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LEASEHOLD RIGHTS IN BANKRUPTCY AND EQUITY PROCEEDINGS

By A. O. STANLEY, JR.*

PART I. LANDLORD AND TENANT RELATIONSHIP

HISTORICAL NOTE

The law of landlord and tenant is perhaps the clearest example of the criticism that the law frequently fails to keep pace with new developments in the economic and social life of the community. The discrepancy which exists between the actuality of modern life and the legal rules which govern landlord-tenant relationship is a subject of unanimous condemnation and nowhere are the injustices which abound in this field so evident as in the situation in which a tenant under an unexpired lease becomes insolvent and is subjected, voluntarily or involuntarily, to bankruptcy or equity receivership.¹

The principle if not the sole underlying cause of the dissatisfaction with the treatment accorded to the claim of the landlord has been the failure to adopt the view of the average business man that a lease contract does not differ from any other type of executory contract. The law is persistent in treating lease contracts apart from all others long after any valid reason for doing so has ceased to exist. This attitude is a relic of the periods during which socage tenure, frankalmoigne lands, and serjeantry were live terms. The feudal system revolved about, and was based upon, the incidents of estates in land. Life itself was dependent upon the land. It was perhaps neutral and just that in an agrarian and military society the concept of rent issuing from the land should have been developed. The theory that rent issued from the land and not as a result of a contract

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¹ Gerdes on Corporate Reorganizations, p. 1097, sec. 683; Schwabacker and Weinstein, Rent Claims in Bankruptcy (1933) 33 Col. L. Rev. 212; Clark, Foley and Shaw, Adoption and Rejection of Contracts and Leases by Receivers (1933) 46 Harv. L. Rev. 1111; Douglas and Frank, Landlords' Claims in Reorganization (1933) 42 Yale L. J. 1003; Holdsworth, The Prerogative in the Sixteenth Century (1921) 21 Col. L. Rev. 554 at 561.
between the landlord and tenant, and that the law to pay for
the use of land sprang from its actual use and occupation and
not from the right to use it, may have worked a certain rough
justice in a feudal society, but has failed to meet the demands in
a commercial and industrial world.2

The "anticipatory breach" clause of modern contracts of
lease has remedied, to some extent, this fault, provided the breach
is the act of a solvent tenant. Bankruptcy, however, usually
has the effect of annulling such clauses.3

WHETHER LANDLORD MAY SUE FOR RENT OR DAMAGES IS
DETERMINED ORDINARILY BY TERMS OF LEASE

Where there is no "anticipatory breach" incorporated into
the lease, the landlord must then refuse to recognize the breach
of lease and consider the premises still rented to the tenant, his
abandonment of it notwithstanding, and hold him responsible for
the payments of rent as they fall due.4 This rule is predicated
upon the theory that the premises remain there for the sole use
and enjoyment of the lessee whether he actually uses them or not.
It has been held, that there is a duty vested in the landlord to
make a reasonable effort to secure a new tenant for the property
at a reasonable rental before he can recover rent from the old
tenant under the contract.5 The weight of authority, however,
is that the tenant may not by abandoning the premises, force a
duty upon the landlord to seek another tenant.6

The landlord may, on the other hand, where there is an
"anticipatory breach" incorporated in the contract of lease,
consider the contract broken by the tenant's abandonment of the

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2In re Roth & Appel, 181 Fed. 667; Bloch v. Bell Furniture Co.,
111 N. J. Eq. 551, 162 Atl. 414; Gardiner v. Butler & Co., 245 U. S. 603,
38 Sup. Ct. 214; Central Trust Co. v. Chicago Auditorium Ass'n,
240 U. S. 581, 36 Sup. Ct. 412; Gerdes on Corporate Reorganizations,
3Manhattan Properties v. Irving Trust Co., 291 U. S. 320; 54 Sup.
Ct. 385; Gerdes on Corporate Reorganizations, p. 1097.
4Heckel v. Griese, 12 N. J. Misc. 211, 171 Atl. 148; Fifty Associates
v. Berger Dry Goods Co., Inc., (Mass.) 176 N. E. 643; Moore v. Rogers,
240 Ky. 743, 43 S. W. (2d) 31; Johnson v. Neely, et al. (Texas) 36
S. W. (2d) 799.
5Marmont et ux. v. Ave et ux., 135 Kans. 368, 10 Pac. (2d) 826;
Lawson v. Callaway, 131 Kans. 789.
643; Moore v. Rogers, 240 Ky. 743, 43 S. W. (2d) 31; Johnson v.
Neely et al. (Texas) 36 S. W. (2d) 799; Heckel v. Griese, 12 N. J.
premises and bring his action for damages resulting from the breach of contract. The general rule in such a case is that the damages will be measured by the difference between the rent stipulated in the lease and a fair rental value for the balance of the term.  

**LANDLORD MUST Prove Damages**

Should the landlord proceed on this theory of damages, according to the opinions expressed in the majority of cases in this country, he may refuse to accept a surrender of the premises and after notice to the lessee of his intention to do so, re-let the premises for the best rent obtainable, and recover the difference between the rent reserved in the lease and the rent received from the subsequent tenant. Upon entering, however, the landlord must make his intention clear—that he is entering in the interests of his tenant and is re-letting the property solely for the tenant’s benefit in order to minimize the damages; where the tenant by a covenant in the lease, however, consents that the landlord may assume possession of the premises for non-payment of rent, or for other cause, and re-let them for the said tenant’s benefit, such notice of landlord’s purposes in re-entering and re-letting is unnecessary. Moreover, the landlord must definitely prove damages, both as to their existence and amount.  

It may be seen, therefore, that in the event of a breach of lease by a solvent tenant there is a wide diversity among the authorities for the proper measure of damages and the procedure that should be properly taken by the landlord to protect himself from loss. For a further discussion of authorities, see 16 R.C.L. 956, secs. 481, 482, 483 and 484.

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*16 R. C. L. 969, sec. 483; also Barlow v. Wainwright, 22 Vt. 88, 52 Am. Dec. 79.


*Crow v. Kaupp et al. (Mo.) 50 S. W. (2d) 995.

PART II. GENERAL EFFECT OF BANKRUPTCY OR INSOLVENCY UPON RENT CLAIMS

EFFECT OF BREACH BY INSOLVENT TENANT

In the event of the breach of a lease by an insolvent tenant, whether such tenant be a natural person or a corporation, a far more intricate and involved problem presents itself.

The legal existence of a corporation is not cut short by the appointment of a trustee or chancery receiver. Even if it ceases to be a going concern it still survives for the purposes of the discharge of its liabilities and the final distribution of its remaining assets. A national bank, for instance, remains liable during the remainder of the term for accrued and accruing rent under a lease of the premises occupied by it although the trustee or receiver may have abandoned and surrendered them.12

If the landlord has a legal claim against the tenant for damages, he may properly prove this claim against the assets in the hands of the receiver. The fact that such claim at the time it accrues is unliquidated will not of itself defeat the claim.13

A trustee in bankruptcy is bound by the forfeiture clauses in leasehold estates of the bankrupt.14 A chancery court receiver can have no better rights to retain possession of a leasehold than has a trustee in bankruptcy. The landlord’s right to enforce a forfeiture of the lease is not less when a chancery receiver is in possession than it is when a trustee in bankruptcy has possession.15

LEASES PASS AS PROPERTY TO TRUSTEE

The District Court for the District of Kentucky, in deciding In re Jefferson, 93 Fed. 948, one of the early bankruptcy cases, held that where the tenant is adjudicated a bankrupt, the relation of landlord and tenant, ipso facto, comes to an end and consequently there cannot, under Section 63, be a provable debt

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15 Odell v. H. Batterman, 223 Fed. 292; Clark on Receivers, 2d Ed. (1920) vol. 1, sec. 446.
against the bankrupt's estate for rent alleged to have accrued after the date of adjudication. The reason employed by the Court in this case was that rent and use or occupation or the right or opportunity to occupy are dependent upon correlative terms and that rent cannot accrue without a tenant. As a result of such reasoning, the Court reached the conclusion that the bankrupt ceased to be a tenant after adjudication and this adjudication destroyed all obligation on the part of both landlord and tenant. This case was followed in 1902 by the District Court for the Western District of Kentucky in the case of In re Hays, Foster & Ward Company, 117 Fed. 879. Such an opinion, however, seems to be the minority opinion for other district courts have not followed these decisions. Loveland on Bankruptcy, 3d Edition, page 365, states: "A contract of lease is not ipso facto terminated by the bankruptcy of the lessee."

Since the bankruptcy of the lessee does not, by the great weight of authority, ipso facto, terminate the tenancy, provided the lease contains no provision to that effect, it will pass with the bankrupt's other property to the trustee.

CLAIMS FOR FUTURE RENT NOT ORDINARILY PROVABLE

Claims for future rent are not provable in equity receivership proceedings and were not provable in bankruptcy proceedings prior to the adoption of amendments to Section 63.
The only way in which bankruptcy proceedings and equity receivership differ in respect of provability of rent claims is as to the time at which the claim has to be in existence. In bankruptcy, the rent claim has to be in existence at the time of the filing of the petition. In unfrettered by statutory requirements and in the belief that they were able to adopt a rule which more nearly accorded with fairness and equity, the equity receivership courts have declared that any claim is provable which comes into being prior to the expiration of the period set for proof of claims, and which can be liquidated without causing delay in the distribution of the estate.

In both proceedings the claim is provable if the covenant in the lease properly fixes the damages and if the lease was breached prior to the institution of the proceedings.

Rent to accrue in the future cannot ordinarily be proven upon the bankruptcy of the tenant, as a claim against the tenant’s estate, since it is not an existing debt or claim, but is a mere possibility of a future debt. It seems to follow from the fact that future rent is not provable against the bankrupt’s estate, that a discharge in bankruptcy does not ordinarily relieve the bankrupt from liability for rent falling due after the adjudication or even after the filing of the petition, since the bankruptcy act limits the effect of the discharge to provable claims.


The liability for rent due before the adjudication, on the other hand, is discharged thereby, since it is provable as a debt involving a fixed liability.

**Acceleration Clauses May Render Future Rent Provable**

The adherence to the historical concept of rent as something which issues from the land prevented a proof of claim for future rent because such rent was not due until the period for which it was reserved had passed. It was in an effort to meet this situation that clauses providing for the termination and for the liquidation of damages were devised. In the absence of such covenants, and upon default in the terms of the lease, the landlord had only the right to sue for past due rent and the proof of claim for this amount was his only remedy in bankruptcy or equity receivership proceedings.

Even if the lease contained a special covenant for damages or indemnity, it was not always certain that the claim would be provable.

**Limitations Placed upon Acceleration Clauses**

Undoubtedly the parties to the lease may agree that bankruptcy shall terminate it and that upon termination all future installments of rent shall at once become due and payable. Possibly claims based upon such leases may be proved in bankruptcy, for such provisions in leases have been regarded as

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29 3 R. C. L. 239, sec. 68; Loveland on Bankruptcy, 3d ed. p. 365.
valid.\textsuperscript{30} It has been questioned, however, whether such a provision would be enforceable, so as to entitle the landlord to prove a claim for future rent as against the other creditors.\textsuperscript{31} A provision that the rent for the whole term shall become due in case of default in any installment of rent does not apply merely because a petition in bankruptcy is filed by the tenant, no rent being due at the time.\textsuperscript{32}

If the lessor accepts a surrender of the premises or exercises his right of re-entry the liability of the lessee is ordinarily thereby terminated.\textsuperscript{33} Liability of the lessee under a lease providing that the lease shall terminate in case the lessee is declared bankrupt, and that the lessor shall have the right to re-enter, obligating the lessee to pay the difference between the amount reserved in the lease and what the lessor is able to secure by re-letting of the property, is not provable as a "fixed liability" under Section 63a(1); for notwithstanding the provision as to the termination of the lease, the latter is unquestionably terminated by the re-entry and not by the bankruptcy. The lessor is not obliged to re-enter and whether he does so or not is manifestly dependent upon uncertainty. Moreover, it is uncertain at the date of the petition in bankruptcy, the ruling date for determining provability, whether or not there will actually be any loss of rents.\textsuperscript{34} If, upon the bankruptcy of the tenant, the lessor re-enters under a proviso for re-entry in the lease, the tenancy is necessarily terminated and neither the bankrupt nor his trustee is thereafter liable for any rent which would otherwise have subsequently accrued.\textsuperscript{35}

Occasionally a lease provides that upon re-entry, the landlord may re-let the premises, and hold the lessee liable for any deficiency between the amount of rent so obtained and the amount originally reserved in the lease. Such contingent liability, like that for the whole rent, cannot ordinarily be proven in bank-

\textsuperscript{30} Platt v. Johnson, 168 Penn. 47, 31 Atl. 955; Tiffany on Landlord and Tenant, p. 1189.


\textsuperscript{32} Atkins v. Wilcox, 105 Fed. 595; Tiffany on Landlord and Tenant, p. 1189.

\textsuperscript{33} 3 R. C. L. 239, sec. 68.

\textsuperscript{34} In re Roth & Appel, 181 Fed. 667; 3 R. C. L. 239, sec. 68.

\textsuperscript{35} Ex parte Houghton, 1 Low. 554, Fed. Cas. No. 6725; Tiffany on Landlord and Tenant, vol. 1, p. 980.
The only type of clause under which the landlord can be reasonably certain of a proof of claim is one providing for an immediate claim for the full damages caused by the breach, such damages to be ascertained by deducting the present rental value for the balance of the term from the present value of the rent stipulated for the balance of the term. Penalty clauses are not enforceable at law and give rise to no proof of claim.

Much of the apparent conflict among the decisions as to the provability of claims by lessors against the bankrupt estates of lessees may be traced to the varying provisions of different leases.

**TRUSTEE MAY REJECT CONTRACT CONTAINING ACCELERATION CLAUSE**

Even where the provision of the lease is held valid and the damages provided for therein are upheld thereby rendering a claim for future rent provable, nevertheless, the trustee may then reject the contract of lease and render such claim not provable. The claim for future rent is therefore neither a liquidated nor an unliquidated provable claim unless the trustee elects to retain the lease as an asset.

**RECEIVER’S OR TRUSTEE’S RIGHT TO ELECT WHETHER OR NOT TO ADOPT LEASES**

Courts and text-writers commonly state that a receiver or trustee may elect to adopt or to reject contracts and leases, and that he has such a reasonable time,—a breathing space,

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\* Loveland on Bankruptcy, 3d ed. p. 365.

speak—as will enable him to elect intelligently whether the interest of his trust will be best served by adopting the lease or by returning the property to the lessor; nor is he bound to accept the leasehold interest if he has reason to believe it will be more of a burden than a benefit, and the cases are to the effect that he incurs no liability under the lease until he actually indicates his acceptance. He then becomes liable because, and only because, of his own act, of electing to assume the lease, or by taking possession of the demised premises and continuing in possession under such circumstances as in law would be equivalent to such an election.

What is an equivalent to an election by the receiver or trustee may depend upon the circumstances in each case. There must be some occupation and use of or some dealing and intermeddling with the estate, or some act, admission, or agreement, which in terms or by necessary implication indicates an election.

In some situations the receiver or trustee is not faced with the problem of adoption or rejection. Contracts and leases under which the obligations of the insolvent have been fully performed, but those of the solvent party remain executory, are assets of the insolvent and rights thereunder should be enforced. On the other hand contracts and leases under which the obligations of the solvent party have been fully performed, but those

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44 Clark on Receivers, 2d ed. (1929) vol. 1, sec. 442.
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of the insolvent remain executory, are liabilities and performance by the receiver would ordinarily be improper as to preference. 46

That a receiver or trustee ordinarily need not perform contract or lease obligations of the insolvent is well established. 47 But if he does not perform he cannot insist on counter-performance by the solvent party, 48 which may, in some instances, be distinctly desirable. 49

The appointment of a receiver or trustee does not of itself cancel a lease between the landlord and tenant. 50

EFFECT ON TRUST ESTATE OF TRUSTEE'S OR RECEIVER'S ELECTION

Upon the bankruptcy or insolvency of the tenant, assuming that this does not of itself terminate the tenancy, the tenant's leasehold interest passes with his other property to the chancery receiver or the trustee in bankruptcy, who may elect to take the lease as an asset of the estate, thereby subjecting himself to liability, like any other assignee, according to the covenants of the lease. In such case the lease is regularly sold, subject to future payments of rent stipulated in it. The consummation of such sale has the effect of releasing the receiver or trustee and the estate from further liability for rent. The purchase price becomes an asset of the estate, subject to the payment of any


50 Clark on Receivers, 2d ed. (1929) vol. 1, sec. 446.
accrued rent secured by such lien as may have been reserved in the lease.\textsuperscript{51}

If the receiver or trustee elects to reject the contract of lease, as he has a right to do, it is a nullity so far as the proceedings are concerned. In such a case future rent although made due and payable at once by the terms of the lease, is not a provable debt. The landlord may prove his claim for rent due prior to bankruptcy or receivership for the use and occupation of the premises either as a "fixed liability due and owing" or as "a debt arising in contract". For the same reason subsequent use and occupancy of the premises by the trustee or receiver will establish a provable claim for rent for such use and occupancy.\textsuperscript{52}

It must be borne in mind, however, that where the trustee or receiver does not elect to carry out the lease then the lease, as between the landlord and tenant, is broken and the landlord has the right to recover damages against his tenant for breach of contract or he may have other remedies against his tenant. Such a breach of contract not being affected by the receiver himself is not a breach of contract by reason of any act of his and the claim of damages for breach of such lease is not strictly against the trustee or receiver, but it may under certain conditions be a claim against the assets in his hands.\textsuperscript{53}

**ENFORCEABILITY OF LIENS AGAINST TRUST ESTATE**

Where a covenant of the lease, or state law entitles the landlord to a lien upon the premises or goods of the tenant to secure the payment of rent, the court will enforce the lien as against the proceeds of such goods when sold by the trustee,\textsuperscript{54} and to the extent of the lien, the landlord will be a preferred creditor.\textsuperscript{55}

It has been held that where the landlord does not have a lien protecting him against a breach of lease, he still may maintain an action for damages against the tenant, but his claim will be a general creditor’s claim and will share ratably with other un-

\textsuperscript{51}Loveland on Bankruptcy, 3d ed., sec. 365; Tiffany on Landlord & Tenant, vol. 1, page 366.

\textsuperscript{52}In re Hinckel Brewing Co., 123 Fed. 942; Loveland on Bankruptcy, 3d ed., p. 365.

\textsuperscript{53}Clark on Receivers, 3d ed., vol. 1, sec. 446.


\textsuperscript{55}Fee-Crayton Hdw. Co. v. Richardson-Warren Co., 18 F. (2d) 617; Clark on Receivers, 2d ed. (1929) vol. 1, sec. 446.
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secured debts. This, however, does not ordinarily apply to rent to accrue in the future.

MEASURE OF RENT OBLIGATION ASSUMED BY RECEIVER FOR PERIOD OF OCCUPATION

The question frequently comes up when a receiver refuses to be bound by the obligations of an executory lease, but nevertheless holds on to the property until he elects,—what is the measure of the obligation he does assume for use and occupation of the property—is it on the basis of the rental reserved in the lease or some other basis? Strictly speaking, he cannot be liable for the rental reserved in the lease, neither is he a successor, strictly speaking, of the lessee. The sovereignty through the courts steps in and occupies the premises with or without the lessor's consent. The Constitution of the United States provides as does the constitution of most of the states that property shall not be taken even by the state without due compensation. It therefore follows that the lessor is entitled to due compensation and that this compensation should be determined, if the matter were pushed to the limit, in the same way, by an impartial jury or otherwise as the matter is determined, when the state takes the property by reason of its power of eminent domain. Such value, in all probability, would be the reasonable rental value of the premises occupied by the receiver during his occupancy.

RECEIVERS ARE NOT ASSIGNEES IN THE GENERAL SENSE OF THE TERM

The liability of a receiver, as an assignee of the leasehold, upon the covenants of the lease, including that for rent, would seem primarily, to depend upon whether or not the title to property of that character is vested in the receiver by his appointment. Whether a receiver, by his appointment, obtains title to the property of which he is given control is a matter on which the decisions are by no means in accord; but it seems that, by

the weight of authority, a receiver, apart from statute, is to be regarded as a mere custodian and representative of the court and not as having title to the property. So regarded, it does not appear that a receiver appointed for a tenant should, unless an appointment were actually made of him by the tenant, be held liable on the covenants of the lease as an assignee, and there are cases to that effect.\textsuperscript{59}

Recognizing that merely the appointment of a receiver does not make the receiver the assignee of the term of the lease and does not make him, strictly speaking, the successor of the original lessee, therefore, a receiver is not ordinarily bound by the terms of the lease which he finds in existence. The courts, however, have frequently regarded the receiver as liable on such covenants, as being an assignee by operation of law,\textsuperscript{60} provided he has indicated an intention to accept the leasehold as a part of the assets of the insolvent tenant, but not otherwise.\textsuperscript{61} The cases are generally to the effect that the assumption of physical possession and control of the leased premises by the receiver does not show an acceptance by him of the leasehold interest, so as to impose liability on him as an assignee of the leasehold, but that he may retain possession for a "reasonable time", and then give up the property if it seems expedient.\textsuperscript{62} A receiver has indeed rarely been held liable, as assignee of the leasehold for a period beyond that of his actual occupation, though he has occasionally


\textsuperscript{61}Spencer v. Worlds Col. Ex., 163 Ill. 117, 45 N. E. 250; Tiffany on Landlord and Tenant, p. 984.

The receiver has a reasonable time after his appointment to examine into such contracts and he is not bound thereby until he has so examined them and assumed their burdens. The rule, however, is not reciprocal and the other party to the contract remains liable for the full performance of his obligation, if the receiver so demands.

**Landlord's Remedy in General**

As to whether, upon a receiver refusing to carry out a contract, the contractee is altogether without a remedy, the decisions are in conflict. Where the breach of the contract occurs before the receiver takes charge, the contractee has a general claim against the receivership estate, similar to that of any other unsecured creditor. Where the breach occurs after the receivership, the question of liability, according to the decided cases, appears to depend, to a certain extent, upon the nature of the contract and the nature of the receivership. For example, some courts hold that there is a liability where the contract repudiated is a lease, or a contract for personal services, but not as to other contracts, while other courts distinguish between cases where the receivership is with the consent of the defendant corporation or in spite of its opposition. Where a receiver is appointed with the consent of the defendant corporation, it has been held that the prevention of performance was not the act of the law, but the voluntary act of the corporation liable on the contract and the contractee is in the same position as if his contract has been breached by the corporation prior to receivership. On the other hand, where the receiver was appointed without the consent of the defendant corporation, it has been held that the prevention of performance was the act of the law and that damages for the breach were not recoverable.

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65 Tracy on Corporate Foreclosures (1929) sec. 83, p. 99; Beach on Receivers, sec. 328.
67 Curtis v. Walpole Tire & Rubber Co., 227 Fed. 698; Tracy on Corporate Relations (1929) sec. 84, p. 100.
where the established rule in the particular jurisdiction is, that in case of the rejection of a contract by a receiver the contractee has no claim against the receivership assets until all other creditors have been paid in full, the court may, nevertheless, if an inequitable result would follow the application of such rule, order damages to be paid from receivership assets. In such case, however, the damages allowed are not necessarily those specified in the contract, but are such damages as the court shall determine should be awarded in order to do equity.69

It is, however, generally held or assumed that apart from any question of the leasehold the landlord is entitled to payment of rent for the period of the receiver's occupation for the purpose of settling the estate as one of the expenses of the receivership,70 at least to the extent of the earnings71 or the rental value72 of the property.73 Such a payment of rent is a *sum quantum meruit* for the actual occupation of the property and is in the nature of expenses, and therefore, a charge upon the assets, but the landlord has no right to distrain for it.74

**EFFECT OF RECEIVER’S HOLDING BEYOND TERM OF LEASE**

Moreover a receiver holding over beyond a term is not for that reason merely to be considered as a tenant from year to year. If he sees fit to adopt the lease he does so for the fixed and definite period. A receiver is merely an arm of the court assisting in winding up the affairs of the insolvent and protecting the interests of the creditors. If he remains after the term, therefore, from the very character of his duties, the law will not imply

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69 Coy v. Title G. & T. Co., 198 Fed. 275; Tracy on Corporate Foreclosures (1929) sec. 84, p. 100.
72 Carswell v. Farmers Loan & Trust Co., 74 Fed. 88.
73 Tiffany on Landlord and Tenant, p. 984.
74 Lowell on Bankruptcy, sec. 376.
that he is creating a new tenancy from year to year. The continued occupation of the premises by the receiver after the expiration of the term, without any further agreement or action upon the part of either the lessor or receiver, will by implication of law, constitute a tenancy at will and nothing more.\textsuperscript{75}

\textbf{PART III. \textit{Railroad Receiverships and Reorganizations}}

\textbf{INTRODUCTION}

We have been considering heretofore the law relating to landlord and tenant with particular reference to the injury and damages accruing to the landlord because of an abandonment of the premises by the tenant resulting in the breach of a contract of lease. Such breach may have been caused by the voluntary act of a solvent tenant in which event the landlord has an action at law to recover damages for his injury caused thereby. The breach may, on the other hand, have been caused directly or indirectly by the insolvency of the tenant resulting in either an equity reorganization or bankruptcy, and in this latter case the procedure is neither as simple nor is the law as well settled. The general law of bankruptcy and equity receiverships applicable to such a situation has heretofore been discussed.

\textbf{PUBLIC NATURE OF RAILROAD CORPORATIONS}

When a railroad company goes into equity receivership or files its petition under Section 77 of the Bankruptcy Act, a highly involved and technical proceeding, of necessity, results. The insolvency, bankruptcy or financial reorganization of a railroad not only affects its security holders and creditors but it is likewise of vital interest to the public generally. Because of the public nature of the enterprise, the road must be kept a going concern, the mails of the government must be transported, and the performance of the other duties of common carriers must not be permitted to be interrupted.\textsuperscript{76}

Unprofitable branch lines are frequently burdensome to the system as a whole. An early disposition, abandonment, or lease cancellation may be advisable, since such leases and operating

\begin{itemize}
\item \textsuperscript{75} Dietrick v. O’Brien, 122 Md. 482, 89 Atl. 717; Clark on Receivers 2d ed. (1929) vol. 1, sec. 443.
\item \textsuperscript{76} Farmers Loan & Trust Co. v. Northern Pac. R. Co., 58 Fed. 257; Quincy, etc., R. Co. v. Humphreys, 145 U. S. 82, 12 Sup. Ct. 787.
\end{itemize}
contracts are considerable factors in railroad financial difficulties.\textsuperscript{77}

When an equity receiver is appointed for a railroad which embraces leased lines, he does not necessarily assume responsibility for the covenants of the leases, nor take the place of the lessees, but he like any other receiver, is entitled to a reasonable time in which to determine whether to adopt or renounce such leases; this has always been the general rule in equity receivership cases.\textsuperscript{78} But upon adoption he becomes liable thereon and the estate is charged with the cost of performing the contract or with damages for its breach.\textsuperscript{79}

\textbf{POWERS AND DUTIES OF RAILWAY RECEIVERS}

Railway receivers are equity receivers, and as such, are ministerial officers appointed by a Court of Chancery to take possession of and preserve \textit{pendente lite} the fund or property in litigation. They are neither representatives of the insolvent corporation nor of its creditors or stockholders, but are officers and representatives of the court, the hands of the court in which it holds the property while it operates the railroads of the insolvent corporation for the benefit of those ultimately entitled to the property and income. They derive their authority from the act of the court appointing them and not from the act of the parties at whose suggestion or by whose consent they are appointed. They are therefore not assignees; they do not take

\textsuperscript{77}Johnson on Bankruptcy Reorganizations, p. 376, sec. 448.


by assignment and the effect of taking possession of a leasehold interest belonging to the company is totally unlike that resulting from one who takes the lease by assignment.80

** Receivers Are Not Bound by Executory Contracts and Leases **

The utmost effect of a receiver's appointment is to put the property from the date of his appointment into his custody as an officer of the court, for the benefit of the party ultimately proved to be entitled, but neither the title or even the right of possession in the property is changed; nor does his appointment change the title to the property in his charge or alter any lien or contract.81

Since a receiver does not by possession, or rather by mere custody, become an assignee of the lease he is not bound to adopt the contracts of the corporation or accept the losses if, in his opinion, it would be unprofitable and undesirable to continue operation beyond a period to ascertain the wisdom of adoption or repudiation of the contract. The court is not bound to pay the debts or to perform the obligations of the insolvent, nor are its receivers.82

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RAILWAY RECEIVERS ARE ALLOWED A REASONABLE TIME TO ELECT WHETHER OR NOT TO ADOPT LEASES

It is the duty of a receiver before electing whether or not to adopt the lease to carefully compare the advantages and disadvantages of every lease, traffic or other executory contract, in the light of the whole situation. The interest of the lessee company is not, and should not, be the controlling factor in reaching a conclusion whether or not to accept the benefits and assume the burdens of such a lease or contract. He should bear in mind at all times that he does not represent merely the interest of the bankrupt but that he is appointed to represent all interests equally.83

Before making his election, however, the receiver is entitled to a "reasonable time" in which to decide whether he will adopt the contract or return the property to the lessor in good condition. He must also surrender the title to any extensions built during the term of the lease, including all tools and equipment added or substituted, and any other property used in connection with the operation of the leased property.84 The "reasonable time", or breathing space, so to speak, varies considerably with the existing circumstances of the individual case; it has been held in one case that such an election must be made within ninety days85 and nearly a year and a half has been allowed in another.86

If the receiver accepts the benefit of a lease for an unreasonable length of time, however, adoption may thereby be implied and the receiver will be deemed to have assumed the liability of the lease. But unless and until he does adopt the lease either expressly or impliedly, there is no privity of contract and no liability upon the lease will attach.87

LEASEHOLD RIGHTS

Effect of Adoption of Lease by Receivers

When the receiver makes his election whether to adopt or repudiate a lease, such election is retroactive and ordinarily dates back to the beginning of the receivership.88

If the receiver accepts and adopts the lease he becomes vested with the title to the leasehold interest and privity of estate is thereby created between the lessor and the receiver whereby the receiver becomes liable upon all the covenants of the lease, including the covenant to pay rent.89 The adopted lease then becomes an integral part of the operating expenses of the trust estate in the hands of the receiver as much as any other ordinary expense of operation; and in this way the claim for rent as stipulated in the lease secures a preference in payment over all the cestuis que trustent out of the proceeds from the sale of the railroad as well as out of its earnings during receivership.90

Such moneys expended and liability incurred by the receiver or trustee in the authorized operation, preservation and management of the property entrusted to him also constitute preferential claims upon the trust estate, which must be paid out of its proceeds before they can be distributed to the beneficiaries of the trust.91

However, under Section 77, subsection (b) of the Bankruptcy Act, as amended, 1935, the adoption of the lease may only bind the receiver and the plan of reorganization may disregard entirely such adoption by the receiver.92

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92 See page 40, infra.
DUTIES AND LIABILITIES OF RAILWAY RECEIVERS UPON FAILURE TO ADOPT LEASE

In the event the receiver does not elect to adopt a contract of lease and thereby bind himself and the trust estate thereto, but either repudiates the lease entirely or gives notice that he does not intend to adopt the lease, his resulting duty and liability to the lessor will be determined by the many and varying conditions and circumstances of the particular situation.

Claims for rent accrued and unpaid before receivership, upon refusal of the receiver to adopt the lease are not entitled to any priority or preference. They are unsecured liabilities and must rank along with all claims of the same class as final distribution of the assets of the lessee company.

The accruing or current duties and liabilities of the receiver to the lessor railroad company are not so simple for its plight is indeed serious. It is seldom so situated that it can immediately take back its property and resume the operation thereof. It may have no working organization. Its rolling stock may have become worn out. It may have insufficient immediate funds. Its public duties, however, must be performed without interruption. It is a quasi public corporation and must keep its railroad going. Its franchises must be preserved. Its obligations as a common carrier must be fulfilled. And these obligations can seldom be fulfilled except by the continued operation of the leased road by the receiver.

If a receiver wishes to reject a contract of lease and at the same time has a present duty to continue the operation of the lessee's trains, he must first apply to the Interstate Commerce Commission for authority to abandon the line, and in all likelihood the time consumed by the Commission in authorizing such

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abandonment may be included in the "reasonable time" admittedly allowed the receiver in which to elect whether to adopt or repudiate the contract of lease. 96

**LIABILITY OF RAILWAY RECEIVERS DURING PERIOD OF PROVISIONAL OPERATION**

During the period of provisional operation, the lease in no way governs the relations between the receiver and the lessor. Such relations are ruled by the equities of the situation, for it is well settled by the great weight of authority, in the case of railroad leases, that a receiver of the lessee corporation by provisionally operating the leased road does not thereby become bound to pay rent for the period at the rate stipulated in the lease. In the absence of special equities he does his full duty when he turns over to the lessor the entire net earnings of the road, acquired by him during such period of operation. 97

Where the leased line or subdivision of a system earns a surplus over expenses rental must be paid to the extent of the surplus, but where a subdivision simply pays operating expenses, no rental will be paid and the line earning nothing beyond its operating expenses, and its possession not having been demanded by its owners, the receiver is not liable for any rent. 98

The reason for the rule that the receiver is bound to account only for net earnings is apparently based on the lessor's acquiescence. If, then, the receiver turns over the entire earnings of the road the acquiescing lessor cannot equitably demand more. 99 Moreover it has been held that where there are no net earnings, and the leased road has been operated with a deficit, the acquiescing lessor will be required to make up the deficiency. 100

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RIGHTS AND REMEDIES OF LESSOR OF RAILWAY PROPERTY WHOSE LEASE HAS NOT BEEN ADOPTED

If either the lessor or subdivisional mortgagee is not satisfied with the earnings allowed him on the pro rata basis as aforementioned, he may at any time proceed to assert his rights by foreclosure. While the court will continue to operate the leased branch lines and subdivisions of the insolvent until some application is made, yet the right of the lessor or mortgagee whose rent or interest is unpaid to insist upon possession or foreclosure will be promptly recognized. 101

While in the absence of such demand for repossession by the lessor, his acquiescence will be implied, and the receiver will be assumed to operate the property for his benefit, and will not, therefore, be required to pay for its use out of the proceeds belonging to creditors who have a claim superior to such lessor; 102 yet if the lessor does not acquiesce, if it knock at the door of the court and demand back its property it will then be in a position to dictate its own terms for the further use of the property. Such demand having been refused, the receiver must thereafter pay for the continued use and occupation of the property according to the terms set out by the lessor, and the compensation paid for such use will ordinarily be measured by the covenants and stipulations of the lease. 103

THE BOYD CASE

At the termination of an equity receivership, and after the debts of the insolvent corporation have been scaled down and its stock issues readjusted by a plan of reorganization agreed upon by a majority of the interested parties, if such plan or agreement provides that if the corporate property is transferred to a new company having the same shareholders, the transaction will be binding between the parties, but will not defeat the claim of a non-assenting creditor. As against him, according to the Supreme Court decision in the Boyd Case the transfer or sale is void in equity, regardless of the motive with which it was made.

When the non-assenting creditor establishes his debt, the subordinate interest of the old stockholders, in the hands of the reorganized company, will still be subject to his claim. Any device, whether by private contract or judicial sale under consent decree, whereby stockholders are preferred before creditors, is invalid.\textsuperscript{104}

If the unsecured creditor declines a fair offer he is left to protect himself as any other creditor of a judgment debtor, and having refused to come into a just reorganization cannot thereafter be heard in a court of equity to attack it.

If no tender is made the creditor, and kept good, however, he retains the right to subject the interest of the old stockholders in the property to the payment of his debt. If their interest is valueless, he gets nothing. If it be valuable he merely subjects that which the law had originally and continuously made liable for the payment of corporate liabilities.\textsuperscript{105}

\section*{Effect of Section 77 of the Bankruptcy Act upon Rent Claims}

During the years 1933 to 1935 the Congress dealt on several occasions with landlords’ claims for future rent. The Act of March 3, 1933, made provision for the relief of individual debtors, agricultural and non-agricultural, and for railroad reorganization. Section 74 defined creditors thus: “The term ‘creditor’ shall include for the purpose of an extension proposal under this section all holders of claims of whatever character against the debtor or his property including a claim for future rent, whether or not such claims would otherwise constitute provable claims under this Act. A claim for future rent shall constitute a provable debt and shall be liquidated under section 63(b) of this Act.”\textsuperscript{106} The Act of June 7, 1934, supplied procedure for corporate reorganization with arrangements per-


\textsuperscript{105} Northern Pac. Railway Co. v. Boyd, 228 U. S. 482, 33 Sup. Ct. 554.

\textsuperscript{106} 47 Stat. 1467-68
mitting the proof of claims for future rent. These provisions have been upheld.

The first provisions for proof of claims for future rent in railroad reorganizations appeared in the Act of March 3, 1933, simultaneously with the broadening of the Bankruptcy Act to include the railroads as debtors.

In the event the trustee should elect not to adopt an existing executory contract or lease the rights of the injured contractee or lessor are provided for under the Act as follows:

"Subsection (b):

The term 'creditors' shall include, for all purposes of this section all holders of claims of whatever character against the debtor or its property, whether or not such claims would otherwise constitute provable claims under this Act, including the holder of a claim under a contract executory in whole or in part including an unexpired lease.

"* * * In case an executory contract or unexpired lease of property shall be rejected, or shall not have been adopted by a trustee appointed under this section, or shall have been rejected by a receiver in equity in a proceeding pending prior to the institution of a proceeding under this section, or shall be rejected by any plan, any person injured by such non-adoption or rejection shall for all purposes of this section be deemed to be a creditor of the debtor to the extent of the actual damage or injury determined in accordance with the principles obtaining in equity proceedings."

It is first to be noted that the successive acts of the Congress, on extension of individual debts and corporate and railroad reorganization, are directed generally at the rehabilitation of debtors. As one of the means used consistently to accomplish this, claims for future rent are made provable and dischargeable, so that the debtor would not be burdened with the rent obligation after discharge. Next, the limitation of the amount of future rent recoverable to one year in Section 4 and to three years in Section 1[77B(b)] of the Act of June 7, 1934, leaves no doubt that the Congress deemed a definite formula advantageous in bankruptcy and general corporate reorganization. Its failure to provide an exact measure in railroad reorganizations shows it was not there considered appropriate. Finally,

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48 Stat. 915.


it seems obvious that the changes of the Committee on the Judiciary in the wording of the Railroad Coordinator's draft, by which "actual" was inserted before "damage" and "determined in accordance with principles obtaining in equitable proceedings" added as a guide, were intended to call emphatically to the attention of those administering the reorganization section the requirement that only those damages susceptible of definite proof should be allowed. A limitation on damages cannot be inferred from the language as enacted. As reorganizations had been traditionally carried on in equity and would be carried on in a bankruptcy court with equity powers, it was natural to add the clause as to equitable proceedings. Leases were placed upon the same basis as executory contracts.\textsuperscript{111}

While it could be said that the general rule in equity receiverships was that only accrued damages could be proven, there was no discernible equitable rule for the determination of damages for rejection or nonadoption of an unexpired lease. The actual damages from the breach were not determined. At the most an arbitrary time limit was set on proof. The reference to equity proceedings does not refer to any rule for the measure of damages in equity receivership.\textsuperscript{112} In their administration of estates, whether railroad or non-railroad, claims for future rents depended for their provability upon the fact or reentry,\textsuperscript{113} the existence of a clause for indemnity in case of breach,\textsuperscript{114} or the incidence of the maturity of the rent claim under the local law.\textsuperscript{115}

"The damages recovered by an injured party," said Mr. Justice Reed in the Connecticut case,\textsuperscript{116} "have always been limited to his 'actual' damages. There is nothing to indicate that the Congress intended to have 'actual' interpreted as

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\textsuperscript{111} Connecticut Ry. and Lighting Co. v. Palmer et al., 305 U. S. 493, 39 S. Ct. 316.
\textsuperscript{112} Connecticut Ry. and Lighting Co. v. Palmer et al., 305 U. S. 493, 39 S. Ct. 316.
\textsuperscript{114} Wm. Filene's Sons Co. v. Weed, 245 U. S. 597.
\textsuperscript{116} Connecticut Ry. and Lighting Co. v. Palmer et al., 305 U. S. 493, 39 S. Ct. 316.
The measure of damages applied by the courts for the breach of a lease, where damages are permitted, is uniform. In William Filene's Sons Co. v. Weed, 245 U. S. 597, 602, and in Kuehner v. Irving Trust Co., 299 U. S. 445, 450, this Court said in analogous situations that the measure was the present value of the rent reserved less the present rental value of the remainder of the term."

The English Bankruptcy Act permits proof of future rents, as any claim is provable which is "as to mode of valuation, capable of being ascertained by fixed rules or as matter of opinion." The measure of damages is the same. The difficulties of proof are well recognized. Since insolvencies are more frequent in economic depressions and since, as a consequence, estimates of the rental value of the remainder of the term are given under subnormal business conditions, the difficulties are multiplied.

Judges in equitable proceedings will have the advantage of evidence in applying the usual rules as to the measure of damages. It is well understood that such evidence must show damages to reasonable certainty. Mere "plausible anticipation" does not merit consideration nor are flights into the realm of pure speculation entitled to be treated as evidence. The determination of the amount to be allowed as the damage will be based on evidence which satisfies the mind.

Such is now the law in respect of the rejection of a lease by the trustee under Section 77, but the effect of the act has not yet been interpreted where the trustee "adopts" an executory contract or lease.

It has been a hitherto generally recognized power of a receiver or trustee to bind the bankrupt estate by adopting executory contracts and leases. This power is now seriously

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27 Act of 1914, 4 and 5 Geo. V, c. 59, sec. 30(8) (c).
28 In re Tickle, 3 Morr. 126; Ex parte Llynvi Coal and Iron Co., L. R. 7 Ch. App. 28; In re Hinks, Ex parte Verdi, 3 Morr. 218; In re Carruthers, 2 Mans. 172; Hardy v. Fothergill, L. R. 13 A. C. 358, where a claim on covenant to deliver well repaired at end of fifty-year term was held provable.
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restricted by Section 77, subsection (b) of the Bankruptcy Act as amended 1935, which is in part as follows:

"A plan or reorganization within the meaning of this section * * * may reject contracts of the debtor which are executory in whole or in part, including unexpired leases; and may include any other appropriate provisions not inconsistent with this section.

"The adoption of an executory contract or unexpired lease by the trustee or trustees of a debtor shall not preclude a rejection of such contract or lease in a plan of reorganization approved hereunder, and any claim resulting from such rejection shall not have priority over any other claims against the debtor because such contract or lease had been previously adopted * * *."

The apparent effect of this section is to give an entirely new meaning to the term "adopt". Under this section, "adoption" of an executory contract or lease means simply an agreement by the trustee to comply with its terms so long as the administration continues. Previously, when a contract had been adopted, as has been heretofore said, there was no basis for any claim for prospective failure of consideration, for both the lessor and the lessee, including the lessee's receiver, were obliged to perform under the terms of the agreement. But under this Act the trustee can only promise to perform so long as the trusteeship continues. This leaves the other party with nothing more than a right to prove a claim against the estate in case the contract should be rejected by the reorganization plan; in such a situation it is submitted he is relieved of his obligations. The actual effect of this provision, it would seem, is to prevent the effective adoption of any contract by a trustee.123

**CONCLUSION**

Future rent, as such, is not a fixed liability absolutely owing at the time so as to render it a provable claim against the estate of the insolvent in an equity receivership proceeding, nor was it provable in a bankruptcy proceeding prior to the amendment to Section 63(a)(7) of the Bankruptcy Act which made a claim for future rent provable not to exceed one year's rent, and the passage of Section 777B (b)(10), which made future rent provable for three years. Section 77 rendered future rent provable for the amount of actual damage sustained by the lessor.

123 Friendly, Amendment of Railroad Reorganization Act (1936) 36 Col. L. Rev. 27.
If the tenant, however, defaulted in the payment of rent or otherwise breached his contract of lease prior to filing his petition in bankruptcy, damages for such breach immediately accrued and are necessarily, therefore, a fixed liability absolutely owing at the time so as to render the claim provable in a bankruptcy proceeding.

Where the contract is breached subsequent to the tenant's insolvency, and the contract contains an acceleration clause providing that full damages are to accrue immediately upon default and that such damages are for compensation and not a penalty, claim for such damages may, by such provision be rendered provable, unless the receiver or trustee elects to reject the contract thereby rendering the claim not provable.

If a receiver or trustee adopts the contract of lease and accepts its benefits, he necessarily assumes its burdens and liabilities, binding the trust estate to its terms. In such a case the receiver or trustee is liable to the lessor for all rent then owing and thereafter to accrue, according to the covenants and stipulations of the lease. A possible exception to this rule may be the case where a trustee acting under Section 77 adopts a lease, but the approved plan of reorganization, by authority of the Act, nevertheless disregards such adoption by the trustee and, by its provisions, fails to accept the lease.

A receiver or trustee may accept or reject an executory contract or lease, but he may not abrogate it; the contract remains binding as between the landlord and tenant. If the contract is not carried out according to its terms, by the trustee, the landlord may have an action for damages against the tenant, his discharge in bankruptcy notwithstanding, for if his claim is not provable, neither is it discharged by bankruptcy. It is submitted that if a receiver or trustee may not abrogate a contract, neither may a plan of reorganization under Section 77. It is likely, then, that where a trustee has accepted a lease, and such lease is thereafter repudiated by the terms of the plan, the landlord, not having accepted the plan, and having an action for damages against the lessee, as a result of the repudiation, may possibly pursue his action against the property of the lessee in the hands of the reorganized company, under the doctrine advanced in the Boyd Case. There are no cases, however, under Section 77, in which this point has been raised.
Where a receiver or trustee has not adopted the lease he is no more liable for rent accrued prior to receivership than he is liable for any other debt owing by the insolvent at the date of his appointment. In such a case the lessor has a claim for the accrued rent, but the claim ranks in a class with all other unsecured creditors of the bankrupt. If by the terms of the contract, or by state law, the lessor holds a lien as security for unpaid rent, however, the court will then enforce such lien against the property of the lessee subject to such lien in the hands of the receiver, and to the extent of the lien the landlord will be a preferred creditor.

Rent accruing during the period that the receiver provisionally operates railroad property is in no way governed by the stipulations of the lease, but such rent will be paid according to the earnings of the leased property. The injured lessor may, of course, upon default of any part of the stipulated rental demand the return of the leased property, thereby showing his lack of acquiescence and his refusal to recognize the abrogation of his full rights under the contract, and upon the court's or the receiver's failure to recognize such demand, the lessor will then be in a position to dictate the terms for any future use of the property. Thereafter, if the lessee continues to use the property, he will be liable for the full rental stipulated in the lease, or for any other terms set forth by the lessor.

It seems to be then, according to the weight of authority, that rent accrued prior to receivership in the absence of a specific lien, is nothing more than an unsecured claim against the estate; that rent accruing during the receivership will be preferred only to the extent of the net earnings of the leased property and will not be paid at all if the property shows no net earnings and that future rent is not a provable claim, with the exceptions aforementioned. The entire situation will, of course, be altered upon the adoption of the lease by the receiver for in such a case thereafter all rent accrued, accruing, and to accrue in the future becomes a preferential debt against all the property, in the hands of the receiver.
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