The Bankruptcy Jurisprudence of Justice William O. Douglas

January 13, 2022, 12:30 p.m.

- **Hon. Whitman L. Holt,** Chief United States Bankruptcy Judge
  Eastern District of Washington, Yakima, WA

- **J. Scott Bovitz**, Bovitz & Spitzer, Los Angeles

- **Robert C. Aronoff**, Law Offices Robert C. Aronoff, APC, Beverly Hills
  Program Chair, Beverly Hills Bar Association

Judge Whitman L. Holt

- Whitman L. Holt appointed to serve as a judge of the U.S. Bankruptcy Court for the Eastern District of Washington beginning November 1, 2019. He maintains chambers in Yakima.

- Judge Holt had been a partner with the Los Angeles law firm of Klee, Tuchin, Bogdanoff & Stern LLP since 2010. Previously, he was an associate attorney with the law firm of Stutman, Treister & Glatt P.C., also in Los Angeles. Judge Holt has served as a Ninth Circuit lawyer representative for the Central District of California since 2017. He has participated as a speaker, lecturer or panelist at more than 50 legal education programs throughout the country, is a co-author of an academic book and series of commentaries about bankruptcy and the U.S. Supreme Court, and regularly counseled and represented consumer bankruptcy organizations on a pro bono basis. In 2015, Judge Holt was elected as a Conferee of the National Bankruptcy Conference, an invitation-only organization. Dedicated to advising Congress on the operation of bankruptcy and related laws, the Conference is widely regarded as one of the most prestigious professional organizations in the bankruptcy field. Among engagements outside of his work in California, Judge Holt served as a lead attorney representing Jefferson County, Alabama, in its chapter 9 municipal bankruptcy case—the second largest in U.S. history.

- Born and raised in rural Montana, Judge Holt received his bachelor's degree, magna cum laude, from Bates College in Lewiston, Maine, in 2002. He received his juris doctor, cum laude, in 2005 from Harvard Law School, where he served as an editor of the Harvard Journal of Law & Public Policy.

J. Scott Bovitz

- Senior partner, Bovitz & Spitzer (bovitz-spitzer.com, 1991-present).
- Board Certified, Business Bankruptcy Law, American Board of Certification (abcworld.org, 1993-present; past chair).
- Certified Specialist, Bankruptcy Law, State Bar of California Board of Legal Specialization (californiaspecialist.org, 1993-present; past chair).
- Rated "AV Preeminent" by Martindale-Hubbell (martindale.com, AV rated 1993-present).
- Selected Southern California "Super Lawyer" in Bankruptcy & Creditor/Debtor Rights (2004-present).
- Adjunct Professor, William S. Boyd School of Law, University of Nevada, Las Vegas (law.unlv.edu, 2022).
- Adjunct Professor, California Western School of Law (cwsl.edu, 2022).
- Adjunct Professor, Loyola Law School, Los Angeles (lls.edu, 1982-1987).
- Lawyer Representative, U.S. District Court, Central District of California, Ninth Circuit Judicial Conference (2018-present).
- Coordinating editor, American Bankruptcy Institute Journal (abi.org, 2014-2021).
- Executive editor, Personal and Small Business Bankruptcy Practice in California (CEB.com, 2003-2006).
- Past president, Los Angeles Bankruptcy Forum (labankruptcyforum.org, 2000-2001).
- California Bankruptcy Forum (education co-chair 2001, conference co-chair 2004).
- Information Technology Committee, United States Bankruptcy Court, Central District of California (2012-present).

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Who Was "Wild Bill"?

Note: much of the following background information is from and further developed in Bruce Allen Murphy, *Wild Bill: The Legend and Life of William O. Douglas* (Random House 2003), which is a fascinating biography.

Early Life

- Born on October 16, 1898, in Minnesota and suffered from an early case of polio (perhaps? some doubts).
- Moved to Yakima, WA in 1904 and spent formative years being raised there by his single mother.
  - Boyhood home was located at 111 North Fifth Avenue in downtown Yakima; now a concrete structure by a Safeway and School District 7, but there is a nice memorial sign.
- Graduated as valedictorian from Yakima High School (now called A.C. Davis High School) and then attended Whitman College in Walla Walla, WA.

Transition to the Law

- Attended Columbia Law School in New York City, graduating near the top of his class in 1925.
  - Claimed to "ride the rails" from Washington to New York.
- Briefly practiced law at the prestigious Cravath firm in NYC and even more briefly – if at all – in Yakima.
- Moved into legal academia, first as a professor at Columbia and then at Yale Law School (while flirting with the University of Chicago for a few years).

Upward Ascent

- William O. Douglas & J. Howard Marshall, *A Factual Study of Bankruptcy Administration and Some Suggestions*, 32 COLUM. L. REV. 25 (1932).
- Selected in 1934 to direct a study for the Securities and Exchange Commission (SEC) regarding the reorganization of bankrupt corporations.
  - Very opposed to the practice whereby so-called "protective committees" would act to advance interests of large bondholders and repeat restructuring players (e.g., Wall Street law firms and banks) at the expense of small holders and, in some cases, even engage in fraudulent conduct.

Upward Ascent

- Served as a member of the SEC from 1936-1939 and as its chairman from August 1937 to April 1939.
- A force behind many post-Depression legal reforms, including the Trust Indenture Act of 1939 and the Chandler Act of 1938, the latter of which made significant changes to the 1898 Bankruptcy Act.
- Nominated to the Supreme Court by President FDR in early 1939; confirmed to the Court at age 40 (the third-youngest justice in history).

Supreme Court Tenure Generally

SCOTUS Records Held by Justice Douglas

- Longest term (so far): more than thirty-six years (1939-1975)
- Most opinions written (so far): more than 1200
- Most books published (so far): more than forty total, along with many articles (including several in *Playboy* magazine!)
- Most speeches given while a justice (so far)
- Most marriages (four) and most divorces (three)

Life Beyond the Court

- Significant early involvement in presidential politics:
  - Almost nominee for FDR's vice president instead of Harry S. Truman
  - Considered running against Truman in the 1948 presidential campaign
  - Declined an informal approach to run as Truman's vice president
- Greatly enjoyed travel and the outdoors:
  - Second home in Goose Prairie near the William O. Douglas Wilderness
  - Extensive travel to Asia and the Middle East in the 1950s
- Court chambers nicely recreated at the Yakima Valley Museum

The Douglas Bankruptcy Decisions

The Expositor

> Justice Douglas doubtless brought to the Supreme Court a greater knowledge of the law and practice of bankruptcy than any Justice who had preceded or any who has followed him. . . . It is therefore not surprising that Justice Douglas has played a leading role in the Supreme Court's contribution to the law and practice of bankruptcy, a contribution which has been a limited one due to the peculiar nature of the subject matter. . . . Because of his background and ability, his solutions to the problems brought before the Court have most frequently been those that would make the federal bankruptcy system operate most fairly and effectively.

Vern Countryman, *Justice Douglas: Expositor of the Bankruptcy Law*, 16 UCLA L. REV. 773, 773-74 (1969).

Raw Numbers

SCOTUS Bankruptcy Opinions Authored by Justice Douglas

- Majority opinions: **30**
  - Unanimous opinions: 22
  - 5-4 opinions: **1** (*United States v. Randall*)
- Concurring opinions: **1**
- Dissenting opinions: **7**
  - 5-4 or 4-3 opinions: **3** (*Reitz v. Mealey*; *St. Joe Paper Co. v. Atlantic Coast Line R. Co.*; *Caplin v. Marine Midland Grace Trust Co.*)

Most Famous Douglas Decisions

- ***Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106 (1939)**
  - Clear articulation and application of the "absolute priority rule" in the context of a corporate reorganization (note: APR was not *class-based* then)
  - References new-value corollary, but only for "a contribution in money or money's worth, reasonably equivalent" to the continued interest. Things that don't count – "a host of intangibles" and "vague hopes or possibilities."
- ***Pepper v. Litton*, 308 U.S. 295 (1939)**
  - Seminal case regarding "equitable powers," substance trumping form, substantial justice trumping technical considerations, and collapsing steps.
  - Sets a "rigorous scrutiny" standard for corporate insiders and applies it forcefully against using the debtor as a "corporate pocket," deploying inside information to get a leg up on outside creditors, or gaining any advantage.

Most Famous Douglas Decisions

- ***Price v. Gurney*, 324 U.S. 100 (1945)**
  - Authority to file a bankruptcy petition is defined by applicable nonbankruptcy law; if "those who purport to act on behalf of the corporation have not been granted authority by local law to institute the proceeding, [the court] has no alternative but to dismiss the petition." Still fundamental law.
- ***Gardner v. New Jersey*, 329 U.S. 565 (1947)**
  - Forceful articulation of the "basic importance" of the claims-allowance process in bankruptcy cases, including the resolution of interests claimed against a common res. This specifically extends to any associated liens – "it has long been a function of the bankruptcy court to ascertain their validity and extent and to determine the method of their liquidation."
  - When participating in the claims-allowance or lien-determination processes, governments waive any otherwise applicable sovereign immunity. *Cf. Central Va. Community College v. Katz*, 546 U.S. 356 (2006).

Common Themes

- **Broad, expansive, uncodified, context-specific bankruptcy powers to get to "right result," especially re: claims and plans**
  - *Pepper v. Litton*, 308 U.S. 295, 304-05, 307-08 (1939)
  - *American United Mut. Life Ins. Co. v. City of Avon Park*, 311 U.S. 138, 146-47 (1940)
  - *Consolidated Rock Prods. Co. v. Du Bois*, 312 U.S. 510, 522-24 (1941)
  - *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215, 219 (1941)
  - *Bank of Marin v. England*, 385 U.S. 99, 103 (1966)

Common Themes

- **Expansive application of the "paramount and supreme" nature of bankruptcy and resulting <u>exclusive</u> jurisdiction**
  - *Marine Harbor Props., Inc. v. Manufacturer's Trust Co.*, 317 U.S. 78, 83 (1942) (general statement of potential displacement power)
  - *Brown v. Gerdes*, 321 U.S. 178 (1944) (exclusive jurisdiction regarding professional fees, including for non-bankruptcy counsel)
  - *Meyer v. Fleming*, 327 U.S. 161, 169 (1946) ("exclusive authority" regarding how estate causes of action should be enforced)
  - *Gardner v. New Jersey*, 329 U.S. 565, 577 (1947) (exclusive jurisdiction regarding operating debtor and its property)
  - *Leiman v. Guttman*, 336 U.S. 1 (1949) (exclusive jurisdiction regarding bankruptcy-related fees, even if not payable from estate)

Common Themes

- **Very negative view regarding undisclosed matters or special side deals, especially for professionals or other fiduciaries**
  - *American United Mut. Life Ins. Co. v. City of Avon Park*, 311 U.S. 138, 144-47 (1940) (undisclosed agent's conflict → vote designation)
  - *Woods v. City Nat. Bank & Trust Co.*, 312 U.S. 262, 268-69 (1941) (conflict of interest → denial of all compensation, even if no injury)
  - *Leiman v. Guttman*, 336 U.S. 1, 6-8 (1949) (attacking private arrangements regarding fee payments, including as a "spectacle")
  - *United States v. Knight*, 336 U.S. 505 (1949) (affirming criminal conviction of attorney who aided and abetted a bankruptcy trustee in misappropriating estate funds through a convoluted sale transaction)

Common Themes

- **Robust yet nuanced view of absolute priority principles**
  - *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106 (1939)
  - *Consolidated Rock Prods. Co. v. Du Bois*, 312 U.S. 510, 520-22, 528-29 (1941) (detailing "step-up" principle re: inferior securities)
  - *Helvering v. Ala. Asphaltic Limestone Co.*, 315 U.S. 179, 183-84 (1942)
  - *Grp. of Inst. Investors v. Chicago, M., St. P. & P. R. Co.*, 318 U.S. 523, 564-71 (1943) (lengthy discussion about how values of replacement plan securities need not be fixed via "mathematical formula" or precisely set as between junior and senior creditors; repeating "step-up" principle)
  - *United States v. Key*, 397 U.S. 322, 333-34 (1970) (Douglas concurring) (explaining that senior creditors cannot receive delayed payments while junior creditors get immediate payments without providing additional "equivalent compensation" to the senior creditors for the delay/risk)

Common Themes

- **Generally endorses settlements and compromises, especially as part of reorganization plans**
  - *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106, 130 (1939)
  - *Grp. of Inst. Investors v. Chicago, M., St. P. & P. R. Co.*, 318 U.S. 523, 565 (1943)
  - *Gardner v. New Jersey*, 329 U.S. 565, 581-82 (1947)

But see Marine Harbor Props., Inc. v. Manufacturer's Trust Co., 317 U.S. 78, 87 (1942) (observing that "adjustments, compromises, and settlements" are "steps which are basic to the reorganization process but which, in selfish hands, led to much abuse" and prompted statutory safeguards "against improvident, unfair, or inequitable" resolutions).

Other Familiar Concepts

- Secured creditors have "no constitutional claim" beyond "the extent of the value of the property" that is subject to an enforceable lien. *Wright v. Union Cent. Life Ins. Co.*, 311 U.S. 273, 278 (1940).

- Valuation requires consideration of projected earnings power, but is context specific and not "a fixed formula." *See Grp. of Inst. Investors v. Chicago, M., St. P. & P. R. Co.*, 318 U.S. 523, 540-42 (1943).

- Enhanced treatment may be provided to creditors who make unique contributions, such as putting in new capital. *See Mason v. Paradise Irr. Dist.*, 326 U.S. 536, 541-43 (1946). This supports modern practice of special rights offering "backstop fees" or the like.

- The bankruptcy trustee takes prepetition contracts subject to all their terms and conditions and such contracts must be "assumed cum onere." *Thompson v. Texas Mexican Ry. Co.*, 328 U.S. 134, 141 (1946). *See also Bank of Marin v. England*, 385 U.S. 99, 101 (1966).

Other Familiar Concepts

- Preferences or priorities for certain claimants must be clearly created. *See Nathanson v. NLRB*, 344 U.S. 25, 29 (1952).

- Trustee's "strong-arm" powers/status get conferred as of the petition date. *Lewis v. Manufacturers Nat'l Bank*, 364 U.S. 603, 607 (1961).

- Parties generally should not receive "a windfall merely by reason of the happenstance of bankruptcy." *Id.* at 609.

- An overarching goal of reorganization cases is "to put back into operation a going concern," which requires stabilizing cash flow "sufficient for operating purposes, at least at the survival level," and designing a plan that works within the standards required by the statute while also preserving the corporate enterprise. *See Baker v. Gold Seal Liquors, Inc.*, 417 U.S. 467, 470-71 (1974).

Canons of Construction

- "[W]here words are employed in an act which had at the time a well known meaning in the law, they are used in that sense unless the context requires the contrary." *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106, 115 (1939). *See also Emil v. Hanley*, 318 U.S. 515, 521 (1943) ("We cannot help but think that, if Congress had set out to make such a major change [to the prior bankruptcy law], some clear and unambiguous indication of that purpose would appear.").

- The word "or" does not mean "and." *Dickinson Indus. Site, Inc. v. Cowan*, 309 U.S. 382, 388 (1940).

- "That being the policy adopted by Congress, our duty is to enforce it." *Finn v. Meighan*, 325 U.S. 300, 303 (1945). *See also Wright v. Union Cent. Life Ins. Co.*, 311 U.S. 273, 281 (1940) (explaining that a contrary holding "would be to rewrite the [Bankruptcy] Act so as to vest in the court a power which Congress did not plainly delegate").

Canons of Construction

- "[W]e do not read these statutory words with the ease of a computer." *Bank of Marin v. England*, 385 U.S. 99, 103 (1966).

Pop quiz! Is the following still good law?

> Rather, the [Bankruptcy] Act must be liberally construed to give the debtor the full measure of the relief afforded by Congress, lest its benefits be frittered away by narrow formalistic interpretations which disregard the spirit and the letter of the Act.

Wright v. Union Cent. Life Ins. Co., 311 U.S. 273, 279 (1940) (citations omitted).

Some Bad Law

- *United States v. Randall*, 401 U.S. 513 (1971), held 5-4 that unsegregated payroll taxes were ***not*** held in trust for the United States and hence were property of the estate. The *Randall* rule was specifically rejected by Congress in the 1970s and thus "did not survive the adoption of the new Bankruptcy Code." *See Begier v. IRS*, 496 U.S. 53, 63-65 (1990) (detailing legislative history).

- *Finn v. Meighan*, 325 U.S. 300 (1945), enforced an "ipso facto" termination clause in an unexpired commercial lease. Bankruptcy Code sections 365(e)(1) and 541(c)(1)(B) now prevent this result.

- *Palmer v. Connecticut Ry. & Lighting Co.*, 311 U.S. 544 (1941), is a split decision (with a Douglas dissent) about what damages were proven for rejection of a 999-year lease of real property. The claim would now be capped by Bankruptcy Code section 502(b)(6).

Notable Dissents

- *Reitz v. Mealey*, 314 U.S. 33 (1941), presented the question whether a New York statute that suspends drivers' licenses until any unpaid auto accident judgments are satisfied gets superseded through a bankruptcy filing and resulting discharge.
  - 5-4 majority enforced the New York law. Justice Douglas wrote a forceful dissent about how the paramount bankruptcy power displaces the state law because it runs afoul of the discharge. "In short, this power which New York has given the creditor is a powerful collection device which should not be allowed to survive bankruptcy." *Id.* at 43.
  - Justice Douglas' view was ultimately vindicated by *Perez v. Campbell*, 402 U.S. 637 (1971), and the enactment of Bankruptcy Code section 525.

Notable Dissents

- *St. Joe Paper Co. v. Atlantic Coast Line R. Co.*, 347 U.S. 298 (1954), presented the question whether a reorganization plan could propose a "forced merger" of the debtor railroad with a different railroad without consent by the debtor.
  - 4-3 majority held that the Bankruptcy Act did ***not*** authorize confirmation of such a plan over the debtor's objection. Justice Douglas dissented because such an approach gave too much power to old management and equity. "*To allow the old management or the stockholders a veto power where Congress has provided they shall not vote is to indulge in as bold a piece of judicial legislation as one can find in the books*." *Id.* at 328 (extreme emphasis in original).
  - Justice Douglas' view was ultimately vindicated by Bankruptcy Code section 1123(a)(5)(C). *See* H.R. REP. NO. 95-595, 407 (1978).

Notable Dissents

- *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972), required the Court to decide whether a bankruptcy trustee could assert litigation claims against an indenture trustee on behalf of all of holders of debentures issued by the debtor.
  - 5-4 majority held that the trustee lacks standing to assert claims belonging to individual creditors, rather than to the debtor or the estate. Justice Douglas dissented on the ground that the outcome regarding the "direct" creditor claims might affect the residual creditor claims against the estate and thus it was efficient to centralize all these claims in the trustee's hands for holistic resolution as part of the plan process.
  - The *Caplin* rule remains good law and often is important for bankruptcy litigation defendants. Other insolvency regimes are different. *See, e.g.*, *Corcoran v. Frank B. Hall & Co.*, 545 N.Y.S.2d 278, 280-82 (N.Y. App. Div. 1989) (rejecting application of *Caplin* in context of state insurance liquidations, including based on public policy and judicial economy).

Notable Dissents

- The *Reg'l Rail Reorganization Act Cases*, 419 U.S. 102 (1974), involved a massive battle about the Regional Rail Reorganization Act, which created a governmental corporation called the Consolidated Rail Corporation (or Conrail) to amalgamate the profitable lines of several bankrupt or otherwise troubled railroads.
  - 7-2 majority upheld this act against various challenges, including based on the takings clause and the bankruptcy clause's uniformity mandate.
  - Justice Douglas, as his final bankruptcy opinion, wrote an epic dissent about why the act was invalid. A taste: "If the rule of law under a moral order is the measure of our responsibility, as I have always assumed, we can only hold that the Rail Act . . . undertakes to sanction a fraudulent conveyance, as those words were used in 13 Eliz., and in our Bankruptcy Act. I have been reluctant so to conclude, implicating as it does our legislative branch in a lawless maneuver of gigantic proportions. But, baldly put, the present law is a *tour de force* to that end." *Id.* at 162.

Questions?