<sup>178</sup>

But ultimately it did not seize the moment.

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bankruptcy legislation and rejecting any interpretive parallel to the federal exclusivity of naturalization doctrine).

173. *Id.* at 148.

174. *Id.* at 146.

175. Dunne, *supra* note 164, at 896–97.

176. *Sturges v. Crowninshield*, 17 U.S. (4 Wheat.) 122, 122 (1819) (noting the action was brought by “the maker of two promissory notes . . . for the sum of 771 dollars and 86 cents each”).

177. See Robert L. Hale, *The Supreme Court and the Contract Clause*, 57 HARV. L. REV. 512, 519–20 (1944) (discussing Justice Marshall’s response to both of these arguments).

178. *Crowninshield*, 17 U.S. (4 Wheat.) at 191.

Given the Chief Justice's role as the guardian of the Hamiltonian legacy, his decision to pass on the first argument<sup>179</sup> and ground his opinion in the second seems somewhat counterintuitive.<sup>180</sup> But, unlike Hamilton, Chief Justice Marshall had lived several decades with the knowledge that Congress was unlikely to actually use its authority under the Bankruptcy Clause.<sup>181</sup>

Thus, the Court focused in on the retroactive nature of the New York statute, seemingly ignoring Justice Livingston's point that some sort of insolvency statute had been in effect for a long time in New York and held that discharge of preexisting contractual obligations violated the Contract Clause.<sup>182</sup> Despite the Chief Justice's probable inclinations to join Justice Washington in holding the Bankruptcy Clause to create an exclusively federal power, his opinion instead holds that the states retain a residual ability to address insolvency in times when Congress has failed to act.<sup>183</sup>

Taken together, the Court's holdings with regard to the two Clauses resulted in the apparent rule that states could pass bankruptcy statutes, so long as they had the foresight to pass the statute well before it might be needed.<sup>184</sup> In many ways, this suggested a hostility to innovation: states that passed an insolvency statute and let it alone would provide the most benefit to their debtor citizens.<sup>185</sup>

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179. See KENNETH N. KLEE, *BANKRUPTCY AND THE SUPREME COURT* 170 (2008) (noting that *Crowninshield* held that the Bankruptcy Clause alone did not preempt state laws).

180. See Daniel W. Levy, *A Legal History of Irrational Exuberance*, 48 CASE W. RES. L. REV. 799, 814 (1998) ("Marshall's initial concession regarding whether New York had any power with respect to debt relief was as unlikely as ever for the great believer in a broadly construed, preemptive federal regulatory power.").

181. See SMITH, *supra* note 130, at 440 (discussing Marshall's view that unless the states were permitted to enact insolvency laws, "no relief would be forthcoming").

182. Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 15 (1995).

183. See Note, *The Abstention Doctrine in Bankruptcy*, 116 U. PA. L. REV. 942, 950 (1968) (noting that "the Bankruptcy Act does not encompass all questions relating to bankruptcy, and state regulation of potentially conflicting areas has been sanctioned").

184. See Robert L. Hale, *Some Basic Constitutional Rights of Economic Significance*, 51 COLUM. L. REV. 271, 279–80 (1951) (discussing a number of cases exhibiting hostility to contract impairment that support this conclusion).

185. See Malcolm P. Sharp, *Movement in Supreme Court Adjudication—A Study of Modified and Overruled Decisions*, 46 HARV. L. REV. 361, 368–69 (1933) (noting the Court's "protection of contracts once formed in reliance on an existing state of the law").

3. Expansion of *Crowninshield*

But hardly anyone seems to have read the case as the last word on the meaning of the Bankruptcy Clause. And as the Court's later opinion in *Saunders* would make clear, it turned out that *Crowninshield's* apparent reconciliation of the Justices' competing conceptions of the Clause was merely temporary.<sup>186</sup>

The true meaning of *Crowninshield* was further confused when, the day after announcing its opinion in that case, the Chief Justice, acting again on behalf of an apparently united Court, issued a short opinion proving that:

[T]his case was not distinguishable in principle from the preceding case of *Sturges v. Crowninshield*. That the circumstance of the State law, under which the debt was attempted to be discharged, having been passed before the debt was contracted, made no difference in the application of the principle. And that as to the certificate under the English bankrupt laws, it had frequently been determined, and was well settled, that a discharge under a foreign law, was no bar to an action on a contract made in this country.

Judgment affirmed.<sup>187</sup>

The defendant had obtained not one discharge but two: in both Louisiana and England. Neither seemed to work in the eyes of the Court.

In one fell swoop, the Chief Justice seemed to have greatly expanded the holding of *Crowninshield* to cover most state bankruptcy laws and foreign laws too.<sup>188</sup> But for reasons that remain unclear, no one seems to have taken this opinion at face value, and the holding of the opinion was undermined by subsequent events.<sup>189</sup>

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186. See Donald G. Morgan, *Mr. Justice William Johnson and the Constitution*, 57 HARV. L. REV. 328, 354 (1944) (noting that, in *Saunders*, a new majority upheld the New York insolvent debtor law).

187. *McMillan v. McNeill*, 17 U.S. (4 Wheat.) 209, 212 (1819).

188. See Bailey, *supra* note 115, at 352 (“[T]he language of the court in *M’Millan v. M’Neill*, was such as to induce a belief that the court meant to declare all State insolvent laws unconstitutional, as impairing the obligation of contracts.”).

189. In two of the majority opinions in *Saunders*, Justices suggested that the reporter misstated the Chief Justice’s *McMillan* holding. Interestingly, the Chief Justice did not address the issue in his *Saunders* dissent. *Ogden v. Saunders*, 25 U.S. (12 Wheat.) 213, 255, 272 (1827).

### III. THE FIGHT *CROWNINSHIELD* PROVOKED

The true meaning of the Bankruptcy Clause remained a matter of contention despite a second effort at a federal bankruptcy code and two interventions by the Supreme Court. In many respects *Crowninshield's* compromise satisfied no one. Hamiltonians still felt that bankruptcy should be purely federal by virtue of the Bankruptcy Clause.<sup>190</sup> And, as the years progressed, state insolvency laws got swept along in a larger, slavery-focused argument for “States’ Rights.”<sup>191</sup>

Thus, Vermont’s high court held that all state bankruptcy laws were unconstitutional following *Crowninshield*,<sup>192</sup> while at almost the same time the New Jersey high court upheld the use of a Pennsylvania discharge in a contract suit.<sup>193</sup> The Supreme Court of Ohio found the federal cases totally inapplicable to its state insolvency statute, provided that all the relevant action in the case occurred within the boundaries of Ohio after the enactment of the statute.<sup>194</sup> Somewhat similarly, the Supreme Court of New York held that “an insolvent or bankrupt law, in force when the contract was made, does not, in the sense or meaning of the constitutional provision, impair the obligation of such contract.”<sup>195</sup>

But the high court of Illinois felt itself bound by the full Hamiltonian position it felt the Supreme Court had adopted, but also made clear that it questioned the “correctness” of *Crowninshield*.<sup>196</sup> At the same time, members of various state legislatures questioned the Supreme Court’s decision as well.<sup>197</sup> And, in New York, there was at least one suggestion that *Crowninshield* should be overruled by Constitutional amendment.<sup>198</sup> In short, the actual meaning of the

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190. See COLEMAN, *supra* note 31, at 35 (noting that even after 1827 many influential people held the view that state insolvency laws were prohibited by the Constitution, as reflected by many state legislatures’ refusal to act after *Crowninshield*).

191. Shelton, *supra* note 11, at 400.

192. Herring v. Selding, 2 Aik. 12, 18 (Vt. 1826).

193. Rowland v. Stevenson, 6 N.J.L. 149, 150 (N.J. 1822).

194. Smith v. Parsons, 1 Ohio 236, 241 (1822).

195. Mather v. Bush, 16 Johns. 233, 249 (N.Y. Sup. Ct. 1819).

196. Mason v. Wash, 1 Ill. (Breese) 39, 41 (1822) (“But as the supreme court of the United States has determined that the discharge is equally unavailing whether the contract was made before or after the passage of the act, this court feels itself bound to yield to that opinion, how much soever some of the court might be disposed to question its correctness.”).

197. *E.g.*, *Jurisdiction of the District Judges of the United States, in Bankruptcy*, 1 U.S. L.J. 15, 15 (1822).

198. *Id.*

Bankruptcy Clause remained a source of confusion after the Supreme Court's first effort.<sup>199</sup>

A. *Ogden v. Saunders: The Court's Attempted Clarification*

The Court's next attempt at resolving the issue hardly helped, as the Court fractured dramatically in *Ogden v. Saunders*.<sup>200</sup> *Saunders* involved an earlier version of the New York insolvency law at issue in *Crowninshield*,<sup>201</sup> the primary difference between the two statutes being the number of creditors needed to bind holdouts to a discharge.

The creditors took the opportunity to reassert the Hamiltonian view of the Bankruptcy Clause, arguing for a general prohibition on state insolvency laws. For example, Daniel Webster told the Court:

The constitution was intended to accomplish a great political object. Its design was not so much to prevent injustice or injury in one case, or in successive single cases, as it was to make general salutary provisions, which, in their operation, should give security to all contracts, stability to credit, uniformity among all the States, in those things which materially concerned the foreign commerce of the country, and their own credit, trade, and intercourse among themselves. The real question is, therefore, a much broader one than has been argued. It is this, whether the constitution has not, for general political purposes, ordained that bankrupt laws should be established only by national authority? We contend that such was the intention of the constitution; an intention, as we think, plainly manifested by a consideration of its several provisions.<sup>202</sup>

This argument was buttressed with the argument that the New York law also violated the Contracts Clause. Importantly, however, the contract in question in *Saunders* had been entered into in 1806, while the New York statute at issue was enacted in 1801.<sup>203</sup> That is, unlike *Crowninshield*, this case did not involve the question of retroactive application of the statute.<sup>204</sup>

The Supreme Court initially produced four distinct “majority” opinions—each member of the majority writing separately.<sup>205</sup> And

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199. COLEMAN, *supra* note 31, at 127.

200. *See* *Ogden v. Saunders*, 25 U.S. (12 Wheat.) 213 (1827) (decided by a 4–3 split).

201. *Id.* at 213–214.

202. 25 U.S. (12 Wheat.) at 237.

203. *See id.* at 271.

204. *See id.*; *Sturges v. Crowninshield*, 17 U.S. (4 Wheat.) 122, 122–23 (1819).

205. Siegel, *supra* note 157, at 13–14; *see also* Currie, *supra* note 156, at 917 (stating, in its explanation of the justice' different approaches: “Headless

Chief Justice Marshall wrote a rare dissent for himself and Justices Duvall and Story.<sup>206</sup>

Then, to make matters more interesting, the second half of the opinion involved a shift by Justice Johnson to join the dissenters in a new majority, with the remaining three Justices of the former majority in dissent.<sup>207</sup>

The primary holding was that the Court would not revisit the notion of a dormant Bankruptcy Clause, despite the Chief Justice's reported desire to do just that,<sup>208</sup> and prospective application of a state bankruptcy statute did not violate the Contract Clause.<sup>209</sup> But, as noted, the majority could not agree amongst themselves precisely why this should be so.

In the second half of the case, the Court held that the application of a prospective state bankruptcy statute must be limited within state borders.<sup>210</sup> That is, a state insolvency statute could have no extra-territorial effect.

What provision of the Constitution this second holding was based on, and where it came from, is hard to figure.<sup>211</sup> Logic would seem to

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for the first time, the majority reverted to the pre-Marshall practice of seriatim opinions").

206. See PAUL BREST ET AL., PROCESSES OF CONSTITUTIONAL DECISIONMAKING: CASES AND MATERIALS 145 (5th ed. 2006) (referring to Marshall's dissent as his only one in a constitutional case); cf. Herbert Hovenkamp, *The Classical Corporation in American Legal Thought*, 76 GEO. L.J. 1593, 1606 (1988) (discussing the Federalists' concerns with "the threat to American creditworthiness that might result from state debtor relief legislation passed during the 1780s recession").

207. 25 U.S. (12 Wheat.) at 358, 369.

208. See SMITH, *supra* note 130, at 498. Smith argues that Marshall's dissent was likely written as a majority opinion several years earlier, when the case was first heard. *Id.* at 498 n.\*. The Court delayed the decision in the case when the justices tied three to three due to one seat on the court being vacant for more than two terms. *Id.* at 498.

209. Cf. Judith Schenck Koffler, *The Bankruptcy Clause and Exemption Laws: A Reexamination of the Doctrine of Geographic Uniformity*, 58 N.Y.U. L. REV. 22, 49–50 (1983) (noting Justice Marshall's concern that allowing nonuniform state bankruptcy statutes would have the practical effect of increasing the economic uncertainty of potential foreign and interstate trade partners, thus suppressing commerce).

210. 25 U.S. (12 Wheat.) at 368.

211. DAVID P. CURRIE, THE CONSTITUTION IN THE SUPREME COURT: THE FIRST HUNDRED YEARS, 1789–1888, at 154–55 (1985) ("Justice Johnson composed a mysterious *cadena* . . . . It seems certain that this opinion was not based upon the contract clause; to determine what it *was* based on is appreciably more difficult."). It seems that the second half of the opinion was the actual *Saunders* case, while the first holding reflected the outcome of some companion cases that are only obliquely mentioned in the opinion. See 25 U.S. (12 Wheat.) at 213, 357; see also



rule out the Contracts Clause, which has no geographical component. Perhaps a rare appearance by the dormant Bankruptcy Clause?

The case predates the Fourteenth Amendment and application of much of the Bill of Rights to the states; a holding based on due process thus is out of the question.<sup>212</sup> Since the case involves an appeal from the district court, general constitutional law might be in play. But, in a footnote to *Saunders*, Justice Johnson applied the holding of the primary case to a state court appeal, seemingly ruling out that possibility.<sup>213</sup>

The dormant Bankruptcy Clause might win this argument by process of elimination, but then there is the primary holding of the case, which seems to rule out any sort of dormant Bankruptcy Clause whatsoever. How could the states enact their own prospective insolvency laws if such a dormant clause was operative? Perhaps some notion of fundamental rights and vested property interests in contracts?<sup>214</sup>

In any event, Justice Johnson provides the deciding vote and forms the common link between the two parts of the case.<sup>215</sup>

### *B. Resulting Confusion*

Application of this muddled holding, or set of holdings, would plague courts, and result in much confusion, for the remainder of the nineteenth century. And if the Federalists and latter Whigs hoped that *Crowninshield* and *Saunders* would prompt Congress to finally use its power under the Bankruptcy Clause, the larger States' Rights trend would leave them sorely disappointed.<sup>216</sup>

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SMITH, *supra* note 130, at 499 (indicating that Justice Johnson—the *Saunders* swing vote—disagreed with “the principle that all state bankruptcy legislation was unconstitutional” but joined Chief Justice Marshall for the second half of the opinion, which was addressed the complicated issue of the case “since it involved a contract with an out-of-state citizen”). At the very least, the second half relates to the actual facts of *Saunders* as elsewhere described in the opinion.

212. See CURRIE, *supra* note 211, at 155 (explaining how due process was thought to apply solely to the federal government until the landmark incorporation cases of the mid-twentieth century).

213. *Shaw v. Robbins*, 25 U.S. (12 Wheat.) 369 (1827) (reported in note *a* following *Saunders*).

214. See *Fletcher v. Peck*, 10 U.S. (6 Cranch) 87 (1810) (holding that a state contract granting land cannot be subsequently repealed to the detriment of a later good-faith purchaser—even if originally illegally procured by bribes—and, accordingly, invalidating a state law that attempted to do so on Contract Clause grounds).

215. See 25 U.S. (12 Wheat.) at 271, 358.

216. See STORY, *supra* note 26, at § 1105 (“It cannot but be matter of regret, that a power so salutary should have hitherto remained . . . a mere dead letter.”).

As one writer noted in 1841, just before Congress finally and briefly acted again,

[F]or the last thirty-seven years, indeed, with the exception of three years, from the adoption of the federal constitution, we have had no national bankrupt law. No commercial country, at all comparable with the United States in the extent of its commerce, has been without such laws within the last century. . . . And the fact seems still more singular, when the condition of our country and the characteristics of our people are considered. Our country is comparatively new; the mass of its population are born to toil; there are vast resources to develop, and numerous hands for their development, with but a scanty supply of the necessary pecuniary means. . . . [T]he whole country, the old and new parts, in different degrees, are indebted for pecuniary aid to the capitalists of Europe.<sup>217</sup>

Almost inevitably, states that had previously recognized out-of-state discharges felt bound to reject such discharges following the Court's opinion in *Saunders*.<sup>218</sup>

But even this did not become a hard and fast rule, and courts developed a myriad of approaches to deal with the contract signed in state or out of state, the creditor who was a resident but who then moved out of state, and the debtor who likewise relocated. Consider, for example, the out-of-state resident who signed the contract in state before leaving again or the parties who live in one state but signed a contract in some commercial center like New York or New Orleans and then relocated to a third jurisdiction. The permutations were almost endless.<sup>219</sup>

And courts were not the only players involved in this confusing attempt to settle on the meaning of the Bankruptcy Clause. State legislatures continued to pass debtor-relief measures, especially in times of financial crisis, prompting one commentator at the time to observe:

It is occasionally remarked, by those who deal in sweeping arguments, that these laws are unconstitutional, and therefore to be disregarded. . . . [Yet u]ntil these statutes have been

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217. Joshua M. Van Cott, *A General Bankrupt Law*, in 4 MERCHANTS' MAGAZINE & COMMERCIAL REVIEW 22, 22–23 (Freeman Hunt, ed. 1841).

218. Hollis Bailey first noted this in his 1892 article. See Bailey, *supra* note 115, at 354–58 (listing affected decisions by state).

219. For a discussion illustrating the complications of these rules with regard to the New York insolvency statutes, see *Art. VI—Bankrupt and Insolvent Laws*, 4 AM. JURIST & L. MAG. 98 (1830).

declared unconstitutional by some competent tribunal, their operation is the same as if their validity were unimpeachable.<sup>220</sup>

Another author complained that because of Congress's failure to act, there had developed at least "twenty distinct systems of bankruptcy, or insolvency, each differing from all the rest, in almost every provision intended to give security to the creditor, or relief to the debtor."<sup>221</sup>

Finally, some continued to argue that Congress had the exclusive power to deal with the subject: that is, the full "Hamiltonian" position continued to be advocated, despite the Supreme Court's efforts to construct a sphere of joint responsibility.<sup>222</sup> For example, one anonymous author, published in 1823, but perhaps writing somewhat earlier (but clearly after the *Crowninshield* opinion), argued:

[B]ankrupt laws form a prominent and important branch of international law: 1. Because they involve the rights of citizens and subjects of foreign States, as well as of our own. 2. Because the government of every State is bound to protect the rights of its own citizens, in all cases whatsoever, and particularly in commercial cases, which relate to the intercourse and comity of nations: And 3dly, Because, in the communication between the courts and tribunals of different nations, evidence from the highest authority is always expected. Proceedings with respect to the bankrupt's estate, or those relating to the discharge of his person, can not emanate from local jurisdiction, but must be stamped with the seal of national authority.<sup>223</sup>

C. *The 1841 Bankruptcy Act: A Brief Federal Intrusion  
in Response to the Panics of 1837 and 1839*

Congress then briefly intruded with the 1841 Bankruptcy Act.<sup>224</sup> Somewhat ironically, many suggest<sup>225</sup> that the law was modeled on the

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220. *Art. II—On a National Bankrupt Law*, 1 AM. JURIST & L. MAG. 35, 39 (1829).

221. Van Cott, *supra* note 217, at 29. The author goes on to argue that the states have done the best they could, given the Constitutional constraints they were required to operate under. *Id.* at 33.

222. Notwithstanding the Court's majority position, Justice Story was skeptical of the states' purview over debtors. See STORY, *supra* note 26, at § 1103 ("Very few persons engaged in active business will be without debtors or creditors in many states in the Union. The evil is incapable of being redressed by the states. It can be adequately redressed only by the power of the Union.").

223. *Bankrupt Law of the United States*, 1 U.S. L.J. 446, 450 (1823).

224. Act of Aug. 19, 1841, ch. 9, 5 Stat. 440 (repealed 1843). For a section-by-section analysis of this law, see 1 J.B. STAPLES, THE GENERAL BANKRUPT LAW 21–38 (1841). Several Pennsylvania cases decided

extant Massachusetts insolvency law.<sup>226</sup> The federal law was to last but eighteen months in this instance.<sup>227</sup>

It is generally argued that the Whig Congress that enacted the 1841 Act intended the Bankruptcy Bill to provide relief to those who had suffered economic losses during the Panics of 1837 and 1839.<sup>228</sup>

### 1. Voluntary Bankruptcy Petitions

The 1841 Act is often noted for its “innovation” in allowing voluntary bankruptcy petition<sup>229</sup> by a wide range of debtors.<sup>230</sup> The 1841 Act provided that, “All persons whatsoever, residing in any State, District or Territory of the United States, owing debts . . . shall be deemed bankrupts within the purview of this act, and may be so declared accordingly by a decree of such court.”<sup>231</sup> Voluntary petitions were unknown to English bankruptcy practice at the time,<sup>232</sup> but

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under the 1841 Act, and one long-in-the-tooth case decided under the 1800 Act, are reproduced in the *Pennsylvania Law Journal's Reports of Cases in Bankruptcy*. See, e.g., *Ex parte Bennet*, 1 PENN. L.J. 145 (1842); *In re Leppein*, 1 PENN. L.J. 223 (1842). Also reproduced are cases from other jurisdictions, including a circuit opinion of Justice Story. See *In re Randall*, 1 PENN. L.J. 133 (C.C.D. Mass. 1842).

225. 5 CARL B. SWISHER, HISTORY OF THE SUPREME COURT OF THE UNITED STATES: THE TANEY PERIOD, 1836–1864, at 133 (1974).
226. Act of Apr. 23, 1838, ch. 163, 1838 MASS. ACTS 83. This law is discussed in *Insolvent Law of Massachusetts*, 19 AM JURIST & L. MAG. 302 (1838). The law provided for voluntary and involuntary petitions. *Id.* at 314–15. It also provided a discharge “as extensive as is supposed to be consistent with the constitution of the United States.” *Id.* at 324. The law had been developed over several years of legislative work. *Proposed Insolvent Law of Massachusetts*, 6 AM. JURIST & L. MAG. 116 (1831).
227. See Act of Mar. 3, 1843, ch. 82, 5 Stat. 614 (repealing the 1841 Act).
228. Edward J. Balleisen, *Vulture Capitalism in Antebellum America: The 1841 Federal Bankruptcy Act and the Exploitation of Financial Distress*, 70 BUS. HIST. REV. 473, 479 (1996). Support for this proposition can also be found in a 1841 article, where the author states that the prior ten years had resulted in mass economic devastation warranting a new federal bankruptcy statute. Van Cott, *supra* note 217, at 33. President Van Buren had proposed a bankruptcy bill for banks only during the crisis. See President Martin Van Buren, Special Session Message (Sept. 4, 1837), available at <http://www.presidency.ucsb.edu/ws/index.php?pid=67234>.
229. WARREN, *supra* note 11, at 60; Rhett Frimet, *The Birth of Bankruptcy in the United States*, 96 COM. L.J. 160, 180 (1991).
230. Tabb, *supra* note 182, at 16 (explaining that the “final compromise” that culminated in the 1841 Act did not limit eligibility for relief to “merchant debtors”).
231. Act of Aug. 19, 1841, ch. 9, § 1, 5 Stat. 440, 441 (repealed 1843).
232. EDWARD J. BALLEISEN, NAVIGATING FAILURE: BANKRUPTCY AND COMMERCIAL SOCIETY IN ANTEBELLUM AMERICA 105 (2001).

many of the state laws already discussed herein provided just such relief to debtors. And efforts to enact a voluntary federal bankruptcy law actually dated back some twenty years earlier, when such a law was considered by Congress.<sup>233</sup>

The alleged novelty of voluntary petitions, and the lack of any such petitions in England at the time of the Constitution, did lead a few lower courts to hold the 1841 Act unconstitutional.<sup>234</sup> The bulk of these decisions were overturned, and a New York court upheld the constitutionality of the voluntary provision, albeit after repeal.<sup>235</sup> That court, which included a future Supreme Court Justice in the majority, used the occasion to interpret the Bankruptcy Clause:

Looking thus at the uniform popular acceptance of the word from the earliest times and in all English countries, and supposing that to be the true one, I read the constitution thus: “Congress shall have power to establish uniform laws on the subject of any person’s general inability to pay his debts throughout the United States.” I do not deny that if we were bound to apply the English statute definition of the word *bankruptcy*, the power of congress would be unequal to the discharge here pleaded . . . . It seems to me too that there is something quite forced and unnatural in supposing that the members of the convention intended to contract the action of congress on the subject of bankruptcies within a limit narrower than that allowed by the British constitution; above all that

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233. Olmstead, *supra* note 3, at 837; see also John C. McCoid, II, *The Origins of Voluntary Bankruptcy*, 5 BANKR. DEV. J. 361, 371 (1988) (explaining how three separate bankruptcy bills that Congress considered between 1820 and 1830 failed to become law).

234. See, e.g., *In re Klein*, 14 F. Cas. 719 (D. Mo. 1843), *rev’d*, 14 F. Cas. 716 (C.C.D. Mo. 1843); *Wattles v. Lator*, 3 W.L.J. 315 (C.C. Ill. 1843) (case reported in 1845), *rev’d*, 8 Ill. (3 Gilm.) 225, 227 (1846). But see *Nelson v. Carland*, 42 U.S. (1 How.) 265, 265–66 (1843) (dismissing case for want of jurisdiction, but noting that the constitutionality of the act had been raised in a handful of cases); *In re Irwine*, 13 F. Cas. 125, 130 (C.C.E.D. Pa. 1842) (internal citations omitted) (“[I]nasmuch as this [voluntary bankruptcy] is a principle unknown to the bankrupt law of England, and of these states before the constitution, or the act of 1800, it ought not to be expanded by construction, so as to interfere with the rights of creditors, further than the law authorizes, or exempt the debtor from any restrictions imposed upon him as requisites to his discharge.”). The New Hampshire Supreme Court suggested that the inability of the United States Supreme Court to hear appeals under the 1841 Act might call into question the law’s uniformity, as required by the Bankruptcy Clause. *Kittredge v. Warren*, 14 N.H. 509, 513 (1844). For a discussion of the Supreme Court’s limited jurisdiction under the 1841 Act, see *Ex parte Christy*, 44 U.S. (3 How.) 292, 292–293 (1845).

235. *Kunzler v. Kohaus*, 5 Hill 317, 321–23 (N.Y. Sup. Ct. 1843); *Sackett v. Andross*, 5 Hill 327, 327–28 (N.Y. Sup. Ct. 1843).

they intended to hamper that body by the letter of the statute, when it was well known that British legislation had already extended itself in one case, and might thereafter, as it has in fact done, extend itself to other cases not then provided for. I allude to the 34 and 35 *H. 8, ch. 4*, and the 6 *Geo. 4, ch. 16*, the first of which comprehended all classes of persons, as well traders as others, and the latter introduced the right of a trader voluntarily to declare himself a bankrupt. The argument is repugnant to the whole spirit of American legislation. It moreover supposes the convention, while engaged in framing a fundamental law, to have been utterly regardless of those obvious vicissitudes in a world full of changes, which might call for a corresponding enlargement or contraction of the bankrupt system.<sup>236</sup>

## 2. Commissioners and Assignees

As in 1800, the 1841 Act followed the English model in providing for the appointment of a commissioner (now one individual, instead of a panel) by the federal court and the management of the debtor's property by assignees.<sup>237</sup> But in contrast to the 1800 Act, the 1841 Act provided that title to all the bankrupt's property vested in the assignee by operation of law, without involvement of the commissioner.<sup>238</sup>

According to Owen's *Rules in Bankruptcy*, the primary role of the commissioner was "to take the proof of debts and to take testimony to be used in the Circuit or District Court in all hearings in cases of bankruptcy."<sup>239</sup> But unlike the assignee, the use of a commissioner was not required by the Act—Rule 34 indicates that the court had the

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236. *Kunzler*, 5 Hill at 321–23.

237. 1 FRANK OLDS LOVELAND, *A TREATISE ON THE LAW AND PROCEEDINGS IN BANKRUPTCY* 12 (4th ed. 1912).

238. Act of Aug. 19, 1841, ch. 9, § 3, 5 Stat. 440, 442–43 (repealed 1843); *see also* LOVELAND, *supra* note 237, at 11 ("The court appointed an assignee, in whom the title to all the bankrupt's property, real, personal, and mixed, vested by operation of law.").

239. SAMUEL OWEN, *RULES IN BANKRUPTCY*, in *A TREATISE ON THE LAW AND PRACTICE OF BANKRUPTCY* app.1, app.8 (1842) (stating Rule 33). The Rules in Bankruptcy contained in the appendix to this treatise appear to be directed at New York jurisdictions, but similar Rules under the 1841 Act can be found in the jurisdictions of Massachusetts, New Hampshire, Pennsylvania, and Virginia. Section 6 of the 1841 Act provided the basis for these enactments. Act of Aug. 19, 1841, § 6; *see also* *Nugent v. Boyd*, 44 U.S. (3 How.) 426, 432 (1845) ("Proceedings in bankruptcy," as per section 6, are of exclusive cognisance in the District Courts of the United States."); STAPLES, *supra* note 224, at 30 (describing the district court's rule making authority under § 6 as serving the purposes of providing "simplicity and efficiency").

power to refer to a commissioner “at its own instance, or on motion of either party.”<sup>240</sup>

Thus, most of the real power under the 1841 Act resided with the federal courts and their appointed assignees—and little control was left in the hands of the creditors.<sup>241</sup> In addition to their role in the selection of assignees and commissioners, judges in bankruptcy cases under the 1841 Act had broad discretion to interpret the vague rules of the written law,<sup>242</sup> which also at least partially explains the 1841 Act’s short shelf life.

### 3. Shortcomings

Anonymous commentary published following the passage of the 1841 Act lamented the likelihood that only large bankrupts in major cities would be able to avail themselves of the benefits of voluntary bankruptcy. In contrast, the commentary continued,

[S]mall traders who live in the interior who may be as unfortunate and quite as honest as the others cannot secure to themselves this advantage. The distance of their residence from the seat of justice; the expense of employing lawyers; the exorbitant fees which marshalls, clerks, assignees, commissioners and newspaper publications will consume, will place relief beyond their reach. . . . The wreck of his ruined fortune will be consumed in the costs of litigation, and the officers of the law will be the only parties who derive any thing [sic] from the division of the estate.<sup>243</sup>

Creditors who brought claims under the 1841 Act also claimed inadequate dividends were paid, blaming in large part the expenses that administration incurred.<sup>244</sup> Under the 1841 Act, the fees earned by professionals—attorneys, and court administrators, such as clerks—often exceeded the recovery from debts owed to creditors.<sup>245</sup>

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240. OWEN, *supra* note 239, at 8.

241. WARREN, *supra* note 11, at 82.

242. *Id.* (citing Roscoe Conkling, then Representative of New York, in reflecting on the incompleteness of the Act: “Indeed the Judges were driven to turn legislators and to help it out by vigorous construction and by cumbrous and interminable rules . . .”).

243. J.C.L., *Observations on the Law to Establish a Uniform System of Bankruptcy Throughout the United States*, 1 LA. L.J. 39, 64 (1842).

244. These concerns were not baseless—according to the 1846 and 1847 congressional reports regarding the 1841 Act, court costs incurred totaled nearly \$1,000,000. H.R. DOC. NO. 223, at 31 (1846); H.R. DOC. NO. 99, at 8 (1847); *see also* Balleisen, *supra* note 228, at 481 n.14 (indicating that this figure was perhaps even an underestimate).

245. BALLEISEN, *supra* note 232, at 137–38.

More generally, a federal bankruptcy law meant the expansion of federal power. And in the 1840s, there was broad and pronounced hostility to greater federal power from those states that would eventually form the Confederacy.<sup>246</sup> Indeed, one of the leading Supreme Court decisions involving the 1841 Act pointedly involved dueling orders from the District of Kentucky and a Kentucky state court. The state court purported to sell the debtor's property in the face of the pending bankruptcy case.<sup>247</sup>

All the while, the question remained whether *Crowninshield* and *Saunders* were rightly decided from the Hamiltonian perspective. For example, one circuit court decision under the 1841 Act argued:

The power "to pass uniform laws on the subject of bankruptcies throughout the United States," is given in the constitution, and belongs to the same class of powers, "as to regulate commerce, establish a uniform rule of naturalization, coin money, establish post-offices and post roads, and to declare war." These, in my judgment, are all exclusive powers. It is true, the supreme court have held that a state may pass a bankrupt law, to operate upon all contracts subsequently made within the state. But I cannot comprehend the principle on which this decision rests.<sup>248</sup>

#### D. After 1841

##### 1. Initial Return to State Regulation and Continuing Debate

The 1800 Act had lasted three years,<sup>249</sup> but the 1841 Act barely survived for a year and a half.<sup>250</sup> For more than twenty-five years

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246. *Id.* at 104; see also J.M.C., *Observations on the Bankrupt Law*, 1 LA. L.J. 1, 1 (1842) (responding to J.C.L., *supra* note 243) ("[H]is arguments very much resemble the squadron which has been drilled by [D]emocratic leaders . . . . The Bankrupt Law involves a high constitutional question, affecting not only the political relations between the several States and the Union, but also the social and commercial relations of men. The consideration of the question should therefore be approached with a mind wholly free from the taint of political prejudice . . . .").

247. *Shawhan v. Wherritt*, 48 U.S. (7 How.) 627, 641, 645 (1849). This case, like many during the era, reminds us that insolvency in this era had extreme consequences for the debtor's slaves, whose lives could be upended by their owner's missteps. *Id.* at 628 (reporter's note explaining that debtor's property included "five negroes, two wagons and teams, about 400 head of hogs"); see also William Goodell, *Slavery Tested by Its Own Code*, 1 Q. ANTI-SLAVERY MAG. 21, 26 (1835) (describing the devastating effect on slaves' family stability that arose from being bought and sold as chattels).

248. *McLean v. Lafayette Bank*, 16 F. Cas. 253, 254 (C.C.D. Ohio 1843).

249. See *LOVELAND*, *supra* note 237, at 10 (indicating that the 1800 Act was "repealed by the act of December 19, 1803").

250. Act of Mar. 3, 1843, ch. 82, 5 Stat. 614 (repealing the 1841 Act).



following the repeal of the 1841 Act, there was no federal bankruptcy law in place in the United States. Once again the states returned to trying to apply their own statutes, now with the added confusion concerning what had happened to those statutes during the brief period of the 1841 Act's life.<sup>251</sup>

The debate about the Bankruptcy Clause, and the Supreme Court's interpretation thereof, remained as vital as ever:

The State Legislatures can pass insolvent laws, and administer them, much better than Congress. . . . The two cases of *Sturgis v. Crownshield*, and *Ogden v. Saunders*, were most unfortunate cases for the people of this country. They have had a most disastrous influence on multitudes of unfortunate debtors, and have very much embarrassed Congress and the whole country. That the decisions in these cases, especially that of *Ogden v. Saunders*, are not in conformity to the Constitution, there cannot, it appears to me, be a doubt . . . .<sup>252</sup>

Taking the Jeffersonian approach to the Clause, the author anticipated the Nadelmann argument by urging that the Full Faith and Credit Clause should be read to support judgments under state bankruptcy statutes.<sup>253</sup>

Others were more hopeful about the state of insolvency laws. For example, Theophilus Parsons reasoned:

We have no national bankrupt law now. We shall probably never have one until another similar national emergency shall arise; and perhaps not then, because the State insolvent laws are now so well constructed and systematized, that they effect, though not quite so well, nearly all the purposes of a national law.<sup>254</sup>

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251. FRANKLIN CHAMBERLIN, *AMERICAN COMMERCIAL LAW, RELATING TO EVERY KIND OF BUSINESS* 627 (1869). For a summary of New York's insolvency laws of the time, see JAMES P. HOLCOMBE, *THE LAW OF DEBTOR AND CREDITOR IN THE UNITES STATES AND CANADA* 149 (1848). For cases discussing the interplay of federal and state insolvency laws at this time, see *Ex parte Eames*, 8 F. Cas. 236 (C.C.D. Mass. 1842); *In re Hawkins*, 34 Conn. 548, 551 (1868); *Griswold v. Pratt*, 50 Mass. (9 Met.) 16 (1845); *Judd v. Ives*, 45 Mass. (4 Met.) 401 (1842).

252. Daniel Raymond, *The Late Bankruptcy Law*, 1 W.L.J. 489, 493 (1844).

253. *Id.* at 490.

254. THEOPHILUS PARSONS, *THE ELEMENTS OF MERCANTILE LAW* 299 (2d ed. 1862).

At the same time, others still argued that the Bankruptcy Clause was more properly read as vesting the entire topic under congressional authority.<sup>255</sup>

The unsettled state of the Bankruptcy Clause can also be seen in the Confederate constitution, which provided in its Section 8 that

The Congress shall have power—

...

4. To establish uniform laws of naturalization, and uniform laws on the subject of bankruptcies, throughout the Confederate States; but no law of Congress shall discharge any debt contracted before the passage of the same;<sup>256</sup>

The initial portion tracked the Constitution directly, but the concluding phrase imposed a kind of Contracts Clause on the bankruptcy power that the Supreme Court had already held applied only to the states. This represented an extreme position, largely absent from the larger debate in the years before the Civil War.<sup>257</sup> It was also not in the initial, interim Confederate constitution.

Writing in 1857, prolific treatise author Theodore Sedgwick summarized the law concerning the Bankruptcy Clause and its interaction with the Contracts Clause thusly:

It appears, then, to have been decided by the Supreme Court of the United States, that the power of Congress to pass a bankrupt law is not exclusive; that the exercise of that power by the States, as to future contracts, does not impair their obligation; that a contract made and to be performed in one State is not, as against a citizen of that State, discharged by a certificate obtained under the laws of another State, though such laws were passed before the inception of the contract; that a discharge under the laws of the State where the contract was made, but not to be performed, could not be pleaded in bar in the Circuit Court of the United States against a creditor, a citizen of another State at the time of the origin of the contract

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255. *See, e.g.*, WILLIAM ALEXANDER DUER, A COURSE OF LECTURES ON CONSTITUTIONAL JURISPRUDENCE OF THE UNITED STATES 306–08 (2d. ed. 1856) (suggesting the need for exclusive power in the federal government, while noting that the Court had held otherwise); *cf.* COLEMAN, *supra* note 31, at 35 (“The constitutional restriction prohibiting the discharge of out-of-state debts provided some legislatures with practical reasons for not enacting relief laws.”).

256. THE CONFEDERATE STATES OF AMERICA, THE STATUTES AT LARGE OF THE PROVISIONAL OF THE CONFEDERATE STATES OF AMERICA 14 (James M. Matthews ed., 1864).

257. Nevertheless, it was advocated. *See, e.g.*, J.C.L., *supra* note 243, at 43, 64.

and of the discharge; that the same is true when the action is brought in the courts of a State other than that of the origin of the contract; that a creditor of one State, who voluntarily makes himself a party to insolvent proceedings in another State, is bound by the result.

The Supreme Court has not decided that a contract which is in terms to be performed within the State where the discharge is granted, may not be barred by such discharge, as against a citizen of another State seeking to enforce the contract in the State where the contract was to be performed and where the discharge was obtained. Nor has it decided the question where the contract was made with a citizen of the State where the discharge is granted, and of which both creditor and debtor were citizens at the time of the proceedings in insolvency, though the contract itself was entered into in another State.<sup>258</sup>

If the Framers had thought that the Bankruptcy Clause would enhance the national economy by rationalizing debtor-creditor law, by the middle of the nineteenth century this goal seemed quite far away. Sedgwick went on to criticize Chief Justice Marshall's opinion in *Crowninshield*, which he argued had thoroughly confused matters:

The most embarrassing cases that have arisen, however, under this branch of our inquiry, are those growing out of a nice distinction taken early by very high authority between the *obligation* of a contract, and the *remedy* for its infringement or non-performance. Out of this has grown much discussion as to the extent to which the legislative action of the States may alter the remedy without impairing the obligation of a contract. In a case already cited [*Crowninshield*], Mr. Chief Justice Marshall used this language, "The distinction between the obligation of a contract and the remedy given by the legislature to enforce that obligation has been taken at the bar, and exists in the nature of things. Without impairing the obligation of the contract, the remedy may certainly be modified as the wisdom of the nation shall direct. Confinement of the debtor may be a punishment for not performing his contract, or may be allowed as a means of inducing him to perform it. But 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 obligation." This very general language has been repeatedly

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258. THEODORE SEDGWICK, A TREATISE ON THE RULES WHICH GOVERN THE INTERPRETATION AND APPLICATION OF STATUTORY AND CONSTITUTIONAL LAW 641-42 (1857).

regretted, and often criticised. And certainly it does not appear to have been necessary for the decision of the cause.<sup>259</sup>

## 2. Bankruptcy Law Developments: Individuals and Corporations

It was also about this time that bankruptcy began to diverge into the two strains that are familiar today: namely, personal bankruptcy and business bankruptcy. To this point bankruptcy had begun as personal business bankruptcy and expanded outward. That is, under the early acts only persons engaged in business could be subjected to bankruptcy, and while that requirement was relaxed over time, it still remained true that most bankruptcy cases involved business or investing to some degree.<sup>260</sup> After all, widely available consumer credit was still several decades away.

The key change that developed in the decade before the Civil War was the increasing use of corporations in place of sole proprietorships and partnerships.<sup>261</sup> Initially, what precisely a corporation was remained unclear—sometimes being something more like a partnership and other times being something more like the business entity we know today.<sup>262</sup> Until 1830, Massachusetts provided that past and present shareholders in manufacturing corporations were fully liable for the debts of the corporation.<sup>263</sup>

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259. *Id.* at 643–44.

260. Leonard J. Long, *Emerging from the Shadow: The Bankrupt's Wife in Nineteenth-Century America*, 21 QUINNIPIAC L. REV. 489, 493 (2002) (“Bankruptcy law is chiefly for the relief of business men . . .”); see Edward J. Balleisen, *Bankruptcy and the Entrepreneurial Ethos in Antebellum American Law*, 8 AUSTL. J. LEGAL HIST. 61, 64 (2004); John Fabian Witt, *Narrating Bankruptcy/Narrating Risk*, 98 NW. U. L. REV. 303, 305 (2003).

261. See *Manufacturing Corporations*, 2 AM. JURIST & L. MAG. 92, 94 (1829) (describing the extensive use of corporations as one of the “striking features of [America’s] social system,” which set it apart from England at the time).

262. See *The Liability of Corporators for the Debts of the Corporation*, 4 AM L. MAG. 363, 363–64 (1844) (discussing a South Carolina decision that extended personal liability for corporate debts to the shareholders individually); *Liability of Corporators*, 1 CAROLINA L.J. 217 (1831) (reprinting the trial and appellate opinions from the noteworthy South Carolina case); *Corporations*, 4 AM. JURIST & L. MAG. 298 (1830) (describing the history, variants, and corresponding laws of corporations throughout Europe and the United States). See also Long v. Penn Ins. Co., 6 Pa. 421, 423 (1847) (holding a shareholder personally answerable for the corporation’s debts, as well as a prior pledge of shares as collateral).

263. Donald Kehl, *The Origin and Early Development of American Dividend Law*, 53 HARV. L. REV. 36, 59–60 (1939).

As early as 1829, it was suggested that a bankruptcy system for corporations might be needed, but that specific article sought such a system primarily to enforce the capital contribution obligations of shareholders.<sup>264</sup> In England, the concern was that being a shareholder might subject the shareholder to bankruptcy, under laws that still limited bankruptcy to traders.<sup>265</sup>

Charles Warren tells us that there was an attempt to add corporations to the 1841 Act, but does not explain why that effort failed.<sup>266</sup> And an earlier source actually suggests that the effort to enact a corporate bankruptcy law was distinct from the enactment of the 1841 Act.<sup>267</sup>

In an 1840 letter to Daniel Webster, Justice Story argued:

[I]f corporations, now existing, should be brought within a Bankrupt Law, without such a discharge [for shareholders], it would at once shake all confidence in corporation stock, and depreciate it excessively. The corporation capital in New England would at once lose a large part of its present value, and be scarcely marketable. This would be a sad consummation of all our public calamities, and depress us still more.

I confess, too, I have some doubts, as to the constitutionality of a Bankrupt Law, which should put corporations upon a different footing from individuals, giving the latter a discharge, and not the former; and providing different rules of bankruptcy in the one case from the other. The act would not be a “uniform act on the subject of bankruptcy,” in the sense of the Constitution.<sup>268</sup>

This advisory opinion might have had some influence on the ultimate shape of the Act.<sup>269</sup> Partnerships filed for bankruptcy under the 1841 Act, but for now Congress did not know what to do with corporations.

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264. *Manufacturing Corporations*, *supra* note 261, at 118.

265. *On the Liability of Shareholders in Joint Stock Companies to the Bankrupt Laws*, 1 PROP. L. 230, 230–31 (1826).

266. WARREN, *supra* note 11, at 64–68; *see also* Tabb, *supra* note 182, at 16–17 (noting that the legislators’ final compromise for the 1841 Act excluded corporations).

267. Olmstead, *supra* note 3, at 838.

268. 2 JOSEPH STORY & WILLIAM W. STORY, LIFE AND LETTERS OF JOSEPH STORY 331 (1851).

269. *See* Morris Weissman, *Some Chapters of Bankruptcy History: From the Bankruptcy Clause to the Act of 1898*, 22 J. NAT’L. ASSOC. REFS. IN BANKR. 99, 101 (1948) (opining that the bill that Daniel Webster introduced may even have been drafted by Justice Story).

While many of the state insolvency proceedings of this era involved banks, in 1842 New Jersey's Court of Chancery held that the State's corporate insolvency statute could also apply to nonbank corporations.<sup>270</sup> Several years earlier, the same statute had been applied to a nonbank corporation without question of its applicability.<sup>271</sup> Connecticut reached a similar result in 1857,<sup>272</sup> while Pennsylvania had previously applied its insolvency statute to a turnpike company.<sup>273</sup> And railroads and other corporations could seek relief under the insolvency statutes of Massachusetts at this time.<sup>274</sup>

In short, the states were beginning to experiment with inclusion of corporations within their existing insolvency systems at the very time the federal government was not even sure that it should have an insolvency system. But, as the years progressed, states found that receivership proceedings were better suited to insolvent corporations.<sup>275</sup> This would have significant implications in the decades after the Civil War.

All the while, the precise meaning of the Bankruptcy Clause remained something of a riddle. As the New York Court of Appeals pointedly noted, "There is some difficulty in ascertaining the precise position occupied by the supreme court of the United States upon the subject of state insolvent laws."<sup>276</sup> This confusion remained despite the Supreme Court's effort to offer further clarification five years before.<sup>277</sup> That opinion would be one of many throughout the nineteenth century.

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270. *Parsons v. Monroe Mfg. Co.*, 4 N.J. Eq. 187, 203 (N.J. Ch. 1842); *Brundred v. Paterson Mach. Co.*, 4 N.J. Eq. 294, 304 (N.J. Ch. 1843).

271. *Goodheart v. Raritan Mining & Mfg. Co.*, 8 N.J. Eq. 73 (N.J. Ch. 1849) (applying state insolvency statute, but ultimately dismissing case for lack of evidence of insolvency).

272. *See Platt v. N.Y. & Bos. R.R. Co.*, 26 Conn. 544, 572 (1857) (dispensing with the argument that the exclusion of non-bank, private corporations follows from the statute's exclusion of municipal corporations).

273. *Huntingdon, Cambria & Ind. Tpk. Co. v. Wallace*, 8 Watts 316 (Pa. 1839).

274. *Perry Mfg. Co. v. Brown*, 19 F. Cas. 299, 300 (C.C.D. Mass. 1847); *Johnson v. Somerville Dyeing & Bleaching Co.*, 81 Mass. (15 Gray) 216, 218 (1860); *Cheshire Iron Works v. Gay*, 69 Mass. (3 Gray) 531, 534 (1855); *cf. Whittenton Mills v. Upton*, 76 Mass. (10 Gray) 582, 598 (1858) (emphasizing the need to "protect the stockholders from liabilities which the charter and laws do not create").

275. *Cf. Galwey v. U.S. Steam Sugar-Ref. Co.*, 36 Barb. 256, 257 (N.Y. Gen. Term 1861) (differentiating between situations best suited for receiverships and insolvency proceedings, respectively).

276. *Donnelly v. Corbett*, 7 N.Y. 500, 503 (1852).

277. *See Cook v. Moffat*, 46 U.S. (5 How.) 295, 299-305 (1847) (explaining and applying the Court's prior holdings on the interstate effect of state insolvency laws).

*E. After the Civil War*

On the cusp of the modern era, state legislatures continued to exercise their power to enact bankruptcy laws. The judiciary was creating the modern law of corporate reorganization. The meaning of Congress's power under the Bankruptcy Clause remained the subject of debate, and the power itself was frequently unused. And although the federal government was disinclined to utilize its power under the Bankruptcy Clause, an effort was made to enact a federal bankruptcy statute in 1861.<sup>278</sup> But the war naturally suspended further efforts in this regard.<sup>279</sup>

Despite *Saunders's* strong incentive to keep old insolvency laws in place, and thus maximize their effectiveness, Massachusetts, Vermont, Connecticut, and Maryland passed new insolvency laws just before and after the Civil War.<sup>280</sup> The states also began to experiment with the use of assignments for the benefit of creditors, especially with regard to corporations. After some initial hand-wringing, the courts largely settled on the rule that insolvent corporations could use assignments to liquidate.<sup>281</sup>

And the Supreme Court again attempted to settle the law regarding the Bankruptcy Clause, restating the various rules after noting:

Controversies involving the constitutional effect and operation of State insolvent laws have frequently been under consideration in this court, and unless it be claimed that constitutional questions must always remain open, it must be conceded, we think, that there are some things connected with the general subject that ought to be regarded as settled and forever closed.<sup>282</sup>

Three years later the court repeated its effort again.<sup>283</sup>

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278. Olmstead, *supra* note 3, at 839.

279. See SKEEL, *supra* note 8, at 25 (noting that the issues precipitating the Panic of 1857 were not addressed until the 1867 Act).

280. COLEMAN, *supra* note 31, at 51 (Massachusetts); *id.* at 72 (Vermont); *id.* at 84 (Connecticut); *id.* at 175 (Maryland).

281. See J.L. High, *Assignments by Corporations for the Benefit of Creditors*, 3 S. L. REV. (n.s.) 553, 553-54 (1877) (examining an assignment made under fraudulent circumstances).

282. Baldwin v. Hale, 68 U.S. (1 Wall.) 223, 228 (1863).

283. See Gilman v. Lockwood, 71 U.S. (4 Wall.) 409, 410-11 (1866) (reciting the contemporary bankruptcy doctrine and its subrules in a brusque and formulaic manner and indicating that the doctrine resolved the case at hand).

1. The Bankruptcy Act of 1867: A Response to the Panic of 1857

The federal government returned to the scene in 1867, when Congress passed the third “Act to establish a uniform System of Bankruptcy throughout the United States.”<sup>284</sup> This new federal legislation was a blend of Massachusetts’s insolvency law, provisions taken from the 1841 Act, and a few contemporary English provisions thrown in for good measure.<sup>285</sup>

Like its predecessors, the 1867 Act was enacted in response to the financial panic resulting from a business meltdown. “The Panic of 1857 . . . brought about renewed public discussion of the need [for] a bankruptcy law.”<sup>286</sup> When the Panic hit, lawyers had to resort to state law to handle collection of debts and other financial troubles brought on, at least in part, by rampant speculation in railroads.<sup>287</sup> Because of the war, the response was quite delayed, but when the Nation’s economy struggled to recover after the war, the issue resurfaced.

While the inclusion of voluntary bankruptcy provisions and the question of their constitutionality had generated much debate during the passage of the 1841 Act, by the time Congress considered the 1867 Act, “everyone, lawyers and Courts alike, had so thoroughly accepted the principle of voluntary bankruptcy as being within the Constitutional power of Congress, that the question was not even raised when the Act of 1867 was being debated.”<sup>288</sup> Moreover, several courts at the time expressly rejected the notion that the Bankruptcy Clause only gave Congress the power to enact laws like those that existed in England at the time of either the American Revolution or ratification of the Constitution.<sup>289</sup>

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284. Act of Mar. 2, 1867, ch. 176, 14 Stat. 517 (repealed 1878).

285. T.W.B., *The Jurisdiction of the United States Circuit Court in Bankruptcy, Original and Appellate—The Extent of the Exclusive Original Jurisdiction of the United States District Court in Bankruptcy—The Limited Sphere of the Concurrent Original Jurisdiction of the Circuit and District Courts, Under the Present-Bankrupt Law*, 16 AM. L. REG. 641, 647 (1868).

286. WARREN, *supra* note 11, at 95.

287. Leonard M. Rosen & Jane Lee Vris, *A History of the Bankruptcy Bar in the Second Circuit, in THE DEVELOPMENT OF BANKRUPTCY & REORGANIZATION LAW IN THE COURTS OF THE SECOND CIRCUIT OF THE UNITED STATES* 153, 164 (1995). In 1857, businesses suffered at extraordinary levels. In New York City alone, there were 900 mercantile failures involving over \$120 million of obligations. *Id.* “In 1861, there were 6,993 insolvencies involving \$207,210,427 of liabilities. Of 256 dry goods businesses in New York at the outbreak of the Civil War, only sixteen were still solvent by the end of 1861.” *Id.*

288. WARREN, *supra* note 11, at 87.

289. *See, e.g., In re Cal. Pac. R.R. Co.*, 4 F. Cas. 1060, 1061 (D. Cal. 1874); *In re Silverman*, 22 F. Cas. 135, 136 (D. Or. 1870).



a. *Treatment of Corporations*

One of the most significant of these departures from earlier legislation was the provision of bankruptcy relief for corporations.<sup>290</sup> The 1867 Act was the first federal bankruptcy legislation to allow for corporate bankruptcy.<sup>291</sup>

Indeed, under the 1867 Act, corporations enjoyed the greatest degree of flexibility with respect to filing bankruptcy petitions of any bankruptcy legislation passed in the nineteenth century.<sup>292</sup> Under the Acts of 1800 and 1841, corporate filings were not permitted; even the 1898 Act<sup>293</sup> did not permit voluntary petitions by corporations (though it did allow involuntary filings against corporations) until an amendment in 1910.<sup>294</sup> Moreover, corporations of all types were permitted to file under the 1867 Act,<sup>295</sup> whereas railroads, banks and insurance companies were excluded in 1898, and indeed remain excluded today.<sup>296</sup>

b. *Registers*

The 1867 Act introduced the concept of “non-judicial ‘registers in bankruptcy’ to assist the district courts in administering bankruptcy proceedings.”<sup>297</sup> The Act required each district court judge to appoint “one or more registers in bankruptcy, to assist the judge . . . in the performance of his duties under [the Act].”<sup>298</sup> These appointments were for an indefinite term,<sup>299</sup> and the 1867 Act’s § 3 required that

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290. Vern Countryman, *A History of American Bankruptcy Law*, 81 COM. L.J. 226, 229 (1976).
291. ELIZABETH LEE THOMPSON, *THE RECONSTRUCTION OF SOUTHERN DEBTORS: BANKRUPTCY AFTER THE CIVIL WAR* 122 (2004).
292. *See* *New Lamp Chimney Co. v. Ansonia Brass & Copper Co.*, 91 U.S. 656, 665 (1875) (mentioning that while there were a few special requirements for corporations’ petitions, by and large the provisions applicable to individuals were also applicable to corporations).
293. Act of July 1, 1898, ch. 541, 30 Stat. 544 (repealed 1978).
294. Act of June 25, 1910, ch. 412, § 4, 36 Stat. 838, 839 (amending an Act entitled “An Act to establish a uniform system of bankruptcy throughout the United States”).
295. *See, e.g., In re Indep. Ins. Co.*, 13 F. Cas. 13, 14 (C.C.D. Mass. 1872) (holding an insurance company is covered under the 1867 Act).
296. 11 U.S.C. § 109(b) (2012).
297. David S. Kennedy & R. Spencer Clift, III, *An Historical Analysis of Insolvency Laws and Their Impact on the Role, Power, and Jurisdiction of Today’s United States Bankruptcy Court and its Judicial Officers*, 9 J. BANKR. L. & PRAC. 165, 172 (2000).
298. Act of Mar. 2, 1867, ch. 176, § 3, 14 Stat. 517, 518 (repealed 1878).

such registers in bankruptcy be “counsellors” of the court and learned in the law.<sup>300</sup>

The registers were intended to expedite the bankruptcy process, because it was widely believed that one weakness of earlier bankruptcy legislation had been too much involvement by the judges themselves.<sup>301</sup> Under the Act, registers had the power to conduct preliminary proceedings in the absence of an opposing interest by any party.<sup>302</sup> If, however, any issue of fact or law was raised or contested, the register was required to memorialize the dispute in writing and submit the issue to the court for adjudication.<sup>303</sup>

In an attempt to depoliticize appointments made in connection with the Act, publications such as the *American Law Review* advocated for term limits of three years for the office of “Register in Bankruptcy.”<sup>304</sup> One article bluntly stated: “We should not then have (for Registers) broken-down politicians in whom the prickings of the stomach far exceed the prickings of conscience, nor poor, witless nurselings.”<sup>305</sup>

*c. Shortcomings*

A major objection to the Acts of 1800 and 1841 was the abuse of power by local assignees. As noted by one Congressman: “When [the assignees] get property into their hands the creditors can never get it out of them.”<sup>306</sup> For this reason, strict provisions to govern the

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299. Prudence Beatty Abram & Andrew DeNatale, *From Referee in Bankruptcy to Bankruptcy Judge: A Century of Change in the Second Circuit, in THE DEVELOPMENT OF BANKRUPTCY & REORGANIZATION LAW IN THE COURTS OF THE SECOND CIRCUIT OF THE UNITED STATES*, *supra* note 287, at 59, 65.

300. Act of Mar. 2, 1867, § 3.

301. NOEL, *supra* note 89, at 150.

302. Act of Mar. 2, 1867, § 4 (“[E]very register . . . shall have power . . . to sit in chambers and despatch there such part of the administrative business of the court and such uncontested matters . . .”).

303. *Id.* (“[A]nd he shall also make short memoranda of his proceedings in each case in which he shall act . . . and . . . forward to the clerk of the district court a certified copy of said memoranda . . .”).

304. WARREN, *supra* note 11, at 113.

305. *Id.* (internal citation and quotation marks omitted); *see also* CONG. GLOBE, 39th Cong., 1st Sess. 4025 (1866) (senators debating similar concerns, with one senator proposing that administration of bankruptcies under the new act be placed under state courts, “where the operation of it could be brought home to the people at their own doors”). Some in the Senate sought to have registers appointed by the Chief Justice of the Supreme Court or the circuit court judges, but the plans were denied by the conference committees. NOEL, *supra* note 89, at 151.

306. CONG. GLOBE, 39th Cong., 1st Sess., 778 (1866).

behavior of assignees were included in the 1867 Act.<sup>307</sup> The court-appointed assignee was intended to alleviate these abuses and serve as a fairer way to deal with the issue of property holding during the course of bankruptcy proceedings.<sup>308</sup>

Much discord arose surrounding the fees and complicated administration of the 1867 Act, and, by 1873, public opinion clamored for its repeal.<sup>309</sup> There was concern, especially in the South, that post-Civil War legislation had “gone too far in increasing the powers and jurisdiction of the Federal Courts . . . .”<sup>310</sup> When the Forty-First Session of Congress commenced, its Members set out to drastically amend the 1867 Act.<sup>311</sup>

The unpopularity of the Act was so great, however, that in January 1873, instead of amending the Act, the House of Representatives opted to pass a bill for repeal of the Act.<sup>312</sup> That repeal might have passed the Senate had the Panic of 1873 not commenced in September 1873.

*d. Amendment*

President Grant cited the 1867 Act as the cause of the Panic of 1873, arguing that the 1867 Act “is productive of more evil than good at this time.”<sup>313</sup> The panic is more conventionally traced to the failure

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307. For example, under section 17, “the assignee shall, as soon as may be after receiving any money belonging to the estate, deposit the same in some bank in his name as assignee, or otherwise keep it distinct and apart from all other money in his possession . . . .” Act of Mar. 2, 1867, § 17.

308. CONG. GLOBE, 39th Cong., 1st Sess. 781 (1866).

309. See THOMPSON, *supra* note 291, at 5 (noting discontent in southern states about the increase in the federal courts’ power at the expense of state courts); see also WARREN, *supra* note 11, at 115 n.27 (“Impair confidence, and credit goes.”).

310. WARREN, *supra* note 11, at 114.

311. See THOMPSON, *supra* note 291, at 5 (clamoring for the return of power to state courts).

312. CONG. GLOBE, 42d Cong., 3d Sess. 723 (1873); WARREN, *supra* note 11, at 114.

313. WARREN, *supra* note 11, at 115 (internal citation and quotation marks omitted).

of financier Jay Cooke's bank.<sup>314</sup> But it was evident that the "conditions of the times clearly demanded relief to debtors . . . ."<sup>315</sup>

Thus, when the Senate considered the 1867 Act for repeal, it determined that a need for uniform bankruptcy legislation continued to exist and, accordingly, struck out the repeal clause. Instead of repeal, the Senate opted to include several monumental amendments to the 1867 Act.<sup>316</sup> This reform and overhaul of the 1867 Act so greatly altered the thrust of the legislation that it could be deemed the fourth federal bankruptcy act.

Most importantly, the 1874 Amendments introduced a composition procedure,<sup>317</sup> which in some ways resembled the reorganization provisions contained in modern bankruptcy acts.<sup>318</sup> The provisions in question were modeled on provisions contained in the English Bankruptcy Act of 1869.<sup>319</sup>

The provisions allowed a debtor to remain in possession of his property if a sufficient number of creditors (majority in number and three-fourths in value) accepted the composition proposal.<sup>320</sup> If the proposal was accepted, it was binding on all unsecured creditors named in the composition agreement. Those creditors who "dissented" from the composition were paid according to a "best interests" test. The "best interests" test required that dissenting creditors receive as much payment as they would have received in a liquidation of the assets.<sup>321</sup>

As with the voluntary provision in 1841, some suggested that the composition provision of 1874 was beyond Congress's power under the

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314. A. J. Thomas, Jr. & Ann Van Wynen Thomas, *The Texas Constitution of 1876*, 35 TEX. L. REV. 907, 911 (1957). But it is perhaps unsurprising that Grant would look for other sources of the calamity. David A. Skeel, Jr., *Icarus and American Corporate Regulation*, 61 BUS. LAW. 155, 156 (2005) ("Grant was staying at Cooke's Philadelphia house the night before the [Northern Pacific] railroad venture and Cooke's bank imploded, ushering in a depression known as the Panic of 1873.").

315. WARREN, *supra* note 11, at 117.

316. *See* Act of June 22, 1874, ch. 390, 18 Stat. 178 (amending and supplementing an act entitled "An act to establish a uniform system of bankruptcy throughout the United States"). The 1874 Amendments were introduced and passed after just two hours of debate in the House, by a vote of 219 to 44.

317. Bump, C.F., *Composition in Bankruptcy*, 3 S. L. REV. (n.s.) 507, 507 (1877).

318. Tabb, *supra* note 182, at 20–21.

319. *Compare* Act of June 22, 1874, § 17, *with* Bankruptcy Act, 1869, 32 & 33 Vict., c. 171, § 126 (Eng.).

320. Act of June 22, 1874, § 17.

321. *Id.*

Bankruptcy Clause. In rejecting this arguing, future Supreme Court Justice Blatchford explained:

It cannot be doubted, that congress, in passing laws on the subject of bankruptcies, is not restricted to laws with such scope only as the English bankruptcy laws had when the constitution was adopted. The authority of text writers, and the adjudged cases cited, and the practical construction of the provision of the constitution, by the fact of the enactment of provisions for voluntary bankruptcy, and for putting into involuntary bankruptcy others than traders, and for granting discharges without the consent of any creditor, are satisfactory evidence that the power to establish laws on 'the subject of bankruptcies' gives an authority over the subject, that is not restricted by the limitation found in the English statutes in force when the constitution was adopted. The power given must, indeed, be held to be general, unlimited and unrestricted over the subject.

But the question recurs—what is the subject? The subject is 'the subject of bankruptcies.' 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. It comprises the satisfaction of the debt for a sum less than its amount, with the relief of the debtor from liability for the unpaid balance, and the right of the creditor to require that the amount paid in satisfaction shall be substantially as great a pro rata share of the property possessed by the debtor as it can pay, or can reasonably be expected to pay.<sup>322</sup>

Although innovative, the 1874 legislation was like its predecessors in having a short life, meeting its demise in 1878<sup>323</sup> as part of the full repeal of the 1867 act and its amendments.

The 1867 law, as amended, lasted much longer than its predecessors. But once Southern debtors had overcome the economic problems inherent in being on the losing side of the war, the South resumed its traditional animosity to federal bankruptcy legislation and the statute was repealed.<sup>324</sup>

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322. *In re Reiman*, 20 F. Cas. 490, 496–97 (S.D.N.Y. 1874).

323. Bruce A. Markell, *Clueless on Classification: Toward Removing Artificial Limits on Chapter 11 Claim Classification*, 11 BANKR. DEV. J. 1, 8 (1995).

324. Act of June 7, 1878, ch. 160, 20 Stat. 99 (repealing the 1867 Act); THOMPSON, *supra* note 291, at 4–7.

2. Continuing State Regulation and Growing Use of Receiverships

The states continued to address insolvency, both through their traditional statutes<sup>325</sup> and by the growing use of receiverships, especially with regard to the increasing problem of insolvent corporations.

When receiverships were converted from their traditional uses to a tool of corporate reorganization is somewhat unclear.<sup>326</sup> But it is clear that equity receiverships were used to reorganize railroads—primarily by means of a going concern sale—before the Civil War.<sup>327</sup> And by the late 1870s, the basic law regarding railroad receiverships had fully developed.<sup>328</sup> It would be this law that would develop the concept of corporate reorganization, not to be federalized until the New Deal.<sup>329</sup>

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325. See, e.g., JOSEPH CUTLER, *THE INSOLVENT LAWS OF MASSACHUSETTS, WITH NOTES OF DECISIONS* (3d ed. 1860); RAPHAEL J. MOSES, JR., *STATE INSOLVENT LAWS: A COMPILATION OF THE LAWS ON INSOLVENCY OF THE STATES AND TERRITORIES OF THE UNITED STATES AND CANADA, IN FORCE NOVEMBER 1, 1878* (1879).

326. For example, one antebellum treatise on receiverships in New York does not touch the issue of using a receivership to restructure an insolvent corporation. CHARLES EDWARDS, *ON RECEIVERS IN EQUITY AND UNDER THE NEW YORK CODE OF PROCEDURE; WITH PRECEDENTS* 164–65 (2d ed. 1857).

327. See, e.g., *Milwaukie & Minn. R.R. Co. v. Soutter*, 69 U.S. (2 Wall.) 510, 511 (1864); *Denniston v. Chi., Alton & St. Louis R.R. Co.*, 7 F. Cas. 482, 483 (C.C.N.D. Ill. 1864); *Ohio & Miss. R.R. Co. v. Davis*, 23 Ind. 553, 555 (1864); *Rankine v. Elliott*, 16 N.Y. 377, 379 (N.Y. 1857).

328. Leonard A. Jones, *Receivers of Railways*, 4 S. L. REV. (n.s.) 18, 18 (1878) (“The whole subject is one of recent growth, and many of the most important decisions embraced within it have been rendered within two or three years . . .”). Important ancillary questions, like whether the receiver could be liable for torts committed by railroad employees, remained points of contention. See L. McMillen, *The Liability of a Railroad Company, Whose Property is Under the Management of a Receiver, for Negligence of Employes [sic]*, 10 W. JURIST 385 (1876).

329. A good summary of this law at a late stage of development, given by one of its leading practitioners, can be found in Paul D. Cravath, *The Reorganization of Corporations; Bondholders' and Stockholders' Protective Committees; Reorganization Committees; and the Voluntary Recapitalization of Corporations*, in FRANCIS LYNDE STETSON ET AL., *SOME LEGAL PHASES OF CORPORATE FINANCING, REORGANIZATION AND REGULATION* 153 (1922). There were unsuccessful efforts during this time to pass federal legislation regarding the receivership process. See, e.g., *Rights of Railroad Mortgagees*, 12 W. JURIST 280, 280–81 (1878) (discussing proposed legislation to allow creditors more say in the appointment of receivers). And at least one state (Kentucky) passed a receivership statute. Act of Mar. 17, 1896, ch. 21, 1896 Ky. Laws 29 (providing for the reorganization of railroad and bridge companies); see also *The Reorganization of Railway and Other Corporations*, 30 AM. L.

The basic problem turned on the capital structure of the enterprise, and the desire to maintain the value of the concern as a whole:

When a corporation approaches bankruptcy, it usually occurs that different portions of its property have been pledged as security for various issues of bonds. If the company is operating a railroad, for example, there are several first mortgages covering the different divisions of the main line of the railroad. Then over these is probably spread the lien of a general or blanket mortgage. Tributary to the main line of the railroad are a number of branch lines, and each one of these may carry mortgages to secure issues of bonds. These bonds have probably been delivered to the parent company . . . . The parent company may have pledged the bonds as security for an issue of collateral trust bonds. The equipment of the company may be covered by the lien of a car trust lease. . . . Suppose, now, each one of these creditors should undertake to enforce his claim against the company, which he has the undoubted right to do. Is it not evident that the property would be completely disintegrated in the contest of creditors?<sup>330</sup>

To solve this conundrum, the reorganization process used all this secured debt, and the right to foreclose, for new ends. As the Supreme Court explained in 1883:

[I]t rarely happens in the United States that foreclosures of railway mortgages are anything else than the machinery by which arrangements between the creditors and other parties in interest are carried into effect, and a reorganization of the affairs of the corporation under a new name brought about. It is in entire harmony with the spirit of bankrupt laws, the binding force of which, upon those who are subject to the jurisdiction, is recognized by all civilized nations. It is not in conflict with the Constitution of the United States, which, although prohibiting States from passing laws impairing the obligation of contracts, allows Congress 'to establish . . . uniform laws on the subject of bankruptcy throughout the United States.'<sup>331</sup>

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REV. 801 (1896) (discussing the Kentucky law). The Kentucky law, of course, simply raised the inevitable state-federal question that had been at the heart of the Bankruptcy Clause since the Constitution's adoption.

330. EDWARD SHERWOOD MEADE, CORPORATION FINANCE 406-07 (1910).

331. *Can. S. Ry. Co. v. Gebhard*, 109 U.S. 527, 539 (1883).

Early cases were typically brought in state court,<sup>332</sup> and after the Civil War receiverships continued, maintaining an uneasy coexistence with the 1867 Bankruptcy Act, which only allowed railroads to be liquidated thereunder.<sup>333</sup> Eventually, receiverships could be brought by the insolvent railroad's own management or at their behest.<sup>334</sup>

It was in federal court that the equity receivership process truly developed into the forerunner of today's Chapter 11.<sup>335</sup> Federal jurisdiction made a key difference here: while state court judges were typically limited to their home state, or even to their home county, federal judges could assert nationwide jurisdiction over a debtor by filing a main petition along with simultaneous ancillary petitions against a debtor.<sup>336</sup> In the days of circuit judges, such a judge could enter all relevant petitions against a debtor within the entire circuit in a single proceeding.<sup>337</sup>

The creation of the receivership produced something akin to today's "automatic stay," in that the receiver could not be the subject of suit without the appointing court's approval.<sup>338</sup> While the receivers

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332. In Vermont, one such receivership was commenced "prior to 1861" and remained pending in the early 1880s. M.M. Cohn, *Railroad Receiverships—Questions of Practice Concerning Them*, 19 AM. L. REV. 400, 410 (1885).

333. See, e.g., *In re Union Pac. R.R. Co.*, 24 F. Cas. 624, 625 (D. Mass 1874); *Kelly v. Ala. & Cincinnati R.R. Co.*, 58 Ala. 489, 500 (1877). H. Campbell Black, *Corporations Under the Bankruptcy Act of 1898*, 8 YALE L.J. 105, 106 (1898).

334. D.H. Chamberlain, *New-Fashioned Receiverships*, 10 HARV. L. REV. 139, 141–42 (1896).

335. See, e.g., *Wilmer v. Atlanta & Richmond Air Line Ry. Co.*, 30 F. Cas. 73, 74 (C.C.N.D. Ga. 1875); *Kennedy v. St. Paul & Pac. R.R. Co.*, 14 F. Cas. 321, 323 (C.C.D. Minn. 1873). One of the best primers on receiverships in this general area is Adrian H. Joline, *Railway Reorganizations*, 8 AM. LAW. 507 (1900).

336. *Farmers' Loan & Trust Co. v. Lake St. Elevated R.R. Co.*, 177 U.S. 51, 61 (1900). As Joline, *supra* note 335, at 510, notes, the ancillary receivership process did develop some problems. In particular, state and federal courts often entered competing receiverships.

337. *Wilmer*, 30 F. Cas. at 73; see also James Byrne, *The Foreclosure of Railroad Mortgages in the United States Courts*, in STETSON ET AL., *supra* note 329, at 77, 92 (1922) ("Meanwhile other assistants are waiting near a circuit judge in each of the other circuits where any substantial portion of the mortgaged property is situated with the papers in the ancillary suits which are to be filed there. As soon as a telegram or a telephone message tells them that the suit in the principal court has been begun and receivers appointed, the pleadings in the ancillary suits are verified and presented to the circuit judge having jurisdiction and he signs orders appointing receivers in all the courts in his circuit.").

338. *Davis v. Gray*, 83 U.S. (16 Wall.) 203, 218 (1872).



operated the railroad, they could “spruce it up” by issuing priority receivers certificates, an early form of negotiable DIP financing.<sup>339</sup>

The receiverships of this era also laid the groundwork for the “first day” orders of today.<sup>340</sup> Arguing that secured creditors were only entitled to the net income of the debtor, the Supreme Court cleared the way for full payment of trade creditors who had provided the debtor with goods and services on the eve of the receivership.<sup>341</sup> Since railroads were deemed a kind of quasi-utility that could not be allowed to liquidate,<sup>342</sup> the Court soon found it necessary to expand the debtor’s ability to pay trade creditors in full to include those who provided vital goods and services postreceivership as well.<sup>343</sup>

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339. *Wallace v. Loomis*, 97 U.S. 146, 162 (1877) (“The bonds on their face, as prepared for issue and sale, promised payment in lawful money. As such, they were guaranteed by the State.”); *Credit Co. of London v. Ark. Cent. R.R. Co.*, 15 F. 46, 49 (C.C.E.D. Ark. 1882) (noting that “it is a power to be sparingly exercised” as it is “liable to great abuse”); *Stanton v. Alabama & C.R. Co.*, 22 F. Cas. 1065, 1068 (C.C.S.D. Ala. 1875) (finding an abuse of the priority certificate power); see also George H. Walker, *The Priority of Receivers’ Certificates Over Mortgage Liens*, 5 COLUM. L.T. 96 (1891) (discussing the rapid spread of receivers’ certificates and the relatively little case law concerning them).
340. Compare Erskine Hazard Dickson, *Liens of the Receivership of a Business Corporation—Part 1*, 47 AM. L. REG. 273, 275–76 (1899) (the receiverships of old), with Daniel A. Austin, *Bankruptcy and the Myth of “Uniform Laws”*, 42 SETON HALL L. REV. 1081, 1130–31 (2012) (the “first day” orders of today).
341. *Fosdick v. Schall*, 99 U.S. 235, 241 (1878); see also *Burnham v. Bowen*, 111 U.S. 776, 776 (1883) (“Debts contracted by a railroad corporation as part of necessary operating expenses (for fuel, for example), the mortgage interest of the company being in arrear at the time, are privileged debts, entitled to be paid out of current income, if the mortgage trustees take possession or if a receiver is appointed in a foreclosure suit.”).
342. *Barton v. Barbour*, 104 U.S. 126, 135 (1881) (“[T]he cessation of business for a day would be a public injury. A railroad is authorized to be constructed more for the public good . . . than for private gain. As a highway for public transportation it is a matter of public concern, and its construction and management belong primarily to the Commonwealth, and are only put into private hands to subserve the public convenience and economy. . . . They take their rights subject to the rights of the public . . .”).
343. See *Miltenberger v. Logansport Ry. Co.*, 106 U.S. 286, 311–12 (1882) (“[P]ayment of that class of claims was indispensable to the business of the road, and that, unless the receiver was authorized to provide for them at once, the business of the road would suffer great detriment.”). The link between these cases and the first-day motions of today was made explicit in early cases under the 1978 Code, particularly in the Eastern Airlines bankruptcy. See *In re Ionosphere Clubs, Inc.*, 98 B.R. 174, 175–76 (Bankr. S.D.N.Y. 1989) (referring to those precedents as establishing “the doctrine of necessity” or “necessity of payment” rule). Of course, there is

When the creditors had agreed on a new capitalization of the railroad, and the rate at which old securities would be exchanged for new, the railroad was sold at foreclosure to a new legal entity.<sup>344</sup> This created something close to the present discharge under today's Chapter 11, as unpaid creditors were left behind with claims against an assetless corporate shell.<sup>345</sup>

#### IV. THE MODERN ERA

##### A. 1880s

##### 1. Continuing Debate Influenced by Growth of Interstate Commerce and the Fourteenth Amendment

The 1880s saw the continued development of state insolvency laws, while business reorganization developed in parallel in receivership proceedings.<sup>346</sup> Throughout, the debate continued over the meaning of the Bankruptcy Clause, and whether insolvency was best handled at the state or federal level. While the debate persisted, states continued to operate their own insolvency systems.<sup>347</sup> And the Supreme Court continued its seemingly endless efforts to explain the contours of the Bankruptcy Clause.<sup>348</sup>

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no public policy against liquidation of most modern debtors, which calls into question the generalization of the railroad rule or at least suggests the need for other justification for the extension of the rule.

344. FREDERICK S. WAIT, *A PRACTICAL TREATISE ON INSOLVENT CORPORATIONS, INCLUDING THE LIQUIDATION, RE-ORGANIZATION, FORFEITURE, DISSOLUTION, AND WINDING-UP OF CORPORATIONS* 387 (1888). Details of several of the largest receiverships can be found in STUART DAGGETT, *RAILROAD REORGANIZATION* (1908).
345. Importantly, these receiverships predated the development of many modern theories of successor liability and de facto merger. *See, e.g.*, DAGGETT, *supra* note 344, at 23–29 (expounding on the receivership of a large railroad in the late nineteenth century, well before modern successor liability doctrine).
346. Receivership practice in this period is nicely detailed in Albert Gallup, *Railway Mortgages and Receiver's Debts in the United States*, 4 L.Q. REV. 300 (1888). For state laws of this era, see, for example, Prescott F. Hall, *Voluntary Assignments and Insolvency in Massachusetts*, 8 HARV. L. REV. 265 (1894).
347. *See, e.g.*, *Brown v. Smart*, 145 U.S. 454, 458–59 (1892) (upholding a filing under the Maryland law).
348. *See, e.g.*, *Denny v. Bennett*, 128 U.S. 489, 495–98 (1888) (“[T]he established construction of the Constitution of the United States against impairing the obligation of contracts requires that [state] statutes of this class shall be construed to be parts of all contracts made when they are in existence, and therefore cannot be held to impair their obligation.”).

The growth of interstate commerce after the Civil War produced a corresponding desire for greater uniformity in debtor-creditor law, which naturally suggested the need for federal legislation.<sup>349</sup> But advocates of state insolvency laws noted that this need not be the case, rather it was argued:

[I]t is uniformity in the rules as to bankruptcy preferences and composition that is desired rather than uniformity of procedure. The commercial want would be met substantially if the State insolvent laws were so far modified that the same tests of insolvency, the same rule as to giving preferences and securing favored creditors, the same rule as to the results of vigilant hostile proceedings, and the same as to compromises, were in force throughout the country, and it would matter little what courts or what diverse practice prevailed in reaching these results.<sup>350</sup>

At the same time, others were observing that the war and the Constitutional amendments that resulted—most importantly the Fourteenth Amendment—had changed the nature of the discussion.<sup>351</sup>

Thus, in an 1888 article, Conrad Reno, a well-known Boston attorney, argued that the various rules regarding state insolvency laws were better seen as rooted in due process, now applicable to the states under the Fourteenth Amendment, rather than the Contract Clause.<sup>352</sup> And later, Hollis Bailey, another leading Boston attorney,<sup>353</sup> would argue that *Saunders's* “second holding” that prohibiting the discharge of claims held by out-of-state creditors was unfortunate—inasmuch as it resulted in a great mass of confusion among the states—and the issue was better seen as a question of jurisdiction, rather than a result mandated by either the Bankruptcy or Contract Clauses.<sup>354</sup>

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349. Seymour D. Thompson, “*Foreign*” *Receivers and Judicial Assignees*, 6 GREEN BAG 170, 173 (1894).

350. *A Uniform System of Bankruptcy*, 14 W. JURIST 486, 487 (1880).

351. See H. Campbell Black, *Legislation Impairing the Obligation of Contracts*, 34 AM. L. REG. 81, 90 (1886).

352. Conrad Reno, *Ogden v. Saunders Reviewed*, 36 AM. L. REG. 611, 612–16 (1888).

353. *Cf. Dana v. Dana*, 250 U.S. 220 (1919) (a famous tax case in which Bailey argued).

354. Bailey, *supra* note 115, at 353.

2. Moving Toward a Permanent Federal Bankruptcy Law

The 1880s also began the long march to a permanent federal bankruptcy law.<sup>355</sup> Beginning with Chester Arthur, every Republican President of the late nineteenth century—which is to say, every President, save Cleveland—expressed support for a national bankruptcy law. Cleveland himself supported a bankruptcy law, but it was a very different sort of bankruptcy law than the Republicans had in mind.

The Democrats generally supported the so-called Bailey Bill, a temporary law that would have provided voluntary relief to those who had suffered in the many financial panics that occurred after the Civil War.<sup>356</sup> The Republicans, on the other hand, supported the Torrey Bill, named after Jay Torrey, an attorney who drafted a proposed law at the behest of merchants.<sup>357</sup> His initial draft was highly reminiscent of the bankruptcy laws of pre-Revolution England: the law provided a way for creditors to force debtors into bankruptcy involuntarily, while debtor discharges would have been hard to obtain.<sup>358</sup>

These two basic laws kicked around Congress for more than a decade, until finally the two were melded into a bill that all could support.<sup>359</sup> And with President McKinley's signature on the 1898 Act,<sup>360</sup> in the midst of the Spanish-American War,<sup>361</sup> the era of state insolvency laws came to an end, while a new understanding of the federal bankruptcy power began to develop.

*B. The 1898 Bankruptcy Act*

One participant in the new bankruptcy system argued that the 1898 law had three main goals:

1. To reduce the fees and expenses to a minimum, and to give to the creditors the control of the settlement of estates, and

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355. See NOEL, *supra* note 89, at 157–58 (describing the cycle of speculation and subsequent panic that led lawmakers to realize “that it was a mistake to deprive the country of bankruptcy legislation”).

356. The story of the various bankruptcy bills is well told, in greater detail, in Charles Jordan Tabb, *A Century of Regress or Progress? A Political History of Bankruptcy Legislation in 1898 and 1998*, 15 BANKR. DEV. J. 343 (1999).

357. See SKEEL, *supra* note 8, at 37 (discussing the Torrey bill).

358. Tabb, *supra* note 356, at 367.

359. SKEEL, *supra* note 8, at 40–44.

360. Act of July 1, 1898, ch. 541. 30 Stat. 544 (repealed 1978).

361. Indeed, on that very day Roosevelt and Jay Torrey, author of the Torrey Bill, charged San Juan Hill. Bruce A. Markell, *Introduction: Bankruptcy, Impeachment, and History*, 15 BANKR. DEV. J. 253, 255 n.11 (1999).

thereby to provide that the assets of the bankrupt shall go to his creditors rather than to officers and lawyers.

2. To provide that all bankrupts and impecunious persons, whether they have assets or not, shall obtain a discharge from their debts at a nominal expense, and thereby make it unnecessary for any man in the United States to be longer hampered by a load of debt which he is unable to pay.
3. To enforce the acceptance of compositions, and thereby put it out of the power of a few creditors to prevent the acceptance of terms of settlement offered by an insolvent, when manifestly better for the whole mass of creditors than a legal settlement of his affairs.<sup>362</sup>

The most important aspect of the 1898 Act was that it was permanent, inasmuch as it contained no inherent expiration date. Congress could repeal the law, and several attempts at repeal would be made, but there was no inborn end point to the law.<sup>363</sup>

Nonetheless, at least one author worried that the relatively generous discharge provisions of the 1898 Act would impair its permanence, making it more like the temporary relief measures that had come and gone before. Apparently referring to the principle outlined in Deuteronomy,<sup>364</sup> he argued:

It is perfectly apparent, however, that there exists among some judges, on the floors of Congress and in the community, a fallacious and superficial view that bankruptcy legislation should partake of the nature of a “Hebrew Jubilee,” and that at intermittent periods the country should have such a law for the purpose of relieving the unfortunate debtor from his burden of debt. While the humanitarian or relief features are meritorious, it should be constantly borne in mind that this principle of the law is merely an incident to its main purpose, and should not prove a menace to the *permanency* of a system intended for the perpetual benefit of merchants in general. If the “Hebrew Jubilee” idea is to prevail, the country will be confronted with successive repeals as heretofore . . . .<sup>365</sup>

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362. Henry G. Newton, *The United States Bankruptcy Law of 1898*, 9 YALE L.J. 287, 287 (1899). In this article, the author suggests that he served as a referee under the Act. *Id.* at 289.

363. The first effort at repeal was voted down in 1902. NOEL, *supra* note 89, at 161.

364. *See supra* Part I.A.

365. Olmstead, *supra* note 3, at 843.

Others fretted that repeal of the law would reduce the United States to the rank of countries like China and Japan, the implication of the argument being that all “civilized” nations had bankruptcy laws.<sup>366</sup> Indeed, it was no accident that the passage of the 1898 Bankruptcy Act coincided with the birth of the kind of nationwide economy that Alexander Hamilton had dreamed of at the beginning of the century.<sup>367</sup>

1. Distinct from English Bankruptcy Law

The 1898 Act also represented a clear break from the English-inspired, creditor-controlled federal systems of earlier years. Cases were placed with referees, who were appointed by the district courts.<sup>368</sup> Initially, the district judge would refer certain administrative tasks, including the liquidation and distribution of the estate, to the referee, while retaining formal judicial responsibility for the case.<sup>369</sup> As the number of bankruptcy cases and workload of the district courts increased, the judges began to cast off some of their judicial power to the referees.

The Act provided for either a composition with creditors, reviving the innovation first introduced in 1874, or a discharge after liquidation.<sup>370</sup> Unlike its predecessors, the new bankruptcy law did not require a creditor vote before discharge.

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366. Amos Burt Thompson, *The Bankruptcy Act of 1898 in Operation*, 6 W. RES. L.J. 157, 162 (1900).

367. See Norman W. Hawker, *Triumph of the Whigs: The Fifty-Fifth Congress and the Bankruptcy Act of 1898*, 15 MIDWEST L. REV. 109, 109–11 (1997) (discussing the political aspects of the dawn of the Gilded Age); see also Larry Neal & Lance E. Davis, *Why Did Finance Capitalism and the Second Industrial Revolution Arise in the 1890s?*, in FINANCING INNOVATION IN THE UNITED STATES: 1870 TO PRESENT 129 (N. Lamoreaux & K. Sokoloff eds., 2007) (examining the transformative effects of the era’s rapid technological and financial innovation).

368. As one treatise explained:

The administration of each law is confided to particular United States courts, designated as courts of bankruptcy. These courts act to a large extent through special officers, subject to have their action reviewed by the judge. In 1867 these officers were called registers and assignees; in 1898 they are called referees and trustees.

LOVELAND, *supra* note 237, at 15.

369. See, e.g., *Gilbertson v. United States*, 168 F. 672, 674 (7th Cir. 1909) (rejecting the argument that the district judge’s delegation of administrative matters to a referee meant that the debtor was not properly adjudicated bankrupt under the Act).

370. Thompson, *supra* note 366, at 157.

2. Distinguishing Personal and Business Bankruptcy

It is in this law that we also begin to see a relatively clear separation between business and personal bankruptcy.<sup>371</sup> But often these changes made the federal bankruptcy system less useful to business debtors.<sup>372</sup>

For example, until an amendment in 1910, the federal bankruptcy law did not allow corporations to enter bankruptcy voluntarily<sup>373</sup>—in that sense reflecting an older view of commercial bankruptcy, albeit one that had in the past applied to individuals as traders.<sup>374</sup> This also represented a change from the 1867 Act, as was the requirement of insolvency for petitions filed under the 1898 Act.<sup>375</sup> And since the advent of corporate bankruptcy in 1867, discharges were never granted to corporate debtors: corporate bankruptcy was a liquidation-only affair.<sup>376</sup>

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371. See Harold Remington, *Bankruptcy Law and Peaceable Settlements of Business Failures*, 18 YALE L.J. 590, 592–93 (1909) (describing the new law as emphasizing fairness among creditors, rather than simply fairness between creditors and debtors).

372. See Benjamin L. Bird, *Financial Associations Which May Be Reorganized Under Section 77B of the Bankruptcy Act*, 15 TEX. L. REV. 65, 70–71 (1936) (explaining that one weakness of the 1898 Act was its reliance upon “powers conferred upon the company [by the state], not [the company’s] activities” to determine the Act’s applicability).

373. Future Chief Justice and President Taft rejected a challenge to the Act’s constitutionality on this basis, where the debtor argued that a law that distinguished between natural and artificial persons was not uniform, as required by the Bankruptcy Clause. *Leidigh Carriage Co. v. Stengel*, 95 F. 637, 646–47 (6th Cir. 1899).

374. LOVELAND, *supra* note 237, at 15; see also C.E.K., Jr., Note, *Right of the Directors of a Corporation to File for It a Voluntary Petition in Bankruptcy*, 2 WASH. U. L. REV. 97, 98 (1917) (“In respect to corporations, there being no special provisions in the bankruptcy act, reference must be made to the state statute controlling the authority of officers and directors of corporations to dispose of the property of the corporation for the benefit of its creditors.”).

375. Black, *supra* note 333, at 112–13; see also Carleton A. Shafer, *Can the Directors of a Solvent Corporation Without the Authority from the Stockholders, by a Resolution, Admitting the Corporation’s Inability to Pay Its Debt Commit the Fifth Act of Bankruptcy?*, 1 L. REV. L. DEP’T. U. DET. 1 (1916) (bringing together the decisions and statutes that bear upon the fifth act of bankruptcy—the 1898 Act—and examining their interaction with the powers of a corporation’s board of directors, including discussion on corporate admission of insolvency).

376. See Act of Mar. 2, 1867, ch. 176, § 37, 14 Stat. 517, 534–35 (establishing a uniform System of Bankruptcy throughout the United States) (repealed 1898) (“No allowance or discharge shall be granted to any corporation . . . , [and] whenever any corporation by proceedings under this act shall be declared bankrupt, all its property and assets shall be distributed to the creditors of such corporations . . .”).

And most importantly from a business perspective, railroads, which made up the majority of very large corporations at the time,<sup>377</sup> were no longer allowed to file a bankruptcy petition, as the 1898 Act replaced the 1867 Act's general provision allowing "moneyed . . . corporations" to file with a provision that instead enumerated specific types of corporations that were eligible.<sup>378</sup> But, as already noted, even before the 1898 Act was adopted, businesses had found a better way to address financial distress.<sup>379</sup>

When this new order was challenged, the Supreme Court favorably cited the lower court opinions supporting the prior bankruptcy laws, and held that "Congress may prescribe any regulations concerning discharge in bankruptcy that are not so grossly unreasonable as to be incompatible with fundamental law, and we cannot find anything in this act on that subject which would justify us in overthrowing its action."<sup>380</sup> Thus, the scope of the Bankruptcy Clause finally seemed to be reaching its full Hamiltonian potential.

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377. See STEPHEN SALSURY, *NO WAY TO RUN A RAILROAD: THE UNTOLD STORY OF THE PENN CENTRAL CRISIS* 3–4 (1982) (listing the pioneering effects of railroads, including innovations in finance, corporate entity law, cost accounting, business administration, competition, and labor relations).

378. Black, *supra* note 333, at 106. As initially drafted, the enumeration proved too narrow; see also R. Jackson Cram, Comment, *Corporations Subject to Bankruptcy*, 19 GREEN BAG 529 (1907) (describing the 1898 Act as "defective").

379. See LOVELAND, *supra* note 237, at 279 (indicating that the railroads did not need inclusion in the 1898 Bankruptcy Act because, even before the act, insolvent railroads could close up their affairs under existing statutes); see also E.G. CAMPBELL, *THE REORGANIZATION OF THE AMERICAN RAILROAD SYSTEM, 1893–1900* (1938) (detailing how the Panic of 1893 and the resultant economic depression forced a rethinking of conventional railroad organization and financing).

380. *Hanover Nat'l Bank v. Moyses*, 186 U.S. 181, 192 (1902). The case remains a key decision on the "uniformity" requirement in the Clause. In another case, the Supreme Court explained:

The Federal Constitution, Article I, § 8, gives Congress the power to establish uniform laws on the subject of bankruptcy throughout the United States. In view of this grant of authority to the Congress it has been settled from an early date that state laws to the extent that they conflict with the laws of Congress, enacted under its constitutional authority, on the subject of bankruptcies are suspended. While this is true, state laws are thus suspended only to the extent of actual conflict with the system provided by the Bankruptcy Act of Congress.

Notwithstanding this requirement as to uniformity the bankruptcy acts of Congress may recognize the laws of the State in certain particulars, although such recognition may lead to different results in different States. For example, the Bankruptcy Act recognizes and enforces the laws of the States affecting dower, exemptions, the validity of mortgages,



### 3. Structure

The structure of the 1898 Act is easily understood by anyone who is familiar with today's Bankruptcy Code.<sup>381</sup> Chapter I set forth general definitions. Chapter II addressed bankruptcy courts. Chapter III defined the relevant universe of debtors and the effects of filing a case, including the effects of the discharge. Chapter IV addressed bankruptcy procedure. Chapter V defined the roles of various officers in the case, like trustees, clerks, marshals, and the referees and provided for their compensation. Chapter VI set forth the rules regarding creditors' meetings and proof of claims. Chapter VII set forth the concept of the bankruptcy estate.<sup>382</sup>

In a short twenty pages, the United States had acquired a full-fledged bankruptcy law, and Congress had begun to explore the boundaries of its powers under the Bankruptcy Clause. And in an acknowledgement of what had come before, the last sentence of the original 1898 Act provides that “[p]roceedings commenced under State insolvency laws before the passage of this Act shall not be affected by it.”<sup>383</sup>

Within five years, more than 14,000 voluntary cases and 2,500 involuntary cases were being filed under the Act each year.<sup>384</sup> Almost 3,000 cases were filed *in forma pauperis*.<sup>385</sup>

#### *C. Pre-New Deal Amendments and Continued Debate over Congress's Power Under the Bankruptcy Clause*

While the 1898 Act would remain in effect until it was heavily amended during the New Deal and repealed with the 1978

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priorities of payment and the like. Such recognition in the application of state laws does not affect the constitutionality of the Bankruptcy Act, although in these particulars the operation of the Act is not alike in all the States.

Stellwagen v. Clum, 245 U.S. 605, 613 (1918) (internal citations omitted).

381. See Walter W. Miller, Jr., *Fraudulent Conveyances—Some Reflections on Section 70a(4) of the Bankruptcy Act*, 48 B.U. L. REV. 222, 228 (1968) (“The Act of 1898, both before and after its later amendments including the Chandler Act revision of 1938, is characterized by fragmentation and disorganization.”).

382. Act of July 1, 1898, ch. 541. 30 Stat. 544 (repealed 1978).

383. 30 Stat. at 566.

384. Edwin C. Brandenburg, *Practical Operation of the Bankruptcy Law*, 21 BANKING L.J. 26, 26–27 (1904).

385. *Id.* at 28.

Bankruptcy Code,<sup>386</sup> significant interim amendments were enacted in 1903, 1906, 1910, 1917, 1922, 1925, and 1926.<sup>387</sup>

As late as 1919, Noel worried that attempts to further amend the Act might result in full repeal, which suggests that the nature of Congress's power under the Bankruptcy Clause remained unsettled.<sup>388</sup> Further to this point, in 1929 the Supreme Court was still trying to explain the effect of the Bankruptcy Clause on state insolvency laws, despite more than thirty years under the 1898 Act.<sup>389</sup>

At the same time, receiverships came under increasing scrutiny and criticism.<sup>390</sup> By the early 1930s, even a key player in the largest receiverships, Robert Swaine of the Cravath firm conceded:

[Even] apart from the tendency of the present practice to break up the business which the courts are, at least theoretically, endeavoring to preserve, the waste and expense to creditors and security holders of the legal machinery thus brought into play is intolerable. Each receivership in each district in which it is necessary to bring proceedings involves a fee to counsel for the plaintiff, for the defendant, and for the receivers in that district, and if any additional receiver is appointed for the property

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386. Act of Nov. 6, 1978, Pub. L. 95-598, § 401, 92 Stat. 2549, 2682 (repealing the 1898 Act and its amendments).

387. Act of Feb. 5, 1903, Pub. L. No. 57-62, 32 Stat. 797 (repealed 1978); Act of June 15, 1906, Pub. L. No. 59-232, 34 Stat. 267 (repealed 1978); Act of June 25, 1910, Pub. L. No. 61-294, 36 Stat. 838 (repealed 1978); Act of Mar. 2, 1917, Pub. L. No. 64-376, 39 Stat. 999 (repealed 1978); Act of Jan. 7, 1922, Pub. L. No. 67-121, 42 Stat. 354 (repealed 1978); Act of Feb. 13, 1925, Pub. L. No. 68-415, § 128(c), 43 Stat. 936 (repealed 1978); Act of May 27, 1926, Pub. L. No. 69-301, 44 Stat. 662 (repealed 1978).

388. NOEL, *supra* note 89, at 166–67.

389. See *Int'l Shoe Co. v. Pinkus*, 278 U.S. 261, 264–65 (1929) (holding an “application to the state court for the appointment of a receiver was an act of bankruptcy” that “operate[d] within the field occupied by the Bankruptcy Act [of 1898]”); see also Note, *Effect of National Bankruptcy Act on State Insolvency Statutes*, 49 YALE L.J. 1090, 1090 (1940) (discussing the impact of the 1898 Act on state insolvency laws).

390. See Henry J. Friendly, *Some Comments on the Corporate Reorganizations Act*, 48 HARV. L. REV. 39, 41–46 (1934) (noting that case law had also become increasingly hostile to many of the procedures used); Stephen J. Lubben, *Railroad Receiverships and Modern Bankruptcy Theory*, 89 CORNELL L. REV. 1420, 1469–71 (2004) (discussing the “attack on receiverships”). For a good overview of receiverships at their peak, see Charles Thomas Payne, *The General Administration of Equity Receiverships of Corporations*, 31 YALE L.J. 685 (1922).

within the district, still another fee to that “ancillary receiver.”<sup>391</sup>

*D. New Deal Amendments and the 1938 Chandler Act:  
Expanding the Bankruptcy Clause*

The 1929 market crash, the resulting Great Depression, and the advent of the New Deal brought all of these issues to a head, with one further round of debate about the meaning of the Bankruptcy Clause.<sup>392</sup> Specifically, the Depression and New Deal resulted in several partial amendments to the 1898 Act<sup>393</sup> and the 1938 enactment of what is known as the Chandler Act,<sup>394</sup> which substantially revised the 1898 Act in an “amendment” that was longer than the original Act and set the Act’s form until 1978.<sup>395</sup>

Federal reorganization had been introduced early in the New Deal with section 77 for railroads<sup>396</sup> and section 77B for other corporations.<sup>397</sup> The Chandler Act maintained section 77, but it replaced section 77B with a four new business-reorganization chapters.<sup>398</sup> With the addition of these new chapters, the Chandler Act made the 1898 Act fully modern: the addition showed Congress’s willingness to expand the contours of the Bankruptcy Clause to

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391. Robert T. Swaine, *Corporate Reorganization Under the Federal Bankruptcy Power*, 19 VA. L. REV. 317, 320–21 (1933); see also Samuel Spring, *Upset Prices in Corporate Reorganization*, 32 HARV. L. REV. 489, 498 (1918) (describing the public’s interest in reorganization).

392. See Theodore McCurdy Marsh, *Aspects of Corporate Reorganization Under Section 77B of the Bankruptcy Act*, 1 U. NEWARK L. REV. 1, 1–2 (1936) (discussing the purposes of the 1898 Act as liquidation and distribution to creditors rather than reorganization).

393. See ALEXANDER L. PASKAY, HANDBOOK FOR TRUSTEES AND RECEIVERS IN BANKRUPTCY 10 (1968) (“This legislation . . . did not materially alter the basic Act of 1898 . . .”).

394. Act of June 22, 1938, Pub. L. No. 75-696, 52 Stat. 840 (1938) (repealed 1978).

395. See PASKAY, *supra* note 393, at 10 (highlighting the Chandler Act’s changes to the 1898 Act).

396. 11 U.S.C. § 205 (1976) (repealed in part 1978) (current version in scattered sections of 11 U.S.C.). Section 77 was enacted in 1933. Act of Mar. 3, 1933, Pub. L. No. 72-420, sec. 1, § 77, 47 Stat. 1467, 1474.

397. 11 U.S.C. § 207 (1934) (repealed 1938). Section 77B was enacted in 1934. Act of June 7, 1934, Pub. L. No. 73-296, sec. 1, § 77B, 48 Stat. 911, 912. For the details of section 77B, see *Developments in the Law, Reorganization Under Section 77B of the Bankruptcy Act—1934–1936*, 49 HARV. L. REV. 1111 (1936).

398. Act of June 22, 1938 pmb., 52 Stat. at 840; Thomas E. Plank, *The Creditor in Possession Under the Bankruptcy Code: History, Text, and Policy*, 59 MD. L. REV. 253, 269 (2000).

encompass a set of procedures far beyond any that were debated throughout the nineteenth century.

Chapter X of the Chandler Act, titled Corporate Reorganizations,<sup>399</sup> was designed for the large corporate debtor,<sup>400</sup> as distinguished from a partnership or individual. Publicly traded debtors were supervised not only by the court and referee but also by the newly created SEC.<sup>401</sup> Also, a trustee took over the debtor's operations.<sup>402</sup> Most notably, the role of the Wall Street banks and their law firms in reorganization was greatly curtailed.<sup>403</sup>

Chapter XI, titled Arrangements,<sup>404</sup> could be used by an individual, partnership, or corporation<sup>405</sup> but was only designed to address unsecured debt.<sup>406</sup> Although limited in its scope, and thus its utility, the ability of the debtor to maintain control of its own estate under this chapter made it attractive.<sup>407</sup>

At the same time, the Chandler Act also added chapter XII for reorganization of real estate debtors<sup>408</sup> and chapter XIII for wage-earner reorganization.<sup>409</sup> The latter was a federal codification of a system that had been tested out in the South since the onset of the Depression.<sup>410</sup>

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399. 11 U.S.C. §§ 501–676 (1976) (repealed in part 1978) (current version in scattered sections of 11 U.S.C.).

400. *Id.* § 506(5) (defining “debtor” as a corporation) (current version at 11 U.S.C. § 101(12) (2012)).

401. *Id.* § 608 (authorizing the SEC to intervene on its own motion or upon request by a judge) (current version at 11 U.S.C. § 1109(a) (2012)).

402. *Id.* § 556 (mandating courts to appoint one or more trustees where the debt is \$250,000 or more) (current version at 11 U.S.C. § 1104(a)(2012)).

403. See VINCENT P. CAROSSO, *INVESTMENT BANKING IN AMERICA: A HISTORY* 383 (1970).

404. 11 U.S.C. §§ 701–799 (1976) (repealed in part 1978) (current version in scattered sections of 11 U.S.C.).

405. *Id.* § 706(3) (1976) (describing “debtor” as a person) (current version at 11 U.S.C. §§ 101(12), 109(d) (2012)).

406. *Id.* § 707(2) (1976) (describing “debts” as unsecured) (current version at 11 U.S.C. § 101(4), (11) (2012)).

407. For a good discussion of the differences between the chapters X and XI, see *In re Mfrs. Credit Corp.*, 395 F.2d 833, 839–40 (3d Cir. 1968).

408. 11 U.S.C. §§ 801–926 (1976) (repealed in part 1978) (current version in scattered sections of 11 U.S.C.).

409. *Id.* §§ 1001–1086 (1976) (repealed in part 1978) (current version in scattered sections of 11 U.S.C.).

410. See Timothy W. Dixon & David G. Epstein, *Where Did Chapter 13 Come From and Where Should It Go?*, 10 AM. BANKR. INST. L. REV. 741, 741 (2002).

On the corporate side, bankruptcy was increasingly federalized. Not only did the new chapter X and previous section 77 directly provide a federal tool to reorganize, but the passage of the Trust Indenture Act of 1939<sup>411</sup> made it quite difficult to restructure bonds in any way but under the new federal bankruptcy procedures.<sup>412</sup> That both the Chandler Act and the Trust Indenture Act grew out of the same SEC study of corporate receiverships makes it clear that this was by design.<sup>413</sup>

### 1. Contention Regarding the New Deal Expansion

But the road to this new reality was typical of the larger fight between the various branches of the federal government during the early years of the New Deal. The key points of contention were the new reorganization provisions that developed during this time, and efforts by Congress to read the Bankruptcy Clause in an expansive way to provide remedies for the ongoing Depression.

As one commentator noted:

Section 77B of the Bankruptcy Act sets up in the federal courts a system for the statutory reorganization of distressed corporations. The procedure which it prescribes makes use of devices which are novel to federal legislation. It applies only to corporate debtors; it permits the bankruptcy court to take jurisdiction over corporations which are not insolvent in the present bankruptcy sense and it authorizes the adjustment of the rights of the stockholders of such corporations; it seeks to control secured as well as unsecured debts; it provides for the circumstances under which creditors may be compelled to accept securities instead of cash in settlement of their claims; it imposes limitations on the allowance of rent claims; it empowers the judge to scrutinize and disregard the provisions of deposit agreements and of trust indentures; it places restrictions upon the labor policies of corporations undergoing reorganization.

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411. Pub. L. No. 76-253, 53 Stat. 1149 (codified as amended at 15 U.S.C. § 77aaa–bbbb (2012)).

412. See 15 U.S.C. § 77ppp(b) (2012) (prohibiting “impairment of holder’s right to payment” except under narrowly enumerated circumstances); see also Yakov Amihud et. al., *A New Governance Structure for Corporate Bonds*, 51 STAN. L. REV. 447, 485–88 (1999) (discussing the potential prohibitive effects of the Trust Indenture Act of 1939 on the use of indenture trustees as a governance structure for corporate bonds).

413. CAROSSO, *supra* note 403, at 382–83; see also Mark J. Roe, *The Voting Prohibition in Bond Workouts*, 97 YALE L.J. 232, 251 (1987) (discussing the impact that the SEC study on corporate reorganization had on Congress’s enactment of the Trust Indenture Act).

Some or all of these provisions may possibly become the pivots of attacks upon the constitutionality of Section 77B.<sup>414</sup>

The last line was an understatement at its best. While many supported the expansion of the Bankruptcy Clause to address the Depression, not all were in agreement. One author reviewed the history of bankruptcy going back to Henry VIII, and then argued:

The remedies which [section 77] attempts to make available for railroads and the procedure regulating the same are frankly foreign to “bankruptcy” and there is not the slightest suggestion that, under any circumstances, the railroad may be adjudicated a bankrupt. The section creates a most novel proceeding, totally non-germane to the “subject of bankruptcies,” and endeavors to extend the jurisdiction of the Federal Courts by forcibly making it a part of the bankruptcy law.<sup>415</sup>

Another author pushed for a Tenth Amendment limitation on the Bankruptcy Clause, arguing that the New Deal’s corporate and municipal reorganization provisions infringed on matters left to the states.<sup>416</sup>

2. Court Treatment of the New Deal Amendments:  
Initially Limiting Under the Fifth Amendment but  
Ultimately Embracing the Modern, Broad Conception

In 1935, the Court upheld the constitutionality of section 77, giving something of an advisory opinion in the face of what it termed “grave doubt,” but no actual challenge to the law, in the particular case before the Court.<sup>417</sup> After first declaring that Congress’s power under the Bankruptcy Clause was not unlimited, and then reviewing the various enactments under the Clause to date, Justice Sutherland concluded:

The fundamental and radically progressive nature of these extensions becomes apparent upon their mere statement; but all have been judicially approved or accepted as falling within the power conferred by the bankruptcy clause of the Constitution. Taken altogether, they demonstrate in a very striking way the capacity of the bankruptcy clause to meet new conditions as

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414. John Gerdes, *Constitutionality of Section 77B of the Bankruptcy Act*, 12 N.Y.U. L. Q. REV. 196, 196 (1934).

415. Albert K. Stebbins, *Constitutionality of the Recent Amendment to the Bankruptcy Law*, 17 MARQ. L. REV. 163, 172 (1933).

416. James R. Morford, *Federal Legislation for Corporate Reorganization; A Negative View*, 19 A.B.A. J. 702, 703 (1933).

417. *Cont’l Ill. Nat’l Bank & Trust Co. v. Chi., R.I. & Pac. Ry. Co.*, 294 U.S. 648, 667 (1935).

they have been disclosed as a result of the tremendous growth of business and development of human activities from 1800 to the present day. And these acts, far-reaching though they be, have not gone beyond the limit of congressional power; but rather have constituted extensions into a field whose boundaries may not yet be fully revealed.

Section 77 advances another step in the direction of liberalizing the law on the subject of bankruptcies. . . .

. . .

. . . Obviously, § 77 does no more than follow the line of historical and progressive development projected by previous acts.

As outlined by that section, a plan of reorganization, when confirmed, cannot be distinguished in principle from the composition with creditors authorized by the act of 1867, as amended by the act of 1874. It is not necessary to the validity of either that the proceeding should result in an adjudication of bankruptcy. The constitutionality of the old provision for a composition is not open to doubt. . . .<sup>418</sup>

But that same year, Justice Brandeis wrote for the Court as it struck down<sup>419</sup> what is known as the Frazier-Lemke Act,<sup>420</sup> which had added to section 75, essentially forcing farm creditors to provide a five-year lease in place of their right to foreclose.<sup>421</sup> The Court stated that “we have no occasion to decide in this case whether the bankruptcy clause confers upon Congress generally the power to abridge the mortgagee’s rights in specific property. . . . [because] another provision of the Constitution is controlling,” namely the Fifth Amendment.<sup>422</sup>

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418. *Id.* at 671–72 (footnotes omitted); *see also* Reconstruction Fin. Corp. v. Denv. & Rio Grande W. R.R. Co., 328 U.S. 495, 505–512 (1946) (discussing “the basic problems of railroad reorganization under § 77 of the Bankruptcy Act” that the Court had recently faced).

419. *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 601–02 (1935). Somewhat confusingly, the Court had upheld a similar state law the year before, rejecting the argument that it violated the Contracts Clause. *Home Bldg. & Loan Ass’n v. Blaisdell*, 290 U.S. 398 (1934). Perhaps importantly, the Minnesota statute in question only extended the obligation to lease for at most two years. *Id.* at 417 n.1.

420. Act of June 28, 1934, Pub. L. No. 73-486, 48 Stat. 1289 (amended 1934 and expired 1949).

421. Sec. 1, § 75(s)(7), 48 Stat. at 1291 (requiring that creditor actions be stayed for five years so long as the debtor pays “reasonable rental”).

422. *Louisville Joint Stock Land Bank*, 295 U.S. at 589.

As Justice Brandeis subsequently explained in upholding a revised version of this same provision:

The original Frazier-Lemke Act was there held invalid solely on the ground that the bankruptcy power of Congress, like its other great powers, is subject to the Fifth Amendment; and that, as applied to mortgages given before its enactment, the statute violated that Amendment, since it effected a substantial impairment of the mortgagee's security.<sup>423</sup>

Thus, the outer margins of the Bankruptcy Clause began to come into view. In 1936, the Supreme Court found another limitation to the Bankruptcy Clause, holding that Congress's initial attempt at municipal bankruptcy<sup>424</sup> disturbed the sovereignty of the states.<sup>425</sup>

In 1937, Congress reacted to the Court's thwarting of municipal bankruptcy by reenacting the municipal bankruptcy provisions with revisions designed to reduce the degree of federal interference with state sovereignty.<sup>426</sup> The Supreme Court upheld the 1937 municipal bankruptcy statute in *United States v. Bekins*,<sup>427</sup> reasoning that at heart it was a cooperative enterprise by the state and federal governments that was carefully drawn so as not to infringe state sovereignty.<sup>428</sup>

And by 1938, just in time for enactment of the Chandler Act, the Court embraced the Bankruptcy Clause's modern broad conception:

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423. *Wright v. Vinton Branch of the Mountain Trust Bank of Roanoke*, 300 U.S. 440, 456–57 (1937). Perhaps importantly, this case appears right after the better-known opinion that first suggested that the Court would begin to view economic legislation with greater deference. *W. Coast Hotel Co. v. Parrish*, 300 U.S. 379 (1937). The Court revisited the Frazier-Lemke Act in 1940. *Kalb v. Feuerstein*, 308 U.S. 433, 440 (1940).

424. Act of May 24, 1934, Pub. L. No. 73-251, 48 Stat. 798, *invalidated by Ashton v. Cameron Cnty. Water Improvement Dist. No. One*, 298 U.S. 513 (1936).

425. *Ashton v. Cameron Cnty. Water Improvement Dist. No. One*, 298 U.S. 513, 530–32 (1936); *see also* Abraham Gorenfeld, Case Note, *Constitutional Law—Federal Bankruptcy Act—An Invasion of State Sovereignty*, 10 S. CAL. L. REV. 202 (1937) (discussing the 1898 Act's effect on state administrative autonomy); Edward J. Dimock, *Legal Problems of Financially Embarrassed Municipalities*, 22 VA. L. REV. 39 (1935) (discussing the bankruptcy power of Congress over municipalities).

426. Act of Aug. 16, 1937, Pub. L. No. 75-302, sec. 1, §§ 81–84, 50 Stat. 653 (adding chapter X to the 1898 Act) (originally codified at 11 U.S.C. §§ 401–418 (1976)) (repealed in part 1978) (current version in scattered sections of 11 U.S.C.). The Chandler Act renumbered the 1937 addition as chapter IX in 1938. Act of June 22, 1938, Pub. L. No. 75-696, sec. 3, 52 Stat. 840, 939.

427. 304 U.S. 27 (1938).

428. *Id.* at 54.



The right of the Congress to legislate on the subject of bankruptcies is granted by the Constitution in general terms. “The Congress shall have Power . . . To establish . . . uniform Laws on the subject of Bankruptcies throughout the United States,” Article 1, s 8, cl. 4. To this specific grant, there must be added the powers of the general grant of clause eighteen. “To make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers . . . .” The subject of bankruptcies is incapable of final definition. The concept changes.<sup>429</sup>

There things stood throughout the 1940s and 1950s.<sup>430</sup>

### 3. Issues Remaining Following the Chandler Act

The key change was that corporate reorganization had been largely federalized in a way that precluded many of the big-city, corporate law firms and bankers from participating. More generally, courts routinely held that compensation under the Bankruptcy Act was to be at a lower level than might be obtained outside of bankruptcy, a trend that undoubtedly removed a substantial number of attorneys from the bankruptcy sphere.<sup>431</sup> Thus, the post-Chandler

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429. *Wright v. Union C. Life Ins. Co.*, 304 U.S. 502, 513 (1938) (omissions in the original). In some sense, *Wright* can be seen as the bankruptcy analogue to the famous *United States v. Carolene Products Co.*, 304 U.S. 144 (1938). The Court in *Carolene Products* held that the Filled Milk Act, which declared sale of certain milk products as “injurious to public health,” was “presumptively within the scope of the power to regulate interstate commerce and consistent with due process.” *Id.* at 144–45.

430. The changes in bankruptcy law that were proposed and enacted during this era seem to have been on largely technical points. *E.g.*, Acts of May 8, 1963, Pub. L. Nos. 88-16, 88-17, 77 Stat. 14; Act of July 7, 1952, Pub. L. No. 82-456, 66 Stat. 420; Act of Dec. 20, 1950, Pub. L. No. 81-879, 64 Stat. 1113; *see also* BANKRUPTCY: HEARINGS BEFORE A SUBCOMM. OF THE S. COMM. ON THE JUDICIARY, 85th Cong. 191 (1958) (discussing legislation that would authorize the courts of bankruptcy to determine dischargeability and nondischargeability of provable debts); Vern Countryman, *For a New Exemption Policy in Bankruptcy*, 14 RUTGERS L. REV. 678 (1960) (discussing the importance of bankruptcy exemption policy); Frank R. Kennedy, *Statutory Liens in Bankruptcy*, 39 MINN. L. REV. 697, 703–22 (1955) (examining section 67 of the Chandler Act and its amendment in 1952); *Final Report of the Committee on Bankruptcy*, 57 COM. L. J. 204 (1952) (reporting on pending bankruptcy legislation in the 82nd Congress). The statutory liens issue was addressed by an amendment to the Bankruptcy Act that passed in 1966. *See* Frank R. Kennedy, *The Bankruptcy Amendments of 1966*, 41 J. NAT’L CONF. REF. BANKR. 5 (1967). Most of the Supreme Court’s decisions during the era were of a similarly technical nature. *See, e.g.*, *Segal v. Rochelle*, 382 U.S. 375, 377 (1966); *King v. United States*, 379 U.S. 329, 332–34 (1964).

431. *See* William J. Rudin, *Fees and Allowances to Attorneys in Bankruptcy and Chapter XI Proceedings*, 34 FORDHAM L. REV. 387, 398 (1965)

Act era saw the development of a group of specialized corporate bankruptcy professionals.

Conventional wisdom has it that there were few large corporate bankruptcy cases during this era, until the big railroad cases of the 1970s. This is, of course, an oversimplification, as even a cursory review of the case law will reveal.<sup>432</sup>

The biggest issue in corporate bankruptcy remained the question of when a publicly traded company, which the New Deal Congress might have expected would have always filed under Chapter X, could nonetheless file a petition under Chapter XI and thus remain a “debtor in possession.”<sup>433</sup> The Supreme Court addressed the issue, always holding that cases could be filed under chapter XI in some circumstances, with a kind of repetition that made this issue something of the postwar analogue to an earlier era’s cases regarding state insolvency laws.<sup>434</sup> While often supporting the transfer of cases into chapter X, the Court soundly rejected the SEC’s frequent argument that chapter X, with its requirement that all plans must be “fair and equitable,” a term the Court had previously read to mean

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(“Probably the most significant factor to be used in determining the amount of the allowance is the referee's own knowledge and experience with respect to the value of the services. Consideration should be given to the entire spectrum of economic facts, including cost of living, comparative value of similar services in private practice, etc. As we have already seen, the services rendered by the attorney for the bankrupt and the attorney for the petitioning creditors are limited in scope, and, therefore, compensation will generally be limited.” (citation and footnotes omitted)).

432. *See, e.g.*, SEC v. U.S. Realty & Improvement Co., 310 U.S. 434, 442 (1940) (describing the extent of respondent corporation’s indebtedness at the time the bankruptcy case was heard); *In re Chi. Express, Inc.*, 332 F.2d 276, 276 (2d Cir. 1964) (affirming “an order of the referee in arrangement proceeding under ch. XI of Bankruptcy Act denying priority status of claim of railroad for its share of interline freight charges collected by debtor . . . prior to filing of arrangement petition”); *Lane v. Haytian Corp. of Am.*, 117 F.2d 216, 218 (2d Cir. 1941) (reviewing proceedings of the lower court that occurred before “the Supreme Court had clarified the procedure and explained the limitations of Chapter XI proceedings” in another case).

433. *See Availability of Chapter XI Relief Broadened*, 38 N.Y.U. L. REV. 1148 (1963) (“Chapter XI . . . provides a relatively simple procedure for arrangements. Generally, the debtor remains in possession, 11 and the investigation by a trustee and the SEC is changed for a less thorough one by a creditors’ committee. The arrangement, which may only affect the rights of unsecured creditors, 13 is confirmed if it is for the best interests of the creditors and is feasible.”); *see also In re Tex. Consumer Fin. Corp.*, 480 F.2d 1261 (5th Cir. 1973) (debtor proceeding under Chapter XI).

434. SEC v. Am. Trailer Rentals Co., 379 U.S. 594, 603–07 (1965) (collecting prior cases that examine the interrelationship between Chapters X and XI).

the “rule of full or absolute priority,”<sup>435</sup> must apply to all public debtors.<sup>436</sup>

*E. 1960s and 70s*

1. Renewed Interest in Bankruptcy and Increased Role of the Judiciary

In the late 1960s, perhaps as a result of the general revival of New Deal-style reform efforts during the Great Society, Congress and others<sup>437</sup> began to consider bankruptcy anew.<sup>438</sup> On the personal bankruptcy side, the push for reform was also motivated by a pronounced boom in bankruptcy filings, which came despite an equally booming economy.<sup>439</sup> The simultaneous nature of the bankruptcy boom and boom in consumer credit did not go unnoticed.<sup>440</sup>

Most interestingly, in 1964 Congress gave the Supreme Court the ability to override the procedural parts of the Bankruptcy Act by rule.<sup>441</sup> Specifically, the Court was given the power to enact bankruptcy rules and any laws “in conflict with such rules shall be of no further force or effect after such rules have taken effect.”<sup>442</sup>

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435. *Case v. L.A. Lumber Prods. Co.*, 308 U.S. 106, 115–17 (1939) (applying section 77B, but citing equity receivership cases).

436. *Am. Trailer Rentals Co.*, 379 U.S. at 610–11; *see also* SKEEL, *supra* note 8, at 160–81 (discussing the advent of Chapter 11 for corporate reorganization).

437. For example, the Brookings Institution established a task force to study the bankruptcy laws in 1965. Frank R. Kennedy, *Foreword: A Brief History of the Bankruptcy Reform Act*, 58 N.C. L. REV. 667, 670 (1980).

438. A helpful overview of bankruptcy practice at this point in time can be found in Max Schwartz, *The Practice of Bankruptcy*, 43 ST. JOHN'S L. REV. 208 (1968).

439. Frank R. Kennedy, *Foreword*, 55 KY. L.J. 533, 533–36 (1966); *see also* Herbert U. Feibelman, *Bankruptcy Cases Attain a New High*, 70 COM. L.J. 147, 147 (1965) (“The Tables of Bankruptcy Statistics for the fiscal year ended June 30, 1964, published by the Administrative Office of the United States Courts, reveal a record number of cases filed—greatly more than in any year for the past decade.” (footnote omitted)).

440. *See* Theodore Sager Meth, *Is Bankruptcy Outmoded?*, 19 BUS. LAW. 673, 673 (1964) (“The purpose of this article is to show that the Bankruptcy Act of 1898 is itself bankrupt as it applies to the problem of consumer insolvency, and further to explain how this condition came about, to outline the nature of its impact and to suggest along what lines we may find a remedy.”).

441. Act of Oct. 3, 1964, Pub. L. No. 88-623, 78 Stat. 1001 (codified as amended at 28 U.S.C. § 2875 (2012)).

442. *Id.*; *see also* Royal E. Jackson, *What's New in Bankruptcy?*, 39 J. NAT'L ASS'N REF. BANKR. 16, 17 (1965) (discussing how the bill “repeals Section 30 of the Bankruptcy Act” to replace it with court-made rules).

Thus began a complete revamp of bankruptcy procedure, which unfortunately took so much time that it was barely in place before the entire Bankruptcy Act was repealed in 1978.<sup>443</sup>

Throughout the twentieth century, the referees became increasingly like judges, and, in 1973, the Supreme Court formally renamed them bankruptcy judges in the newly enacted Rules of Bankruptcy Procedures.<sup>444</sup> This recognized the obvious reality that had existed since at least 1946 with the enactment of what is known as the Referees' Salary Act,<sup>445</sup> which made the referees salaried employees of the federal government, who no longer collected fees for services performed.<sup>446</sup> In short, bankruptcy and the Bankruptcy Clause now supported its own, standalone judicial system, distinct from the powers of the Chancellor who had appointed the original commissioners.

But since the advent of the 1898 Act, the bankruptcy judges had labored under very limited jurisdiction, with the referees and then bankruptcy judges only able to exercise jurisdiction over a small group of staple bankruptcy matters.<sup>447</sup> All other matters were left to

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443. See generally Lawrence P. King, *The History and Development of the Bankruptcy Rules*, 70 AM. BANKR. L.J. 217, 217–36 (1996) (discussing the evolution of Federal Rules of Bankruptcy Procedure from their inception to the time of the 1978 Bankruptcy Code, Act of Nov. 6, 1978, Pub. L. 95-598, 92 Stat. 2549 (codified as amended at 11 U.S.C.)).

444. FED. R. BANKR. P. 901(7) (1973) (defining “bankruptcy judge” as “the referee of the court of bankruptcy in which a bankruptcy case is pending, or the district judge of that court when issuing an injunction under § 2a(15) of the Act or under Rule 102”) (superseded 1983).

445. Act of June 28, 1946, Pub. L. No. 79-464, 60 Stat. 323 (repealed 1978).

446. Sec. 6, § 40(a), (d), 60 Stat. at 326, 328 (setting forth the salaried compensation of referees and noting their treatment as employees of the federal judicial branch) (repealed 1978).

447. George M. Treister, *Summary Judgment: Bankruptcy Jurisdiction: Is It Too Summary?*, 39 S. CAL. L. REV. 78, 78–81 (1966); see also John T. Copenhaver, Jr., *Summary Jurisdiction*, 41 J. NAT'L CONF. REF. BANKR. 108 (1967) (a bankruptcy referee describing questions relating to summary jurisdiction as the “most important and the most troublesome” of bankruptcy issues). For examples of case law that discuss bankruptcy jurisdiction issues, see *Katchen v. Landy*, 382 U.S. 323, 328 (1966) (“But Congress has often left the exact scope of summary proceedings in bankruptcy undefined, and this Court has elsewhere recognized that in the absence of congressional definition this is a matter to be determined by decisions of this Court after due consideration of the structure and purpose of the Bankruptcy Act as a whole . . . .”); *Pepper v. Litton*, 308 U.S. 295, 304–08 (1939) (using statutory interpretation to ascertain the scope of the bankruptcy court’s equitable powers); *Robertson v. Howard*, 229 U.S. 254, 259–60 (1913) (rejecting petitioners’ argument that the bankruptcy court’s jurisdiction was limited so that ancillary proceedings were required in other states or districts); *U.S. Fid. & Guar. Co. v. Bray*, 225 U.S. 205, 217 (1912) (such

either state courts or the federal district courts, if diversity jurisdiction existed.<sup>448</sup> By the 1960s, leading practitioners were suggesting that the referees needed a power and jurisdiction more like that of district judges.<sup>449</sup>

In short, bankruptcy was in a state of flux at the dawn of the 1970s, with new rules being drafted and reforms being proposed, but there had been little recent consideration of the scope and nature of the power granted by the Bankruptcy Clause.

The decade opened with two key events that would presage large changes. First, on a Sunday afternoon in June of 1970, Penn Central, the largest railroad in the country, filed a section 77 petition.<sup>450</sup> The petition came just two years after the company had been formed by the merger of the Pennsylvania and New York Central Railroads.<sup>451</sup> The filing was the largest bankruptcy case to date, and within a few short years almost every other railroad in the Northeast would also be in bankruptcy.<sup>452</sup>

Next, in July of 1970, Congress passed legislation creating the Commission on the Bankruptcy Laws of the United States.<sup>453</sup> The

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proceedings include, among others, all matters of administration, such as the allowance, rejection and reconsideration of claims, the reduction of the estates to money and its distribution, the determination of the preferences and priorities to be accorded to claims presented for allowance and payment in regular course, and the supervision and control of the trustees and others who are employed to assist them.”). Bankruptcy jurisdiction had long been a tortured issue. *E.g.*, Ira Jewell Williams, *Actions by Trustees in Bankruptcy*, 48 AM. L. REG. 543 (1900) (discussing jurisdictional issues in bankruptcy cases in the years leading up to 1900).

448. Treister, *supra* note 447, at 79.

449. *E.g.*, William J. Rochelle, Jr. & John L. King, *A Proposal to Raise Bankruptcy Courts to District Court Level*, 39 J. NAT’L ASS’N REF. BANKR. 118, 119 (1965) (“Why not a bankruptcy court at district court level, with both plenary and summary jurisdiction over all matters arising under the Bankruptcy Act, except criminal matters, and with power to impanel juries where juries are permitted and demanded?”).

450. *Penn Central Bankrupt*, PITTSBURGH POST-GAZETTE, June 22, 1970, at 1 (“The order was signed in the home of U.S. District Judge William Kraft Jr. at 5:35 p.m. after a morning and afternoon of secret conferences mixed with denials to newsmen that anything important was going on.”).

451. Penn Central Transportation Company, List of Deals, Lehman Brothers Collection, Harvard Business School Baker Library Historical Collections, [http://www.library.hbs.edu/hc/lehman/industry.html?company=penn\\_central\\_transportation\\_company](http://www.library.hbs.edu/hc/lehman/industry.html?company=penn_central_transportation_company) (last visited Oct. 6, 2013).

452. *See infra* note 464 and accompanying text.

453. Act of July 24, 1970, Pub. L. No. 91-354, 84 Stat. 468.

Commission produced a report in 1973<sup>454</sup> that, among other things, called for bankruptcy judges to be appointed by the President for fifteen-year terms with full jurisdiction,<sup>455</sup> have the administrative functions of the bankruptcy judge separated from the judicial functions,<sup>456</sup> implement the use of uniform federal exemptions in personal bankruptcy cases,<sup>457</sup> and apply a relaxed absolute priority rule in corporate bankruptcy cases.<sup>458</sup>

The Commission also proposed a new bankruptcy law, which was introduced but never passed.<sup>459</sup> Shortly thereafter, the National Conference of Bankruptcy Judges drafted a competing bill that was also introduced but not passed.<sup>460</sup> With these proposals, full-fledged bankruptcy reform was back in front of Congress.

## 2. Validity of Congress's Act to Save the Railroad Industry

But before Congress could consider revamping the entire bankruptcy system, it felt compelled to first address the collapse of the American railroad industry and the near collapse of the country's largest city.<sup>461</sup> Similarly, the collapse of several brokerage houses in

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454. The Commission's report was published in three parts as REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 93-137 (1st Sess. 1973).

455. *Id.* at pt. I 85-94.

456. *Id.* at pt. I 88.

457. See Richard M. Lombino, *Uniformity of Exemptions: Assessing the Commission's Proposals*, 6 AM. BANKR. INST. L. REV. 177, 184 (1998) (discussing prior proposals for uniformity of exemptions and comparing them to the Commission's proposals).

458. Vern Countryman, *Justice Douglas and the Law of Business Regulation*, 91 BANKING L.J. 312, 317 (1974); see also Note, *The Proposed Bankruptcy Act: Changes in the Absolute Priority Rule for Corporate Reorganizations*, 87 HARV. L. REV. 1786, 1796-98 (1974) (discussing the Commission's objections to the absolute priority rule).

459. H.R. 10792, 93d Cong. (1973); S. 4026, 93d Cong. (1973); see also Anthony T. Kronman, *The Treatment of Security Interests in After-Acquired Property Under the Proposed Bankruptcy Act*, 124 U. PA. L. REV. 110, 110 n.1 (1975).

460. H.R. 16643, 93d Cong. (1973), *reintroduced as* H.R. 32, 94th Cong. (1975); S. 4060, 93d Cong. (1974), *reintroduced as* S. 235, 94th Cong. (1975); see also Kennedy *supra* note 437, at 673 n.35.

461. For example, chapter IX of the Bankruptcy Act was modernized in 1976, with the aim of making it more usable by New York City. See Act of Apr. 8, 1976, Pub. L. No. 94-260, 90 Stat. 315 (allowing "voluntary reorganization procedures for the adjustment of the debts of municipalities"); see also Note, *Municipal Bankruptcy, the Tenth Amendment and the New Federalism*, 89 HARV. L. REV. 1871, 1871 (1976) (examining "the trend toward increasing solicitude for state interests," presenting "a suggested framework for judicial review of

the “paperwork crisis” of the late 1960s and early 1970s resulted in a new insolvency proceeding for brokers under SIPA.<sup>462</sup>

But it was the railroads that provided a chance for new consideration of the scope of the Bankruptcy Clause. Faced with the widespread collapse of the railroad industry, Congress adopted a two-fold approach to the problem. First, commercial railroads were relieved of the responsibility of providing long-haul passenger service, and that task was given to the newly formed Amtrak.<sup>463</sup> Second, and most importantly for these purposes, Congress proposed to consolidate several bankrupt Northeast freight railroads into a single entity that would come to be known as Conrail. As summarized by one participant in the process:

By 1973 the railroads in the northeast and midwest regions of the country were in such desperate straits that there was no hope for resuscitation through section 77 of the Bankruptcy Act. Penn Central, the major rail carrier in the northeast and midwest, was in a reorganization proceeding. By March of 1973, Judge Fullam, supervising the reorganization, aware that Congress was considering the plight of the Penn Central and other railroads, warned, “On the basis of the record to date, it appears highly doubtful that the Debtor could properly be permitted to continue to operate on its present basis beyond October 1, 1973.” . . . Congress came to the rescue by enacting the Regional Rail Reorganization Act of 1973. The Act created the United States Railway Association (USRA) and Consolidated Rail Corporation (Conrail). USRA was vested with authority to prepare a “Final System Plan” (FSP) for reorganizing rail service in the northeast and midwest and, according to that plan, determine the rail properties to be

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legislation challenged on federalism grounds,” and applying the framework to Chapter IX of the Bankruptcy Act). Although New York avoided filing for bankruptcy, the municipal bankruptcy procedure has been utilized recently by another large city, Detroit. *See* Ed White, *Detroit Ruled Bankruptcy-Eligible*, CLEV. PLAIN DEALER, Dec. 4, 2013, at A7 (discussing a bankruptcy judge’s ruling that “Detroit is eligible to shed billions of dollars of its long-running debt, including the pensions of thousands of workers and retirees”).

462. *See* Note, *The Securities Investor Protection Act of 1970: An Early Assessment*, 73 COLUM. L. REV. 802, 802 (1973).

463. Rail Passenger Service Act of 1970, Pub. L. No. 91-518, 84 Stat. 1327 (repealed in part 1994) (codified as amended in scattered sections of 49 U.S.C.); *Nat’l R.R. Passenger Corp. v. Atchison, Topeka & Santa Fe Ry. Co.*, 470 U.S. 451, 454–56 (1985) (explaining how Amtrak, created under the Rail Passenger Service Act of 1970, is a “private, for-profit corporation . . . [that] is not ‘an agency of the [federal] Government’ but is authorized by the Government to operate or contract for the operation of intercity rail passenger service”).

transferred to Conrail by the bankrupt carriers, those to be sold, and those to be abandoned. Conrail, as a private but government-supported organization, would operate rail service on the transferred properties and was to issue securities to the estates of the bankrupt railroads in exchange for their properties.

The Act required the Panel on Multidistrict Litigation to consolidate in a Special Court all proceedings with respect to the Final System Plan, and directed the Panel to select the members of the Special Court. . . . The Special Court is authorized to exercise the powers of a district judge, including those of a reorganization court, and has “original and exclusive jurisdiction” in any civil action challenging the constitutionality of the Act or the legality of any action or inaction of USRA.<sup>464</sup>

The Regional Rail Reorganization Act of 1973,<sup>465</sup> and its creation of a special court that addressed to a specific set of debtors,<sup>466</sup> almost inevitably led to a challenge that Congress had exceeded its authority under the Bankruptcy Clause and violated the Fifth Amendment. The latter argument challenged the requirement that railroads turn over their operations to Conrail in exchange for securities and the obligation of the railroads to continue operations until the date of the turnover.

Several district courts that were handling the individual section 77 proceedings of the railroads held the 1973 Act unconstitutional,<sup>467</sup> but the special railroad court, comprising a three-judge panel headed by Judge Friendly, upheld the Act.<sup>468</sup> In affirming, the Supreme Court addressed the contention that the Act violated the Bankruptcy Clause because the process was not sufficiently “uniform” because as it applied to but a part of the United States.<sup>469</sup> The Court

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464. John Minor Wisdom, *Views of A Friendly Observer*, 133 U. PA. L. REV. 63, 67–70 (1984) (internal footnotes omitted).

465. Pub. L. No. 93-236, 87 Stat. 985 (1974) (repealed in part) (codified as amended in scattered sections of 45 and 49 U.S.C.).

466. § 209(b), 87 Stat. at 999 (codified as amended at 45 U.S.C. § 719(b) (2006)).

467. *See, e.g., In re Penn Cent. Transp. Co.*, 382 F. Supp. 856, 870 (E.D. Pa. 1974); *In re Lehigh Valley R.R. Co.*, 382 F. Supp. 854, 855 (E.D. Pa. 1974); *In re Penn Cent. Transp. Co.*, 382 F. Supp. 821 (E.D. Pa. 1974); *In re Cent. R.R. of N.J.*, 273 F. Supp. 282 (D.N.J. 1974); *In re Lehigh & Hudson River Ry. Co.*, 377 F. Supp. 475, 476 (S.D.N.Y. 1974).

468. *In re Penn Cent. Transp. Co.*, 384 F. Supp. 895, 951 (Reg'l Rail Reorg. Ct. 1974).

469. *Blanchette v. Conn. Gen. Ins. Corp. (Reg'l Rail Reorg. Act Cases)*, 419 U.S. 102, 158 (1974).



acknowledged the “surface appeal” of the argument, especially in light of the *Hanover National Bank v. Moyses*,<sup>470</sup> but it ultimately rejected the argument because “it overlooks the flexibility inherent in the constitutional provision.”<sup>471</sup> The Court went on to explain:

The uniformity provision does not deny Congress power to take into account differences that exist between different parts of the country, and to fashion legislation to resolve geographically isolated problems. “The problem dealt with [under the Bankruptcy Clause] may present significant variations in different parts of the country.” We therefore agree with the Special Court that the uniformity clause was not intended “to hobble Congress by forcing it into nationwide enactments to deal with conditions calling for remedy only in certain regions.”<sup>472</sup>

Despite the complaint of Justice Douglas—who was joined by Justice Stewart—that the majority had ignored the “Just Compensation Clause of the Fifth Amendment [and] the uniformity requirement of the Bankruptcy Clause,”<sup>473</sup> the Court further expanded Congress’s powers under the Bankruptcy Clause. Several years later, the Court did find that a law passed to address a single railroad debtor violated the uniformity requirement, suggesting that the provision is not entirely without substance.<sup>474</sup>

### 3. 1978 Bankruptcy Code: The Modern Framework

The final major change to bankruptcy law occurred with the enactment of the 1978 Bankruptcy Code.<sup>475</sup> Ultimately the 1978 Code

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470. 186 U.S. 181 (1902).

471. *Id.*

472. *Id.* at 159 (alteration in original) (internal citations omitted).

473. *Id.* at 185 (Douglas, J. dissenting).

474. *Ry. Labor Execs.’ Ass’n v. Gibbons*, 455 U.S. 457, 470–73 (1982) (“To survive scrutiny under the Bankruptcy Clause, a law must at least apply uniformly to a defined class of debtors.”). *But see id.* at 475 (Marshall, J., concurring) (“Our cases do not support the Court’s view that any bankruptcy law applying to a single named debtor is unconstitutional.”). Justice Marshall, joined by Justice Brennan, concurred rather than dissented because “[a]lthough the question is close, I conclude that Congress did not justify the specificity of RITA in terms of national policy. Rather, the legislative history indicates an attempt simply to protect employees of a single railroad from the consequences of bankruptcy.” *Id.* at 476.

475. Act of Nov. 6, 1978, Pub. L. 95-598, 92 Stat. 2549 (codified as amended at 11 U.S.C.). The Code was signed into law on November 6, 1978 and became effective on October 1, 1979. The 1978 Bankruptcy Code officially repealed the 1898 Bankruptcy Act as of September 30, 1979 (but the 1898 Act still applied to any pending cases thereunder). For

continued the incremental development of bankruptcy court powers in relation to the district courts, albeit only after an abortive attempt to give the bankruptcy judges full judicial powers that the Supreme Court found wanting.<sup>476</sup> Recent case law shows that this remains a work in progress.<sup>477</sup>

Under the 1978 Code, business bankruptcy was consolidated into two basic chapters, while individual debtor provisions remained largely the same as under the 1898 framework. Business debtors could now choose between liquidation under Chapter 7,<sup>478</sup> with the appointment of a trustee, or reorganization or liquidation under Chapter 11,<sup>479</sup> which involves no trustee.<sup>480</sup> The initial choice of chapters tends to sort by debtor size, although some larger business debtors ultimately end up in Chapter 7 after either a sale of all assets or the failure of efforts to reorganize.<sup>481</sup> Individual debtors continued to be offered a choice between straight liquidation and reorganization. The old composition procedure, long suffering from disuse, faded away without many people noticing.

*F. Recent Changes to Federal Bankruptcy Law Changes and Court Interpretations Invoking a Rediscovered Hamiltonian View*

After nearly ten years and one veto, on April 20, 2005, the President signed the Bankruptcy Abuse Prevention and Consumer

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more detail, see Kenneth N. Klee, *Legislative History of the New Bankruptcy Law*, 28 DEPAUL L. REV. 941 (1979). The differences between the 1898 Act and the 1978 Bankruptcy Code are nicely summarized in J. RONALD TROST ET. AL, ALI-ABA RESOURCE MATERIALS: THE NEW FEDERAL BANKRUPTCY CODE 79–227 (1979).

476. The bankruptcy court's broad jurisdictional features were declared unconstitutional in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982), and were then repealed and replaced by the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333.

477. See *Stern v. Marshall*, 131 S. Ct. 2594 (2011) (holding that a bankruptcy court lacked authority under Article III to enter judgment on a particular state law counterclaim, even though the counterclaim was a “core” proceeding under the 1978 Act). See also Ralph Brubaker, *A “Summary” Statutory and Constitutional Theory of Bankruptcy Judges’ Core Jurisdiction After Stern v. Marshall*, 86 AM. BANKR. L.J. 121 (2012) (discussing current issues with the jurisdiction of bankruptcy courts); Troy A. McKenzie, *Judicial Independence, Autonomy, and the Bankruptcy Courts*, 62 STAN. L. REV. 747, 758 (2010) (examining the autonomy of, and process for appointing, bankruptcy judges).

478. 11 U.S.C. §§ 701–784 (2012).

479. *Id.* §§ 1101–1174.

480. Tabb, *supra* note 182, at 35.

481. Stephen J. Lubben, *Business Liquidation*, 81 AM. BANKR. L.J. 65, 75 (2007).

Protection Act of 2005<sup>482</sup> (BAPCPA)—an extensive overhaul of both the business and consumer provisions of the 1978 Code.<sup>483</sup>

In 2006, the Supreme Court surprised many by holding that the Bankruptcy Clause overrode state sovereign immunity, at least with respect to matters “ancillary” to the central jurisdiction of the bankruptcy court over the debtor’s estate.<sup>484</sup> Relying on the original intent of the founders, Justice Stevens, writing for a slim five-member majority,<sup>485</sup> rediscovered a Hamiltonian interpretation of the Bankruptcy Clause that reflects a strong grant of federal power.<sup>486</sup> Or, more precisely, he may have discovered a neo-Hamiltonian interpretation of the Clause, inasmuch as his opinion rests on the protection of debtors, whereas the Federalists would have seen the Clause as a creditor-protection measure, primarily designed to prevent preferences to home-state creditors.

All the while, Congress has continued to expand the scope of the Bankruptcy Clause, with little apparent challenge from the other branches. For example, in 1969—before the current Bankruptcy Code was enacted—Congress invoked its powers under the Bankruptcy Clause when it enacted the main legislation regulating creditors’ nonbankruptcy collection activities, the Consumer Credit Protection Act,<sup>487</sup> citing a desire to reduce bankruptcy filings.<sup>488</sup>

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482. Pub. L. No. 109-8, 119 Stat. 23 (2005) (codified as amended in scattered sections of 11 U.S.C.). See Susan Jensen, *A Legislative History of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 485 (2005) (detailing the decade-long struggle to “comprehensive[ly] overhaul” the Bankruptcy Act of 1978).

483. See Richard Levin & Alesia Ranney-Marinelli, *The Creeping Repeal of Chapter 11: The Significant Business Provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 603 (2005) (discussing business provisions); Katherine Porter & Deborah Thorne, *The Failure of Bankruptcy’s Fresh Start*, 92 CORNELL L. REV. 67, 80 (2006) (discussing consumer provisions).

484. Cent. Va. Cmty. Coll. v. Katz, 546 U.S. 356, 373 (2006).

485. Because the opinion was Justice O’Connor’s last, and her replacement is known as a states’ rights proponent, some have suggested the precedent is unstable. Leading Cases, *State Sovereign Immunity—Bankruptcy*, 120 HARV. L. REV. 125, 126 (2006).

486. *Katz*, 546 U.S. at 362–63.

487. Pub. L. No. 90-321, 82 Stat. 146 (1968) (codified as amended in scattered sections of 15 and 18 U.S.C.).

488. 15 U.S.C. § 1692(a) (2012). See also 15 U.S.C. § 1671(a) (2012) (discussing garnishment as “destroy[ing] the uniformity of the bankruptcy laws and frustrat[ing] the purposes thereof in many areas of the country”).

## V. IMPLICATIONS FOR FUTURE LAWSUITS

But understanding the Bankruptcy Clause is not merely of historical interest. In 2010, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act.<sup>489</sup> Title II of Dodd-Frank—commonly referred to as the Orderly Liquidation Authority (OLA)—established a process for “liquidat[ing] failing financial companies that pose a significant risk to the financial stability of the United States in a manner that mitigates such risk and minimizes moral hazard.”<sup>490</sup> The decision to invoke OLA is subject to extremely limited judicial review.<sup>491</sup>

While Congress did not indicate which constitutional provision it was relying on in enacting this measure, several plaintiffs recently challenged OLA as a violation of the Bankruptcy Clause, particularly its uniformity requirement.<sup>492</sup> As a necessary part of this argument, the plaintiffs alleged, “Title II constitutes an exercise of Congress’s power under the Bankruptcy Clause.”<sup>493</sup> Next, the plaintiffs argued that “Title II’s delegation of unlimited power to the Treasury Secretary and the [Federal Deposit Insurance Corporation (FDIC)], without meaningful judicial review of the execution of that power, constitutes a non-uniform law of bankruptcy that must be declared unconstitutional and must be enjoined.”<sup>494</sup> The basic argument was

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489. Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of 7, 12, and 15 U.S.C.).

490. 12 U.S.C. § 5384(a) (Supp. V 2011).

491. *Id.* § 5382(a)(1)(A)(iii).

492. First Amended Complaint for Declaratory and Injunctive Relief, *State Nat’l Bank of Big Spring v. Lew*, No. 1:12-cv-01032 (D.D.C. Sept. 20, 2012) (No. 6). The Bankruptcy Clause claim is Count VI. *Id.* ¶¶ 234–39. The merits of the claim may never be determined because the district court granted the defendants’ motion to dismiss on standing and ripeness grounds. *State Nat’l Bank of Big Spring v. Lew*, No. 1:12-cv-01032, 2013 WL 3945027 (D.D.C. Aug. 1, 2013).

493. First Amended Complaint, *supra* note 492, ¶ 235. The argument against rooting OLA in the Bankruptcy Clause, and perhaps instead basing it in the Commerce Clause, could begin with the fact that Dodd-Frank was handled by the congressional finance committees and not the judiciary committees that would normally have jurisdiction over bankruptcy matters. And some who were involved in the enactment of OLA swear that Congress never considered OLA to be “bankruptcy” legislation. Of course, it is not clear that such internal congressional considerations “matter” for Constitutional purposes. Moreover, there is some doubt about Congress’s ability to pass debtor-creditor legislation under any provision other than the Bankruptcy Clause. *See, e.g., Ry. Lab. Execs.’ Ass’n v. Gibbons*, 455 U.S. 457, 468 (1982) (“We do not understand either appellant or the United States to argue that Congress may enact bankruptcy laws pursuant to its power under the Commerce Clause.”).

494. First Amended Complaint, *supra* note 492, ¶ 239.

that the FDIC and the Secretary are vested with so much power under OLA that each case is apt to proceed upon a different path, resulting in nonuniform outcomes for similarly situated financial institutions.

Only by understanding the Bankruptcy Clause and its development over the years is it possible to explain why this argument is deeply flawed. As developed in this Article, Congress is free to adopt different types of bankruptcy procedures for different debtors. Consider the New Deal state of bankruptcy law, with section 77 for railroads and chapters X and XI for liquidation, reorganization, and composition proceedings for other corporations and individuals.<sup>495</sup> At this same time, Congress created the FDIC<sup>496</sup> and vested it with authority over bank insolvencies.<sup>497</sup> The OLA litigation proceeded from the faulty notion that Chapter 11 provides a one-size-fits-all solution, but it is quite clear that one reason Chapter 11 and its predecessors have been so successful rests in the flexible nature of the proceedings. In short, the OLA litigation reflected a misunderstanding of the Bankruptcy Clause.

The debates about whether the Bankruptcy Clause allowed more than the bankruptcy laws of Georgian England are now but a distant memory. Based on current precedents, the Clause allows for a strong federal power over all types of creditors, constrained perhaps by the Fifth Amendment when dealing with secured creditors,<sup>498</sup> but subject only to a weak internal requirement of uniformity.<sup>499</sup>

The key question for litigants, which may largely depend on the future makeup of the Court, is whether this broad understanding will prevail or whether it represents the fleeting high tide of the

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495. See *supra* Part VI.D. For a general discussion on the trends and evolution of bankruptcy law in the 1930s, see SKEEL, *supra* note 8, at 73–100.

496. Banking Act of 1933, Pub. L. No. 73-66, sec. 8, § 12B(a), 48 Stat. 162, 168 (current version at 12 U.S.C. § 1811(a) (2012)).

497. Sec. 8, § 12B(l), 48 Stat. at 174 (current version at 12 U.S.C. § 1821 (2012)).

498. James Steven Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause*, 96 HARV. L. REV. 973, 997–98 (1983) (examining whether the Takings Clause should be considered a substantive limitation on the Bankruptcy Clause).

499. See *In re McFarland*, 481 B.R. 242, 259 (Bankr. S.D. Ga. 2012) (internal citation and quotation marks omitted) (“The uniformity required by the Bankruptcy Clause is geographical, not personal. The Clause neither recognizes nor grants individual rights, and it is not a straightjacket that forbids Congress to distinguish among classes of debtors.”). See also Jonathan C. Lipson, *Debt and Democracy: Towards a Constitutional Theory of Bankruptcy*, 83 NOTRE DAME L. REV. 605, 612–14 (2008) (calling for greater clarity on the outer limits of federal bankruptcy power that other constitutional provisions may provide).

Bankruptcy Clause's reach. To date, the only times the Supreme Court has found a bankruptcy law to exceed Congress's powers under the Bankruptcy Clause has been when the Court believed that the law violated the Fifth Amendment, by prohibiting a secured creditor's foreclosure without adequate compensation,<sup>500</sup> and when the law in question applied to but a single debtor.<sup>501</sup> Over two centuries after its adoption, it is quite clear the Bankruptcy Clause is a source of congressional power far more often than it is a serious limitation. But that source might become more significant as the Supreme Court begins to scale back the Commerce Clause from its New Deal heights.<sup>502</sup> In the past, it made little difference if Congress acted under Clause 3 or Clause 4 of Section 8. But going forward, that distinction just might matter. As such, understanding the Bankruptcy Clause becomes more important.

### CONCLUSION

This Article proposes a new understanding of the Bankruptcy Clause that is more consistent with the history and progression of bankruptcy law in the United States. Congress rarely invoked its powers under the Bankruptcy Clause for the first century following the country's founding, likely due to the general understanding that states retained the power to regulate bankruptcy, subject to certain limitations. It was not until the growth of interstate commerce and the new state-federal dynamic brought by the Fourteenth Amendment that Congress passed the first permanent federal bankruptcy law in 1898. These external factors led to the inevitable evolution of the Bankruptcy Clause to the Hamiltonian view we largely subscribe to today: a broad power that works with other constitutional provisions to ensure consistent interstate regulation.

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500. *See supra* Part IV.D.2.

501. *See supra* note 474 and accompanying text.

502. *See Nat'l Fed'n of Indep. Bus. v. Sebelius*, 132 S. Ct. 2566, 2587–88 (2012) (holding the Commerce Clause constitutionally insufficient to uphold the individual mandate of the Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119 (2010)).