27th Congress, 1st Session. Rep. No. 5. Ho. of Reps.

BANKRUPTCY.

[To accompany bill H. R. No. 16.]

JULY 21, 1841.

Mr. BARNARD, from the Committee on the Judiciary, to which the subject had been referred, submitted the following

REPORT:

The Committee on the Judiciary, to whom have been referred the petitions and memorials presented to the House on the subject of a bankrupt law, respectfully report:

In the opinion of the committee, a bankrupt law ought to be passed by Congress without unnecessary delay; and they present a bill for the consideration of the House.

This bill is essentially the same that was matured in the Senate in the 1st session of the last Congress, after great deliberation, and which finally passed that body. It was not then considered in the House for want of time.

The policy of laws designed to afford remedy and relief, as between creditors and their debtors, who are hopelessly insolvent, has the sanction of usage in the past and the present among nearly all highly civilized and business communities. The leading idea upon which these laws have proceeded, has, certainly, not always been the same—it has varied with the general state of the law and with the progress of society. In a country where the creditor was, by law, the undisputed arbiter of liberty and life to his insolvent debtor, the immediate motive for interposition must have been different from that which has prompted legislative interference where the relation of debtor and creditor has been differently understood.

In England, bankrupt laws had their origin apparently in the idea that debtors who did not pay were merely unwilling, and not unable to pay. The first bankrupt law, passed in the time of Henry VIII, was levelled against those "who craftily obtained the goods of other men, and fled, or kept their houses, not minding to pay their debts." It came in aid of the law, proceeding on the same idea of ability and unwillingness, which authorized imprisonment for debt, a thing unknown to the common law. If a debt was not paid, the credit itself was supposed to have been *craftily* obtained; the ability to pay was presumed; the debtor was arrested and imprisoned till he should be made willing; or if he had fled or kept house, so that arrest was impossible, his estate passed into the custody of the law for the liquidation of the debt.

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So long as this idea of ability and unwillingness prevailed, and no other was admitted, the whole evil, so far as creditors were considered, was supposed to be adequately met by the punishment of imprisonment or confiscation. When, however, it was found, as industry and production came to be increased by the use of capital and credit, that the mass of debtors who did not pay were only unable, but not unwilling, it became necessary to turn round, and, without disarming the creditor, throw a shield over the defenceless head of his honest and innocent debtor.

The law in England on this subject, often variously modified in matters of detail, now is, and has long been, in substance—

First: That where creditors invoke the punishment of imprisonment on their debtor, the latter, if willing, but unable to pay, may regain his freedom upon a voluntary and honest surrender of his property, to be applied towards liquidation.

And, second: That where creditors invoke the punishment of confiscation on their debtor, which can only be done where the debtor belongs to one or another of certain specified classes, the creditors shall take the full benefit of the proceeding by the application of the property towards the payment of their debts, *provided* the debtor, being honest and willing, but unable to pay in full, shall, on certain terms and conditions, be forever discharged from all legal obligation to pay the rest and residue of his debts.

Thus the law of interposition and relief in England, as between creditors on the one hand, and debtors who cannot pay their debts on the other, stands and is administered in two distinct branches and under two distinct systems. In the one system, the debtors are denominated insolvent; in the other, they are called bankrupt. In a report made to the Queen, in July, 1840, and signed by eight out of nine commissioners appointed to investigate this subject, it was strongly recommended to reduce these two branches of the law and systems of administration, to one consistent system, and make the whole law of the case more conformable to reason and to right.

The principal improvements in the law relating to insolvency, proposed by the commissioners, are these:

To extend the benefits of the discharge from debts, in case of bankruptcy, beyond the mercantile and other specified classes, to which they are now chiefly confined, so as to embrace "all persons engaged in business requiring capital and credit;"

To allow and encourage a voluntary cession of property on the part of insolvents, "at such period of their difficulties as will best insure equal justice to all their creditors;"

To make the granting of a certificate of discharge a judicial act, which may be opposed by creditors for cause, but to which their consent shall not be necessary.

The suggestion of these improvements are sufficient to indicate the great change which public sentiment has undergone, or is undergoing, in England, in regard to the proper basis on which those laws ought to rest, that interpose their special authority, between creditors and their insolvent debtors.

At this day, and in this country, if a system of laws relating to bankruptcies is to be established, it is believed that it is not difficult to perceive, and state, the grounds on which it ought to stand.

Credits, or demands, are property in which, not unfrequently, the bulk of large individual estates consist. As property, they are under the pro-

tection of the law, as much as any other kind of property. All the rights of property attach to them; the right of protection and defence against all encroachment and injury, and the right of recovery when wrongfully taken away or withheld. They are private property, and private property is sacred. It must be respected; and the law must be vigilant and efficient in its guardianship of it. Failure in this is failure in the highest duty of civil society, and tends directly to dissolution.

But the nature of credits, or demands, is such as to constitute them a peculiar species of property; and before we can undertake to pronounce with certainty on the whole duty of society and the law in regard to them, we must consider attentively their nature and peculiarities.

They are held by a peculiar tenure—a tenure which implies and includes a contingency. The foundation of loan is trust, wherever securities are not taken; it is confidence; it is credit—all terms which imply risk, and the possibility of failure. The risk relates to the question of solvency or insolvency when the period comes for demanding payment. This kind of property is held subject to this contingency; and the lender himself takes the risk; he is his own insurer. If his debtor fails, he loses; if not, he has his own. He charges, too, for this risk—in the shape of interest, premium, or commission. He parts with the immediate possession of his property, expecting it to come back to him, in proper time, with increase; he puts it afloat, and takes the hazards of the voyage for a consideration; if whelmed in the turbulent sea, he expects to sustain the loss. He is content to hold his property subject to this contingency.

While his debtor remains solvent—which is always to be presumed until the contrary appear—the duty of society and the law towards him, and this property of his, is plain enough. If he invoke the law in the case, it will come efficiently to his aid. If his debtor attempt to elude his demand by flight or fraud, it will arrest him and restrain him of his liberty; and, otherwise, it will seize the unwilling debtor's estate, and make the debt out of it, for the creditor. When the law, by these means, has aided the creditor in the recovery of his property, it has done all its duty, as against his insolvent debtor.

But suppose, before such recovery is had, the debtor is found to have fallen into a state of hopeless insolvency; in other words, that contingency has arisen subject to which the demand has been holden from its inception? in this case, a new duty has arisen on the part of the law.

The fact of insolvency being ascertained—the fact of utter and hopeless inability to pay all his debts—the debtor stands to each creditor, if not in in a new relation, at least in a relation materially modified. His creditors, taken together, now form a class looking for a common relief to a common fund which is insufficient to satisfy them all; and every principle of equity and justice requires that the law should interpose to give to each his distributive share, according to the relative amount of his demand—at the same time casting on each an amount of loss proportioned to the risk and insurance undertaken by him.

When this is done, the inquiry arises, what more remains for the law to do? What further aid can the creditors demand? They cannot have the body of their debtor cut up and divided between them, as was said might have been done under the law of the Twelve Tables; or sell him, with his wife and children, into slavery, *trans Tyberim*. They cannot at this day, and in this country, load him with chains, inflict stripes upon him, or throw

him into a perpetual prison. With us, in this country, it may be considered as wholly settled, by a wise and humane public sentiment and policy, that the law will pursue and will permit creditors to pursue an honest but unfortunate and hopelessly insolvent debtor no further, after what remains of his wrecked fortune has been equitably divided amongst those to whom he is indebted.

Beyond this the law sees and wisely adjudges that there is an end of all reasonable hope of further advantage to creditors. A form of indebtedness still remains, but the substance is gone. Nothing is left to the debtor with which to recover himself but his hands. He may labor in employments more or less profitable, according to his skill or his habits; but in no regular employment will or can the wages of labor afford more than a current support to the laborer and those dependent on him, so long as he is not permitted to turn one dollar of his surplus earnings into capital, or obtain one dollar of capital upon credit, with which to aid him in enhancing the profits of his business—a thing utterly forbidden and rendered impossible to the bankrupt debtor. To hold the debtor, or allow his creditors to hold him, in this hopeless position, is unjust, unnecessary, and cruel. It is to bind him hand and foot, and lay him down at the feet of his creditors, a victim and a sacrifice—as much lost to himself, to his family, and to society, if not as much degraded, as if, like the debtor in Rome, he might be led through the public streets by his creditors, with a halter round his body, and be made the unresisting subject of blows and personal chastisement.

It is at this point, then, that society has an eminent duty to perform towards the debtor and towards itself. That contingency has now happened, the hazard of which the creditor was content to run for such consideration as was satisfactory to himself; his debtor has fallen into hopeless insolvency, and his demand, or some part of it, has sunk with him. He has nothing to complain of. By the very act of lending the debtor his property, without exacting security, he consented to take his share, with other creditors, in the risk of loss and sacrifice to which the debtor's business necessarily exposed their property in his hands, and he took or stipulated beforehand for his pay for that very risk. The enterprise has turned out an unlucky one, and he must bear his loss. The law has stepped in, as he knew it would, or as he knew it might and ought, by the terms of the constitution of the country, to make an equitable adjustment of profit and loss between him and his partners in the enterprise—the other creditors; and having done this, it has done all that the nature of the case admitted of for *his* aid and benefit. And now comes the case of the debtor, and the interest which society has in his restoration.

It is undoubtedly true, that to interfere in the slightest degree to impair the obligation of contracts between individuals, is an exercise of high transcendental power on the part of Government. This Government does it when it undertakes to release a party from the performance of any part of his contract. This power is expressly prohibited to the States by the constitution; and it is believed that it belongs as little to this Government as to the States, except so far as it may be included in the power, expressly given, to establish laws on the subject of bankruptcies. Within the legitimate range of such laws, the power undoubtedly exists; and it had long been the part of the policy of such laws, before the adoption of the constitution, to discharge the honest bankrupt from the remainder of his debts

after his entire estate had been applied rateably towards the payment of them.

It is believed that a power like this exists, of necessity, in every country where capital and credit are extensively employed in the prosecution of business and of enterprise. In our country, it has been expressly confided to the Federal Government, and it can be exercised, with full effect, by no other authority. The duty of this Government, then, is as plain as its power, and it is believed to be matter of just reproach that it has been so long neglected. After the law has compelled the debtor to the performance of his contracts, as far as all his means will go, and when it has, on mature deliberation, pronounced its solemn judgment that further performance, at the present time, or at any time, has, through unavoidable misfortune, become morally impossible, while the ordinary legal power of his creditors over him remains, then the release of the debtor from any further *legal* liability on his contracts becomes the indispensable duty of the governing power. Let the *moral* obligation remain, as it will, as strong as ever. It is the legal liability only which is touched. It affects the *remedy* rather than the *obligation*. Government does not tear the contract, or order it to be delivered up to be cancelled. It leaves to the creditor the evidence of his debt in full possession, and it does not relieve the debtor in the least degree from the full moral force of his promises and undertakings, whenever he may have ability to perform them. It does nothing more than withhold from the creditor the aid and power of the courts, after it has judicially ascertained that further performance on the part of the debtor has become impossible. The duty of civil society to supply to creditors the means of coercion and remedy, through its courts, in case of a breach of contract, is one of indispensable obligation; but Government must decide for itself when this duty has been faithfully performed, and when it has gone far enough for the ends of substantial justice. It must have the right to judge, in the first place, what modes and forms of remedy it will give, and then, how far such remedy shall be pursued and carried. When it has been pushed as far as it is safe for human power to go—as far as it can go without unmitigated evil—then it is time to withhold it.

On the general principles which have now been stated, the main provisions of this bill rest. No distinction is here attempted to be set up between an insolvent system and a bankrupt system. All persons, whatever may be their occupation, who are unable to meet their debts and engagements, are insolvents; and, if they so declare themselves, they are deemed bankrupts. These are *voluntary* bankrupts.

It is in regard to the mercantile classes only, or those whose business renders them directly liable to the peculiar hazards which attend mercantile operations; it is in regard to debtors in these classes only, and where their indebtedness amounts to a certain sum, that the right is given to creditors, under limitations, and in the happening of certain events, to cause such debtors to be declared bankrupt, and have their estates seized for their behoof. These are, then, *involuntary* bankrupts. And this is the only distinction made in the bill, in regard to the various classes of insolvent debtors in the community, to whom such a bill is deemed at all applicable.

The bill proceeds upon the principle that every person in the community, of whatever calling, who, in the employment of capital and credit, applied by his skill and industry in production, has fallen into hopeless insolvency,

so that all further effort to restore and redeem himself has become evidently useless, is entitled to the relief which this bill is intended to afford; and that, in all cases, the debtor may, if he choose, take the initiative. With respect, however, to the particular classes just referred to, it has been thought adviseable and proper, on account of the great importance and necessity of promptness and punctuality in meeting all their engagements, that it should be put in the power of their creditors to move against them, in certain circumstances, without waiting for them to stir the subject of their insolvency.

In the principles already stated, will be found the reasons for making the provisions of this bill apply as well to existing cases and contracts as to those which arise after the passage of the act.

All the legitimate power of civil society would be exerted in vain to coerce a full compliance with the contracts of insolvents, who have first lost the means of payment which they had in possession, and then are stript by existing laws of all the ordinary and indispensable means and instruments of accumulation and recovery. There are supposed to be not less than 500,000 such persons now in the United States; men who, though now bankrupt and ruined themselves, have, by their industry and skill in business, and the use of capital and credit, added millions upon millions to the aggregate wealth of the nation—a wealth that still subsists, though no part of it is theirs; and who need only to be relieved from the bondage of oppressive debt, to enter again with renewed but chastened energy on the field of enterprise, and add again new millions to the wealth of the community. Society, any more than their own families, cannot afford to lose the services of such men.

It is believed, too, to be the highest interest of creditors themselves, that the condition of their insolvent debtors, either voluntarily or at their instance, should be disclosed, before their affairs, once on the decline, become desperate, leaving nothing available for the payment of their debts. No doubt whatever is entertained, that, under a judicious bankrupt system, more will be realized to creditors on the whole from their insolvent debtors than would be if they should be left to follow up the usual remedies without it. Among other advantages which creditors will have under this bill, is that of being relieved from those unjust preferences, by which it too often happens that the whole estate of a failing debtor is applied to satisfy a favorite creditor in full, while all the rest are left to bear the loss of their entire demands.

That creditors themselves now feel a deep interest in the passage of a bankrupt law, whether viewed as a question of property or a question of policy and humanity, is abundantly evinced by the numerous petitions which have come to us from every quarter of the country, and especially from the great commercial cities. The number of those who still cling to ancient opinions in this matter, and who remonstrate against the escape of their insolvent debtors out of their hands, on any terms, is comparatively very small, and is believed to be diminishing almost daily. As we have said, more will be saved out of insolvent estates under a judicious bankrupt law than could be without it; while to all persons engaged in prosperous business, and to the community at large, the gain which must be realized by restoring so many valuable customers and co-operators in productive employment to active and profitable life and business, cannot fail to be immense.

This bill does not include corporations among the debtors on whom it operates. A recurrence to the principles stated in this report will show that a bill framed on such a basis as this could not, without serious discrepancy, embrace corporations. Corporations aggregate cannot be imprisoned; nor, where the corporate body is alone liable for debts, could the corporators be imprisoned or held personally responsible in any way. As a general, if not an invariable rule, these corporations end their existence on falling into insolvency. Their effects are distributed among their creditors, and the corporation ceases. Every thing is done, in this respect, in the case of a corporation under its own charter, which is proposed to be done under this bill in the case of individuals; while such corporations, being dissolved after their effects are distributed, could not require, and could not receive, a discharge from their debts as bankrupts. They would be discharged already. The law of their organization is or should be bankrupt law enough for them. The remedy, moreover, in case of insolvency of a corporation, is complete, or may be in the State where the corporation exists. The corporation is a creature of the State law, having a local existence, which, from its very nature, lasts no longer than its solvency; and, if the corporation falls into insolvency, no aid or authority on the part of the Federal Government is necessary to give all the relief which the case requires or is susceptible of. State authority and State power is sufficient for this purpose.

The proposition which has sometimes been made to include incorporated banks in a bankrupt bill, proceeds evidently on the notion of the necessity of restraining them in the exercise of their power of creating currency. It is a question of currency; and if the power of arresting State banks in their business of creating currency, or upon their abuse of that business, belongs to this Government at all, it is believed that it is not appropriately derived from the clause in the constitution concerning bankruptcies, but from some authority which it possesses over the subject of currency.

The committee have not deemed it their duty to go into an inquiry concerning the constitutional power of Congress to legislate over State banks, in the mode and with the view proposed; which is understood to be that of arresting their proceedings by the legal interposition of this Government whenever they shall suspend payments in specie. Whether such a power exists, and, if it does exist, whether it is expedient to exercise it, seems to have no immediate connexion with the subject now under consideration. We are clearly of opinion that such an enactment could not find a proper, if it could a constitutional place, in a bankrupt law framed on the principles and with the objects of this bill.