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IN THE

Supreme Court of the United States

CENTRAL VIRGINIA COMMUNITY COLLEGE, VIRGINIA MILITARY INSTITUTE, NEW RIVER COMMUNITY COLLEGE, and BLUE RIDGE COMMUNITY COLLEGE,

Petitioners,

v.

BERNARD KATZ, Liquidating Supervisor of the Bankruptcy Estate in *In re Wallace's Bookstores, Inc.*,

Respondent.

On a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

BRIEF OF HISTORIAN BRUCE H. MANN, *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

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INTEREST OF THE *AMICUS CURIAE*[1]

Amicus Curiae teaches and writes on the history of bankruptcy. He is the author of *Republic of Debtors: Bankruptcy in the Age of American Independence* (Harvard University Press 2002). His interest in this case lies solely in ensuring that legal issues that rest, even in part, on historical arguments are decided on the best historical evidence possible. He is not predisposed for or against debtors, creditors, or federal or state governmental bodies. He files this brief because this case, which addresses an issue of vital importance to the bankruptcy system, turns in large part on eighteenth-century American history.[2]

SUMMARY OF ARGUMENT

Petitioners—Central Virginia Community College, Virginia Military Institute, New River Community College, and Blue Ridge Community College—have stated the issue in this fashion: "May Congress use the Article I Bankruptcy Clause, § 8, cl. 4. to abrogate the States' sovereign immunity." Brief of the Petitioners, p. i. Although that may be one way to frame the issue, the more precise question raised by the opinion of the United States Court of Appeals

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[1] Pursuant to Rule 37.6 of the Rules of the Supreme Court of the United States, the *amicus* files this brief with the written consent of all parties, which are submitted with this brief. The petitioners' consent was given generally. The respondent's consent came in an August 15, 2005 letter. No counsel for a party wrote this brief in whole or in part. No person or entity other than the *amicus* or his counsel made a monetary contribution for the preparation or submission of this brief; it has been prepared *pro bono*.

[2] Bruce H. Mann, J.D., Ph.D., is Leon Meltzer Professor of Law and Professor of History at the University of Pennsylvania. He filed an *amicus curiae* brief in *Tennessee Student Assistance Corp. v. Hood*, 541 U.S. 440 (2004) ("*Hood II*").

in *Hood v. Tennessee Student Assistance Corp.*, 319 F.3d 755 (6th Cir.), *aff'd on other grounds*, 541 U.S. 440 (2004) ("*Hood I*"), which controlled the judgment from which petitioners here sought certiorari, is whether the states surrendered their sovereignty in bankruptcy matters through the adoption and ratification of the Constitution.[3]

If the states did surrender their sovereignty in bankruptcy matters, then any attempted abrogation by Congress is, at worst, redundant. *See* 11 U.S.C. § 106(a). This issue is specific to bankruptcy and the Bankruptcy Clause. It was not addressed in *Seminole Tribe of Florida v. Florida*, 517 U.S. 44 (1996), or in any of the Court's subsequent cases on the scope of the Eleventh Amendment and the sovereign immunity of the states.

Bernard Katz, the court-appointed liquidating supervisor of the bankruptcy estate of Wallace Bookstores, Inc., commenced adversary proceedings in the U.S. Bankruptcy Court for the Eastern District of Kentucky against petitioners to recover preferential payments that each had received. *See In re Wallace's Bookstores, Inc.* (No. 01-50545) (Bkr. E.D. Ky.). Petitioners moved to dismiss the proceedings on the ground of sovereign immunity. The Bankruptcy Court denied the motions in multiple proceedings. *Id.* The U.S. District Court for the Eastern District of Kentucky and the United States Court of Appeals for the Sixth Circuit both affirmed, relying on *Hood I. Katz v. Central Virginia Community College (In re Wallace's Bookstores, Inc.)*, 106 Fed. Appx. 341 (6th Cir. 2004).

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[3] "Because the sole basis for the [Sixth Circuit's] decision [here] was its previous decision in *Hood I*, this court is, for all practical purposes, reviewing the correctness of the [sovereign immunity] holding in *Hood I*." Petitioners' Brief, p. 10.

Petitioners argue that the Eleventh Amendment bars actions to recover preferences against unconsenting States, notwithstanding the bankruptcy power conferred in art. I, § 8, cl. 4. However, petitioners did not limit their petition for a writ of certiorari to this narrower issue. Rather, they have invited the Court to address the larger issue of whether Congress may abrogate the sovereign immunity of the States pursuant to the bankruptcy power, an issue this Court declined to address in *Hood II*. Accordingly, it is appropriate to address the historical underpinnings of that larger issue. Nonetheless, even on the narrower issue of preferences, contemporaries well understood that bankruptcy process limited the ability of debtors to prefer one creditor over another.

The Court of Appeals based its decision in *Hood I* in large part on the original plan of the Constitution, the framers' understanding of bankruptcy law and policy, and the ratification debates in the states. The Court of Appeals was correct, although for historical reasons only lightly touched upon in its opinion.

Contrary to petitioners' argument, there is no evidence that at the time of the ratification of the Constitution the states reserved any right to assert sovereign immunity in any bankruptcy proceedings established pursuant to any Congressional exercise of the bankruptcy power conferred in art. I, § 8, cl. 4. None of the known public or private discussions of bankruptcy—before, during, or after the adoption and ratification of the Constitution—drew any distinction between public and private creditors. Any such distinction would have undermined the concept of a "fresh start," which was generally understood even then to be the fundamental purpose of the bankruptcy discharge.

Petitioners assert that the bankruptcy clause "effectively was ignored in both the Constitutional

Convention and the subsequent struggle for ratification." Petitioners' Brief, p. 40. This mistakes common understanding for unimportance. The historical record—the economic and financial issues that informed the Bankruptcy Clause, the ratification debates, and the subsequent Congressional debates on proposed bankruptcy legislation, including the bill that became the Bankruptcy Act of 1800—demonstrates that the federal bankruptcy power was intended by the framers and understood by their contemporaries to bind all creditors. These understandings rested on the states' surrender of their sovereignty in bankruptcy matters through the adoption and ratification of the Constitution. Both proponents and opponents of federal bankruptcy legislation recognized that the federal bankruptcy power necessarily entailed a concomitant abrogation of state sovereignty by binding states to discharges and by otherwise interfering with state sovereignty.

ARGUMENT

I. PETITIONERS AND THE *AMICI CURIAE* THAT SUPPORT THEM MISUNDERSTAND THE HISTORY OF BANKRUPTCY.

Petitioners and *amici curiae* in their support assert that the comparative lack of attention given the Bankruptcy Clause at the Constitutional Convention "confirms that the scope of Bankruptcy Clause power is narrow,'" Petitioners' Brief, p. 40, "an interpretation confirmed by the historical record," *id.*, p. 33. On the contrary, the contemporary understanding of bankruptcy was quite expansive: it embraced both the "fresh start" of the discharge and a large measure of voluntariness—that is, a choice by the debtor.

The first published argument for outright bankruptcy discharges in the American colonies appeared in an anonymously-written pamphlet in 1755. *See* [N.N.], *Some*

Reflections on the Law of Bankruptcy: Wrote at the Desire of a Friend: Shewing, That such a Law would be beneficial to the Publick, and analogous to Reason and our Holy Religion (1755). The author explicitly recognized the value of providing insolvent debtors with a fresh start, lamenting that "[m]en who prove insolvent, are commonly branded as villains." *Id.* at 4. While some insolvent debtors deserved the label, he observed that "a great many" were "Men of Probity and Honour" whose ruin stemmed from nothing more sinister than their "not being sufficiently instructed in the Nature of Trade." *Id.*

Imprisoning those debtors served no purpose other than to disgrace and demoralize them. Releasing them from jail without addressing their debts did no better. The insolvent debtor freed from jail by the poor debtor's oath,[4] which did not provide a discharge, remains "so sunk with the Weight of his Debts, he has no Heart to contrive or work for his relief," and so will do nothing. *Id.* at 5. He imagines "that he is Nothing but a Slave to his Creditors; that he is like never to possess any Thing for himself or Family, and so the remaining Part of Life is lost (and worse than lost) to himself, his Creditors, and to the Publick." *Id.*

If, however, an insolvent debtor could "deliver up his Effects to his Creditors, and *begin the World anew*, he might be encouraged to Frugality and Industry, and do every Thing in his Power to make an Interest for himself, as every Thing that he should then acquire would be his own." *Id.* (emphasis added). For that reason and others, N.N. argued

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[4] Indigent debtors, those whose debts were small and their assets even less and who had been in jail for thirty days, could swear to those facts and be released. *See* Bruce H. Mann, *Republic of Debtors: Bankruptcy in the Age of American Independence* 50-51 (2002) ("Mann").

that a bankruptcy act was "consistent with Reason, and agreeable to the Genius of our holy Religion." *Id.* at 7.

In the eight years after N.N. wrote, four colonies enacted bankruptcy laws with discharges. Three statutes—in Massachusetts, Rhode Island, and Connecticut—were voluntary. Only New York passed an involuntary act. Three—Rhode Island, Connecticut, and New York—applied to noncommercial as well as commercial debtors. Only the Massachusetts act was limited to commercial debtors. *See* Mann at 59-65. New York, Connecticut, and Rhode Island also permitted debtors to petition the colony legislature for bankruptcy discharges. *See id.* at 62-63, 72-77. After the Revolution, but before the Constitutional Convention, Pennsylvania and New York enacted bankruptcy laws that included discharges. Pennsylvania's was nominally involuntary and limited to commercial debtors. New York's was voluntary and applied to both commercial and noncommercial debtors. *See id.* at 177-79.

Creditors and debtors alike understood that the purpose of the discharge was to provide the debtor with a fresh start. As Clement Biddle, a Philadelphia broker, wrote, "Most of my principal Creditors advised me to suffer a Commission of Bankruptcy to issue against Me to Close my old affairs so as to be able to proceed with more security ... in my present Business." Clement Biddle to Richard Smith (Apr. 25, 1789), Clement Biddle Letterbook, 1789-1792, Historical Society of Pennsylvania, Philadelphia; *see* Mann at 179.

Against this background, it is clear that the framers recognized that personal discharge and a fresh start were fundamental to bankruptcy law and therefore understood them to be an integral part of "uniform Laws on the subject of Bankruptcies." At least one delegate to the Constitutional Convention knew this to be the case first-hand: Jared

Ingersoll had argued before a state court in 1787 that failure to recognize an out-of-state bankruptcy discharge—and perforce the fresh start of the discharge itself—would mean that "perpetual imprisonment must be the lot of every man who fails; and all hope of retrieving his losses by honest and industrious pursuits, will be cut off from the intemperate bankrupt." *Millar v. Hall*, 1 U.S. (1 Dall.) 229, 230 (Pa. 1788); *see* Mann at 184-85; *see infra* at 17. Moreover, this remained the understanding of the members of Congress who drafted the first national bankruptcy legislation.

As Congress took up bankruptcy bills in the 1790s, no one disputed that commercial creditors and commercial debtors alike wanted a federal bankruptcy system that would sort out claims, distribute assets, and provide a discharge.[5] Robert Goodloe Harper of South Carolina, a leading Congressional proponent of bankruptcy, said in 1798 that a bankruptcy system "is greatly desired by the mercantile part of the community" and would have "beneficial effects in the support of mercantile credit, the prevention of fraud, the restraint of imprudent and destructive speculation, and the relief of honest industry, reduced to distress by the vicissitudes of trade." 5th Cong., 2d sess. (Jan. 3, 1798), 7 *The Debates and Proceedings in the Congress of the United States* 796-97 ("*Annals of Congress*").

Congressman James A. Bayard of Delaware, the most vigorous advocate of a bankruptcy law, made essentially the same point a year later when he stated that "[t]he principle of a bankrupt law ... is peculiarly applicable to merchants, and is manifestly calculated for the benefit of both debtor and

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[5] Petitioners assert that "after the adoption of the Constitution, Congress almost completely ignored the Bankruptcy Clause power." Petitioners' Brief, p. 41. On the contrary, proposals for "uniform Laws on the subject of Bankruptcies" arose in every Congress from the First through the Sixth. *See* Mann at 187.

creditor." 5th Cong., 3d sess. (Jan. 15, 1799), 9 *Annals of Congress* 2657. He embraced the importance of the fresh start to bankruptcy by arguing that it was "reasonable" that a debtor's creditors "should accept of his property equally among them and have him at liberty *to begin the world anew*, as such a treatment will inspire a man with activity in making a future provision for himself and family; but if a person in such a situation is told that any exertions which he may make shall not go to the benefit of himself or to his family, but to his creditors, all his hopes are blasted, and he has no motive for industry or frugality, and he is lost to himself and the world." *Id.* (emphasis added).

It is commonly claimed, albeit erroneously, that English law, which could only be invoked by creditors, was the sole governing model for the Bankruptcy Act of 1800 and that, therefore, the plan of the Convention could not have included a surrender of the states' immunity from suit by insolvent debtors because there were no voluntary proceedings. Such claims make the common mistake of looking only at the language of the Act and not at the practice under it. *See* Petitioners' Brief, p. 35 n.43. They also ignore the several colonial and state bankruptcy statutes that permitted voluntary petitions by debtors. *See supra* at 6. It is true that the language of the Act of 1800 differed little from the various statutes that comprised English bankruptcy law. In application, however, the two differed sharply. Although in form involuntary, in substance the Act of 1800 was frequently wielded voluntarily by debtors. A comprehensive examination of all of the extant filings under the Act reveals numerous collusive or cooperative filings, the result of insolvent debtors enlisting sympathetic creditors—often family members—to sue out commissions of bankruptcy against them. *See* Mann at 228-39; *see also infra* at VI.

The immediacy with which debtors, creditors, and their lawyers recognized the voluntary potential of the process, together with the assertions of the drafters that the Act was necessary to protect entrepreneurial debtors, strongly indicate that the latent voluntarism of the process was deliberate. Upon learning of the adoption of the Act, debtors imprisoned in New York were so excited by "the prospect of returning to the world" that they celebrated by toasting "[t]he Bankrupt Law, this Godlike act," which presumably they would not have done had they thought its benefits uncertain or attainable only at the whim of hostile creditors. *See Forlorn Hope* (New York), Apr. 7 and 19, 1800.

Shortly before the Act went into effect, an anonymous interlocutor submitted thirty-six questions about the Act to five of the most prominent lawyers in New York—Aaron Burr, Robert Troup, Richard Harison, Brockholst Livingston, and Cornelius S. Bogert—all of whom treated the Act as an American original that did not require citation to English law, in which all were well-versed, to explain. While Burr made only a cursory reply, the other four gave thoughtful, concise answers to each question. *See* Opinions, Questions, and Answers on the Bankruptcy Act, May 27, 31, 1800, *The Papers of Aaron Burr, 1736-1836*, ser. I, reel 4, frames 656-83 (Mary-Jo Kline ed., microfilm ed., 1977).

All four explicitly described the steps that debtors who had already failed should take to qualify themselves for inclusion under the Act, since the acts of trading and acts of bankruptcy required by the new law had to occur after the effective date of the Act. *See id.* at frames 656-59, 661-62. They did not regard their responses as merely hypothetical. Five months later, Troup counseled a client how to make a voluntary proceeding appear involuntary. *See* "Memorandum for Mr. [Nicholas] Low respecting

Mr. [Jacob] Halletts bankruptcy" (Oct. 18, 1800), Robert Troup Papers, box 2, folder 1, New York Public Library, New York. Harison later gave detailed advice on how to initiate a "friendly" bankruptcy for an upstate merchant. *See* "Draft opinion on Case of Mr. [Jacob] Cuyler" (May 11, 1802), Richard Harison Papers, box 4, New-York Historical Society, New York.

Troup and Harison each served as commissioners of bankruptcy under the Act and so advised with particular authority. *See* Mann at 225, 233-34. In advising their clients how to turn the formally involuntary Act of 1800 into a *de facto* voluntary Act, Troup and Harison were simply acting on a widespread understanding of bankruptcy as a process that was available to debtors on a voluntary basis, both *de jure* in states that permitted voluntary petitions and *de facto* in states that did not.

On the narrower question of preferences, contemporaries well understood that a major advantage of bankruptcy process was that it limited the ability of debtors to prefer one creditor over another. A pervasive problem in the increasingly commercial colonial economies of the eighteenth century was that, compared to local creditors, distant creditors worked with imperfect information, compounded by the slowness with which it traveled. News of a debtor's decline reached faraway creditors after nearer creditors had already had an opportunity to act on the same information, which they would do by persuading the debtor to secure the debt or by serving attachment process on the debtor and securing for themselves a place of priority in the queue. *See* Mann at 47-49.

The statutory oaths that several colonies required of insolvent debtors for release from jail acknowledged this problem by including, as New York did, the affirmation that the debtor had not "at any time Since my imprisonment or

before Directly or indirectly, Sold, leased, assigned or otherwise disposed or made over in trust for my Self or otherwise ... any part of my lands, estate, Goods Stock Money Debts or other real and personal estate, whereby to have or expect any benefit or profit to my Self or to Defraud any of my Creditors"—language that could encompass fraudulent conveyances and preferences. "An Act for the relief of Insolvent Debtors within the Colony of New York with respect to the imprisonment of their persons," 2 *The Colonial Laws of New York from the Year 1664 to the Revolution*, at 670 (1894).

William Samuel Johnson, a member of the Connecticut delegation to the Constitutional Convention, also recognized the problem. As a creditor's lawyer before the Revolution, he ignored a client's instructions to try to negotiate security for a debt and instead gave writs of attachment to an officer to be served on the debtor when he discovered that another creditor had given his own writs to the same officer to serve on the same debtor. Johnson explained to his client that he had done so to place his client "on the same footing with" the competing creditor rather than suffering "while a less favorable creditor is secured." William Samuel Johnson to James McEvers, Oct. 23, 1764, William Samuel Johnson Papers, Letterbook 12, Connecticut Historical Society, Hartford, Connecticut.

II. WIDESPREAD BUSINESS FAILURES AND INCREASING PRIVATE DEBT PROMPTED COLONIES IN THE 1750s AND STATES IN THE 1780s TO EXPERIMENT WITH BANKRUPTCY LEGISLATION.

The framers' understanding of both debt and bankruptcy had deep roots. Issues of debt—both public and private—loomed large in the 1780s. The American Revolution was fought on credit in the form of direct loans

and, more importantly, of paper currency and scrip issued by the Continental Congress and state governments. Congress and the individual states issued bills of credit and loan certificates of various kinds to purchase supplies and pay soldiers on the promise to pay interest on them or to redeem them in the future in specie or, more commonly, by accepting them in payment of tax obligations.

Massive emissions of new currency were required to sustain the war effort, thereby precipitating a sharp decline in the value of the currency in circulation. Depreciation was aggravated by inflation as large-scale government purchases drove prices upward, prompting Congress to print even more currency. By the end of the war, Congress had issued some $200 million in continental currency, which had fallen in value from near par to less than a hundredth of the value of specie. The states had emitted a similar amount, with similar results. *See* Mann at 169-70; *see generally* E. James Ferguson, *The Power of the Purse: A History of American Public Finance, 1776-1790* (1961).

Private debts were only slightly less daunting. The war had disrupted foreign trade, which was the linchpin of the entire economy. Peace did not undo the disruption. The American economy contracted steadily throughout the 1780s as exports fell, imports grew, and income and wealth declined. The decline of prices, the scarcity of cash, depreciation, competition from British manufactures, the obstacles to establishing export markets when no longer part of the British empire, and efforts by British commercial creditors to collect pre-war debts, all contributed to a wave of business failures after the American Revolution. *See* Mann at 170-71; *see generally* John J. McCusker and Russell R. Menard, *The Economy of British America, 1607-1789, with Supplementary Bibliography* (1991).

The instability of paper currency in the 1780s generated three responses that influenced the debate over bankruptcy legislation in the following decade. The most immediate response was proposals to charter banks, which could issue bank notes as a form of private currency that would be backed by something more substantial than the traditional hope-and-a-prayer of government issues. The second response, corollary to the first, was the enactment of state tender laws, which required creditors to accept paper currency at face value in payment of debts, without regard to the actual depreciated value of the currency. The third response was the rapid spread of speculation in every kind of government issue that contemplated future redemption, whether land warrants or debt certificates. Within just a few years, most of the state and national public debt was held by speculator-investors who had bought warrants, certificates, and indents from the original holders at steeply discounted prices. As prospects for a stronger national government increased with the announcement of the Constitutional Convention, so, too, did speculation in the public debt. *See* Mann at 172-76.

The sharp rise in private debt and the spread of business failures after the Revolution directly influenced the debate over bankruptcy legislation. Even before the Revolution, the growing geographic complexity of credit created by trading networks and the assignment of debt obligations had planted the idea that an insolvent debtor's assets rightfully belonged to all of the debtor's creditors rather than to the creditor quickest to seize them. *See id.* at 47-53. The economic dislocations of the Seven Years' War in the 1750s and 1760s had reinforced this idea by demonstrating that economic failure need not imply moral failure, thereby sweeping aside the principal objection to discharging debts. Indeed, the impact of war-time economic risk helped redefine insolvency from a moral delict to an economic one. Between 1755 and 1763, four colonies

enacted bankruptcy systems that distributed insolvent debtors' assets among their creditors and discharged them from further liability on their debts. *See id.* at 53-55. The economic consequences of the Revolution and its aftermath taught the same lessons twenty years later on an even larger scale. *See id.* at 53-61, 82-83, 102.

Debtors and creditors alike in the eighteenth century appreciated the value of bankruptcy process. Every colony, and later every state, permitted imprisonment for debt. *See id.* at 79. Without statutory mechanisms for apportioning a debtor's property, priority among unsecured creditors was determined by order of suit. Imprisoned debtors could not purchase their freedom simply by paying the first arresting creditor and ignoring the rest. Colonies and, later, states sporadically experimented with insolvency statutes that released those with small and middling debts from jail and apportioned their assets among their creditors but did not discharge them from liability. Experiments with true bankruptcy discharges were even more limited. *See id.* at 44-67. Large-scale insolvent debtors had little choice other than avoiding arrest or going to jail. The jails they went to were grim places where debtors, unlike criminal prisoners, had to provide their own food, fuel, and clothing—whether supplied from their own resources, the generosity of family or friends, begging, or the beneficence of local relief societies—or they did without. *See id.* at 78-108.

Not surprisingly, calls to abolish imprisonment for debt went hand in hand with proposals to enact bankruptcy legislation. From the first published argument for bankruptcy discharges in 1755,[6] bankruptcy was promoted as

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[6] [N.N.], *Some Reflections on the Law of Bankruptcy: Wrote at the Desire of a Friend: Shewing, That such a Law would be beneficial to the Publick, and analogous to Reason and our Holy Religion* (1755).

a benefit for creditors as well as for debtors. It would allow creditors to intervene and preserve the debtor's assets for all creditors, and the availability of discharge would induce debtors not to waste their assets in futile efforts to avoid debtors' prison. Merchants in particular demanded bankruptcy legislation because they understood that commercial creditors were themselves debtors and saw the value of asserting mercantile control over business failures.

Thus, the bankruptcy statute enacted by Pennsylvania in 1785 in response to the post-war rise in business failures announced its commercial purpose in the preamble: a bankruptcy law was "necessary and proper as well as conformable to the usage of commercial nations." "An Act for the Regulation of Bankruptcy," 12 *The Statutes at Large of Pennsylvania from 1682 to 1801*, at 70 (James T. Mitchell and Henry Flanders comps., 1906).[7] Indeed, proceedings under the Pennsylvania statute often began only after commercial creditors had met and agreed to file a petition against the debtor. *See* Mann at 177-79.

The debt-related issues that dominated the 1780s thus included widespread private and public indebtedness, a fragile economy, unstable currency, mounting business failures, and the constant prospect of imprisonment for debt. Calls for bankruptcy legislation were one response; armed resistance, such as Shays's Rebellion and other violent episodes,[8] was another. This was the context for the Bankruptcy Clause of Article I, Section 8 of the Constitution.

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[7] During the same period, New York enacted several limited, short-lived, and often-confusing bankruptcy statutes. *See* 2 *The Law Practice of Alexander Hamilton: Documents and Commentary* 332-36 (Julius Goebel, Jr., and Joseph H. Smith, eds., 1969); *see also* Mann at 179-80.

[8] *See In Debt to Shays: The Bicentennial of an Agrarian Rebellion* (Robert A. Gross ed., 1989).

III. DELEGATES TO THE CONSTITUTIONAL CONVENTION RECOGNIZED THE IMPORTANCE OF A UNIFORM LAW OF BANKRUPTCY THAT APPLIED TO ALL DEBTORS AND CREDITORS.

Bankruptcy first arose at the Constitutional Convention in a brief exchange over the full faith and credit clause. The Articles of Confederation had required the states to give full faith and credit to each other's judicial decisions. The Committee of Detail proposed enlarging this to include acts of the state legislatures. James Wilson of Pennsylvania and William Samuel Johnson of Connecticut explained that just as court judgments in one state should be accepted as the bases for legal proceedings in others, so, too, should the acts of each state's legislature, expressly naming those "for the sake of Acts of insolvency." Upon which Charles Pinckney of South Carolina moved to commit the provision to the committee, with the additional proposition "To establish uniform laws upon the subject of bankruptcies, and respecting the damages on the protest of foreign bills of exchange." 2 *The Records of the Federal Convention of 1787* at 447-48 (Max Farrand ed., 1937). When the matter returned to the floor of the Convention five days later, the expanded full faith and credit clause and the newly-created bankruptcy clause were voted on one after the other, although the final draft of the Constitution placed them in widely separated articles. *Id.* at 488-89; *see infra* at 21 & n.10.

The early close association between the full faith and credit clause and the bankruptcy clause is significant. By effectively binding each state to the judicial determinations of every other state, the full faith and credit clause necessarily invaded the sovereignty of each state in the same way that state subordination to a federal bankruptcy discharge would.

As Wilson and Johnson made clear, insolvency drove the extension of full faith and credit to acts of the legislatures. Alone among the states that had some form of insolvency process, Johnson's state, Connecticut, granted insolvency relief by legislative act rather than judicial decree. Although the Connecticut assembly was sparing in its grants of relief, many of the petitioners were merchants and traders who, if granted an act of insolvency or the lesser boon of temporary freedom from arrest, could travel to meet with their creditors in neighboring states and do business there if those legislative acts conferred extraterritorial protection. *See* Mann at 183. For its part, Pennsylvania, Wilson's state, had already dealt with issues of comity in insolvency in a case that decided the question of whether a debtor who had been released from jail in New Jersey under that state's insolvency act could plead the New Jersey discharge from jail to set aside a judgment entered against him by a Pennsylvania court for the same debt.

Lawyers for the debtor, Andrew Allen, argued that the full faith and credit clause of the Articles of Confederation meant that the New Jersey discharge "may be carried about by the Defendant into each of those states, as an impenetrable suit of armour to guard him from all future attacks upon his liberty, for a cause of action existing at the time it was granted." *James et al. v. Allen*, 1 U.S. (1 Dall.) 188, 190 (Pa. C.P. Phila. Co. 1786). The creditors' lawyers—one of whom, Jared Ingersoll, later served with Wilson in the Pennsylvania delegation to the Constitutional Convention—replied that the New Jersey discharge was "entirely a municipal regulation," merely "a local order confined to a limited district," which only released Allen from the Essex County jail and shielded him from further arrest in New Jersey but did not determine the underlying

debt or how Pennsylvania could proceed. *Id.*[9] The creditors' lawyers further argued that "[t]he articles of conf[ederation] require full faith to be given ...; but they do not introduce the Laws of one State into another state; they do not enable a P[laintiff] to issue an exe[cution] in one State for a judgment obtained in another." "James & Carsen v. Andrew Allan," in Peter Stephen DuPonceau, Precedent Book, 1785-1798, at 149, 157, Peter Stephen DuPonceau Papers, Historical Society of Pennsylvania, Philadelphia.

The presiding judge of the court of common pleas for Philadelphia County agreed. If the New Jersey order had discharged the underlying debt, he stated, full faith and credit might have required Pennsylvania to follow suit, but an order discharging a debtor from jail in one state did not discharge him from a different jail in a different state. In a passage with which Wilson surely would have been familiar, and Ingersoll clearly was, the judge wrote that "[i]nsolvent laws subsist in every State in the Union, and are probably all different from each other; ... and they have never been considered as binding out of the limits of the State that made them." *James et al. v. Allen*, 1 U.S. (1 Dall.) at 191; *see* Mann at 183-84. Only a federal bankruptcy power could redress this weakness, and only if a bankruptcy discharge bound all creditors wherever located.

While the delegates were meeting in Philadelphia, Ingersoll was preparing to argue—or perhaps had recently argued, the precise timing is uncertain—a case that squarely raised the issue of what effect a full bankruptcy discharge in one state should have in another. For a brief period in 1787,

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[9] The phrase "a local order confined to a limited district" appears not in the published report but in a slightly fuller manuscript version of the arguments in "James & Carsen v. Andrew Allan," in Peter Stephen DuPonceau, Precedent Book, 1785-1798, at 149, 156-57, Peter Stephen DuPonceau Papers, Historical Society of Pennsylvania, Philadelphia.

Maryland had a bankruptcy statute. A debtor, one Hall, a resident of Maryland, had received a discharge under the statute. His creditor, one Millar, who lived in Philadelphia, had not seen the notice of Hall's intent to seek the benefit of the act, which had been published as the statute required in the *Maryland Gazette*, nor had Hall listed Millar as a creditor in his schedule of debts. When Hall next set foot in Pennsylvania, Millar had him arrested for the unpaid debt. Ingersoll, representing Hall before the Pennsylvania Supreme Court, argued that the full faith and credit clause of the Articles of Confederation required Pennsylvania to recognize the Maryland discharge. He also contended that the same result was compelled "from general principles; ... from the reason of the thing, and from the mischievous consequences of a contrary position," because without a universally-recognized discharge "perpetual imprisonment must be the lot of every man who fails; and all hope of retrieving his losses by honest and industrious pursuits, will be cut off from the intemperate bankrupt." *Millar v. Hall*, 1 U.S. (1 Dall. at 230).

This last argument was the one on which Chief Justice Thomas McKean based his ruling for the debtor. *See* Mann at 184-85. It was an argument that justified a uniform law of bankruptcy binding on all creditors and debtors. It was also an argument that recognized that one purpose of a bankruptcy discharge was to provide the debtor with a fresh start, unburdened by continuing liability to any of his creditors. And it was an argument made by a delegate to the Convention while the Convention was weighing the bankruptcy clause.

IV. IN THE RATIFICATION DEBATES, FEDERALISTS AND ANTIFEDERALISTS ALIKE UNDERSTOOD THAT THE FEDERAL BANKRUPTCY POWER ENTAILED AN ABROGATION OF STATE SOVEREIGNTY BY BINDING STATES TO DISCHARGES.

The idea that bankruptcy raised issues that were better addressed on a national level rather than through mechanisms of interstate comity thus took root during the Constitutional Convention. The lawyers and judges in the two Pennsylvania cases, and, through them, key delegates to the Convention, clearly recognized the problems inherent in applying varying state insolvency and bankruptcy rules to debtors and creditors who lived in different states. Credit, like commerce, could not be contained within state boundaries. Full faith and credit helped somewhat, but it could harm out-of-state creditors by imposing on them state bankruptcy discharges that stripped them of the debts owed them without their participation in the process. As Wilson remarked at the Pennsylvania ratifying convention, "Merchants of eminence will tell you that they can trust their correspondents without law; but they cannot trust the laws of the state in which their correspondents live." Proceedings and Debates of the Convention, Dec. 7, 1787, 2 *The Documentary History of the Ratification of the Constitution* 519 (Merrill Jensen *et al.*, eds., 1976) ("*Documentary History*").

Federal "uniform Laws on the subject of Bankruptcies," which subjected debtors and creditors to the same rules and procedures regardless of where they lived, would be more consonant with the interstate nature of commerce and the credit relations on which commerce rested. James Madison recognized this in the single mention of the bankruptcy clause in *The Federalist*, when he wrote that the "power of establishing uniform laws of bankruptcy,

is so intimately connected with the regulation of commerce, and will prevent so many frauds where the parties or their property may lie or be removed into different States, that the expediency of it seems not likely to be drawn into question." *The Federalist* No. 42 at 287 (James Madison) (Jacob E. Cooke ed., 1961).[10] So did Samuel Holden Parson, a delegate to the Connecticut ratifying convention, when he explained that "[t]he general laws of bankruptcy appear to be necessary both for creditors and debtors, and it appears reasonable, when conformed to in one state, they should be effectual to secure the debtor throughout the union," which could only be accomplished by a uniform federal law. Parson to William Cushing, Jan. 11, 1788, 3 *Documentary History* 572.[11]

None of the discussions of bankruptcy before, during, or after the ratification debates drew any distinction between public and private creditors. All the available evidence suggests that Antifederalist opponents of the Constitution believed that the proposed federal bankruptcy power recognized no such distinction. The anonymous "Federal Farmer," for example, argued that a federal bankruptcy power was an interference "with the internal police of the separate states, especially with their administering justice

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[10] Madison discussed the full faith and credit clause in the very next paragraph, thus maintaining the juxtaposition of the clauses at the Convention despite their separation in the Constitution he was defending.

[11] Petitioners state that "the Bankruptcy Clause power was not mentioned in the States' Ratification Debates." Petitioners' Brief at 41. Parson's letter indicates this statement is incorrect.

among their own citizens."[12] Such a power threatened to extend the reach of the federal judiciary—always a concern of the Antifederalists—by drawing "almost all civil causes" into the federal courts. This interference "with the internal police of the separate states" would necessarily entail a concomitant abrogation of state sovereignty by binding states to federal bankruptcy proceedings. The "danger" perceived by the Antifederalists was the very benefit intended by the framers. Because of the ratification debates, that would have been the understanding of the federal bankruptcy power as ratified by the people.

V. THOMAS JEFFERSON OPPOSED THE FEDERAL BANKRUPTCY POWER AS AN INVASION OF STATE AUTHORITY.

Thomas Jefferson recognized the extraordinary federal powers contemplated by bankruptcy laws proposed pursuant to the Bankruptcy Clause.[13] He was no less aware of the extent to which those powers curtailed state sovereignty. Upon reading the bankruptcy bill that was before Congress in 1792, he outlined his objections to provisions that later were enacted in the Bankruptcy Act of 1800 and sent them to James Madison. The bill in question had been prompted in part by a petition from 148 South

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[12] *An Additional Number of Letters From the Federal Farmer to the Republican Leading to a Fair Examination of the System of Government Proposed by the Late Convention; To Several Essential and Necessary Alterations in It; And Calculated to Illustrate and Support the Principles And Positions Laid Down in the Preceding Letters* (1788), 2 Herbert J. Storing ed., *The Complete Anti-Federalist* 214, at 344 (1981).

[13] "It is appropriate to consult not only *The Federalist*, but also the 'writings of other intelligent and informed people of the time' that 'display how the text of the Constitution was originally understood.'" Petitioners' Brief, p. 46, n.50, quoting Antonin Scalia, *A Matter of Interpretation: Federal Courts & the Law* 38 (1997).

Carolina merchants and traders—creditors as well as debtors—praying for a bankruptcy law. *See* Mann at 196. Jefferson objected that the bill would invoke federal intervention too readily by treating any move across state lines as an act of bankruptcy, which would enable a creditor to petition his debtor into bankruptcy even though the debtor remained subject to state debt-collection process under the full faith and credit clause. Jefferson also objected to the proposal to give federal bankruptcy commissioners the authority to "enter houses, break open doors, chests, etc." to arrest bankrupt debtors—a power denied to state officers executing state process. *See* "Extempore thoughts and doubts on very superficially running over the bankruptcy bill" (Dec. 10, 1792), 24 *The Papers of Thomas Jefferson* 722-23 (Julian P. Boyd *et al.* eds., 1990).[14]

These reservations paled beside what Jefferson saw as the most threatening part of the bill—that it permitted the land of bankrupt debtors to be seized and sold under federal law in direct contravention of state laws that shielded land from execution process. Jefferson explicitly cast the issue as one of federal trespass on state prerogative: "Is not this a fundamental question between the general and state legislatures?" *Id.* at 722-23. To John Francis Mercer he wrote that the bankruptcy bill "assumes the right of Seizing and selling lands, and so cuts the knotty question of the Constitution whether the general government may direct the transmission of land by discent [sic] or otherwise." Jefferson to John Francis Mercer (Dec. 19, 1792), *id.* at 758. To Thomas Mann Randolph, Jr., he complained about the bill that "[h]itherto we had imagined the general government

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[14] Jefferson sent the "loose thoughts" to James Madison. *See* Jefferson to Madison [ca. Dec. 10, 1792], 24 *Papers of Thomas Jefferson* 717. The extraordinary arrest power became law in the Bankruptcy Act of 1800, "An Act to establish an uniform system of Bankruptcy throughout the United States," 2 Stat. ch. 19, § 4.

could not meddle with the title to lands." Jefferson to Thomas Mann Randolph, Jr. (Dec. 21, 1792), *id.* at 775. Jefferson clearly saw that the federal bankruptcy power entailed a circumscription of state authority beyond that implied by the concept of mere geographic uniformity alone.

VI. THE BANKRUPTCY ACT OF 1800 STRENGTHENED NATIONAL AUTHORITY AT THE EXPENSE OF THE STATES.

The Bankruptcy Act of 1800 passed by the Sixth Congress was virtually identical to the bankruptcy bills considered by the five preceding Congresses.[15] It therefore embodied an understanding of the nature and extent of the federal bankruptcy power and its relationship to state sovereignty that was unchanged from the ratification of the Constitution. Although the Act passed the House of Representatives only on the tie-breaking vote of the Speaker, the only difference of opinion between proponents and opponents of the bill was whether the nation required a bankruptcy system at all. No one in any of the extensive floor debates on the bill across several sessions of Congress questioned that Congress had the authority under the Bankruptcy Clause to override state laws on the seizure of land or on the arrest and imprisonment of debtors. On the contrary, everyone recognized that a federal bankruptcy system would strengthen national authority at the expense of the states.

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[15] The immediate impetus for the Act was the financial collapse of the Panic of 1797, when numerous prominent men—including an associate justice of this Court—found themselves imprisoned for debt or fugitives from their creditors. Their presence in the pool of insolvent debtors confounded the normal expectations of social and economic status and altered the political dimensions of debtor relief. *See* Mann at 202-05. A uniform federal bankruptcy law would not help these men if it did not override the very state process by which they had been imprisoned.

For example, when James A. Bayard of Delaware, a leading proponent of the bill, argued that a "great advantage of this law will be that it will generalize, by an uniform system through the United States, the most important law of any society—the law regulating the relation of debtor and creditor," he had in mind more than certainty and predictability of legal relations. 5th Cong., 3d sess. (Jan. 15, 1799), 9 *Annals of Congress* 2664. To Bayard, uniformity was a means, not an end. A uniform national bankruptcy law would "unite and naturalize the United States, and ... cement together the different parts of the Union and connect more closely the nation with the Federal Government." *Id.* This was why he regarded a bankruptcy act as "among the greatest national objects." *Id.*

Similarly, Theodore Sedgwick of Massachusetts believed that a bankruptcy law would promote the authority of the government "by submitting to it all the relations of creditor and Debtor, and the active agency of commercial interests and passions." More importantly, he said, "it will render it absolutely necessary to spread out the national judicial by a creation of new districts and Judges, and instituting the offices of justice or some thing similar to it." Sedgwick to Henry Van Schaack (Jan. 15, 1800), Theodore Sedgwick Papers, box 3, folder 1, Massachusetts Historical Society, Boston. As Bayard reported to his father-in-law, "The Antis have discovered that [the bankruptcy bill] will add strength to the federal compact, and they make every exertion to defeat it." Bayard to Richard Bassett (Feb. 1, 1800), Bayard Family Papers, Library of Congress, Washington, D.C.; *see generally* Mann at 208-14.

The ways in which the Bankruptcy Act of 1800 curtailed state sovereignty were clear and deliberately designed. As Sedgwick informed one correspondent, the bill would undermine the attachment laws common in New England. It would also subject land in Virginia to the

payment of debts in certain circumstances "and may form a precedent for the further extension of the principle" of levying on land in others. Sedgwick to Rufus King (Feb. 6, 1800), Copies of Letters from Theodore Sedgwick to Rufus King, Theodore Sedgwick Papers, box 9, vol. 10. In addition to giving federal bankruptcy commissioners arrest powers, denied by every state to its own officers, *see* 2 Stat. 19, § 4, the Act barred state attachment process, *id.* at § 13, superseded state arrest process, *id.* at § 22, authorized use of the writ of habeas corpus to free discharged debtors from jail, *id.* at § 38, and included real property in the debtor's estate to be distributed to creditors without regard to state statutes that barred seizure of unmortgaged land or that imposed other restrictions, such as valuation requirements designed to prevent distress sales at artificially low prices, *id.* at §§ 29, 30, 44, 59. Each of these provisions represented a significant restriction of state sovereignty. None of them encountered objections on Constitutional grounds.

This is not to say that the Act was uncontroversial.[16] The leading opposition newspaper, the Philadelphia *Aurora*, denounced the law as a Federalist plot to extend the power of the federal judiciary and create "a patronage of nearly 250 offices great and small." *Aurora, or General Advertiser* (Philadelphia), Mar. 18 and 29, 1800. Congressman Anthony New made the same charge to his constituents in Virginia, reporting that the law transfers to the federal courts "a great portion of the jurisdiction now held by the State

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[16] Significant support for the Act came from urban commercial creditors, who hoped federal bankruptcy process would help sort out claims against and reach the assets of the large numbers of commercial debtors imprisoned in the wake of the collapse of speculation schemes in the Panic of 1797. The only real concern for debtors came from opponents of the Act, who feared that the Act, although limited to commercial debtors, would sweep in farmers and other landowners. *See generally* Mann at 198-220.

Courts, ... greatly increases Executive patronage, and may be made to extend to almost every description of citizens." He paired the bankruptcy act with the pending judiciary bill as examples of the Federalists' "favorite scheme of consolidation." Anthony New, Circular Letter (Apr. 8, 1800), 1 *Circular Letters of Congressmen to Their Constituents, 1789-1829* at 196 (Noble E. Cunningham, Jr., ed., 1978). Congressman John Fowler of Kentucky suspected that the law "will be little more than a machine for extending the influence of the executive administration" and "an instrument to injure the incautious agriculturalists." John Fowler, Circular Letter (May 15, 1800), *id.* at 209. None of the opponents argued that the Act was an unconstitutional impairment of state sovereignty. To the contrary, it was clear to both proponents and opponents of the Act that the states had already surrendered their sovereignty in bankruptcy matters through the adoption and ratification of the Constitution.

Chief Justice John Marshall, who as a member of Congress from Virginia had voted for the Bankruptcy Act of 1800, *see* 6th Cong., 1st sess. (Feb. 21, 1800), 10 *Annals of Congress* 534, acknowledged this surrender just five years later when he expressly rejected the argument that a "claim of priority on the part of the United States will ... interfere with the right of the state sovereignties respecting the dignity of debts" with the reply, "But this is an objection to the constitution itself. The mischief suggested, so far as it can readily happen, is the necessary consequence of the supremacy of the laws of the United States on all subjects to which the legislative power of congress extends." *United*

States v. Fisher, 6 U.S. 358, 396-97 (1805).[17] In this, unlike in so many other Constitutional matters, Marshall and Jefferson were agreed.

CONCLUSION

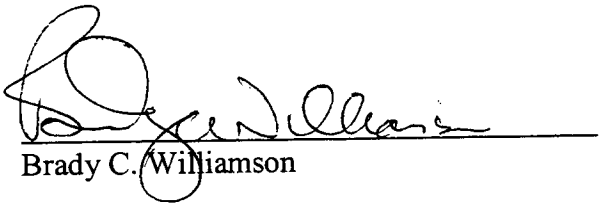
There is no evidence that at the time of the ratification of the Constitution the states reserved any right to assert sovereign immunity in bankruptcy proceedings established pursuant to Congressional exercise of the bankruptcy power conferred in art. I, § 8, cl. 4 of the Constitution. Any attempt to assert such a right now is contrary to the historical evidence. None of the known public or private discussions of bankruptcy before, during, or after the adoption and ratification of the Constitution drew any distinction between public and private creditors. The historical record demonstrates that the federal bankruptcy power was intended and understood to bind all creditors. The same record also indicates that proponents and opponents alike of federal bankruptcy legislation recognized that the federal bankruptcy power would entail a concomitant abrogation of state sovereignty by binding states to federal bankruptcy proceedings and otherwise interfering with state sovereignty.

[17] The defendants were the assignees of the bankruptcy estate of Peter Blight, a Philadelphia import merchant whose bankruptcy proceedings were unusually contentious. *See* "Peter Blight," Records of the U.S. District Court for the Eastern District of Pennsylvania, Bankruptcy Act of 1800, Record Group 21, National Archives—Mid-Atlantic Region, microfilm 993, reels 4-5; *see* Mann at 242-43.

Dated: August 22, 2005.

Respectfully submitted,

LA FOLLETTE GODFREY & KAHN

By: 

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