Realistic Approach to the Study of Insolvency Law

Thomas Clifford Billig

Melba Stucky Billig

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A REALISTIC APPROACH TO THE STUDY OF INSOLVENCY LAW
THOMAS CLIFFORD BILLIG*
MELBA STUCKY BILLIG†

INTRODUCTION

For two years and more the files of at least the larger New York law offices have been crowded with federal equity receivership cases. Many a huge industrial concern, unable to survive the lull of waning business, has been placed by the federal court under the protecting wing of a receivership so that attorneys in downtown offices might work unmolested on plans of refinancing or reorganization. In fact, an examination of the records of the United States District Court for the Southern District of New York might lead readily to the conclusion that that tribunal had become a specialized agency for refinancing, reorganizing, rehabilitating and, if necessary, liquidating corporate business enterprises.

This epidemic of equity receiverships has not been confined to the United States District Court sitting in New York City, nor to the federal courts generally. The state tribunals have experienced a similar "rush of business", especially in those jurisdictions where statutes facilitate the appointment of receivers. In Ohio, for example, during the four years ending December 31, 1930, some 1474 petitions praying the appointment of a receiver either for a corporation, a partnership or an individual were filed in the Common Pleas Court sitting in Columbus. And it is common knowledge that receivership cases

*Assistant Professor of Law, Ohio State University. Formerly associated with Root, Clark, Buckner & Ballantine, New York City.
†Member of the Pennsylvania Bar.

†Columbus is the county seat of Franklin County, Ohio, and has a population of about 300,000. A study now in progress of receiverships in that county reveals some interesting figures. During a two-year period (1927-1928) a total of 593 petitions asking a receiver were filed and a total of 462 receivers were appointed by the Common Pleas judges. The following table classifies the cases according to petitioners:

<table>
<thead>
<tr>
<th>Petitioners</th>
<th>Petitions Filed</th>
<th>Receivers Appointed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Judgment Creditors</td>
<td>183</td>
<td>145</td>
</tr>
<tr>
<td>Simple Contract Creditors</td>
<td>75</td>
<td>54</td>
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<tr>
<td>Real Property Mortgagees in Foreclosure Proceedings</td>
<td>183</td>
<td>151</td>
</tr>
<tr>
<td>Chattel Mortgagees in Foreclosure Proceedings</td>
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</tbody>
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occupy much of the courts’ time in Delaware and New Jersey, where state statutes enable either a simple contract creditor or a stockholder to have a receiver appointed for a corporation on a bill alleging little more than that the defendant is insolvent.²

Petitions in bankruptcy compete with receivership bills in demanding the attention of the federal courts. The vast number of bankruptcies ground through the judicial mill every year is now an old story. The New York Bankruptcy Investigation emphasized this condition with telling effect by setting forth figures showing that “from 1925 to 1928, inclusive, there were nearly 200,000 bankruptcies, representing about twice the number of civil cases concluded in all the District and Circuit Courts of Appeal”, and by stressing the fact that “the assets realized [in these bankruptcies] were more than the total of all the judgments rendered by the District Courts in these [civil] cases.”³ Certainly, in the light of these statistics, it would seem that the successful judge of the future must be not only a highly trained lawyer, but also a master of business administration.

| Partners Seeking Partnership Accounting | 5 | 2 |
| Partners Seeking Partnership Dissolution | 40 | 33 |
| Stockholders Seeking Corporate Dissolution | 14 | 12 |
| Other Stockholders Suits | 20 | 15 |
| Lien Creditors | 13 | 10 |
| Sureties | 6 | 6 |
| Creditors Proceeding under Bulk Sales Law | 7 | 2 |
| Spouses Seeking Receivers in Divorce Actions | 3 | 2 |
| Miscellaneous | 31 | 18 |
| | | |
| 593 | 462 |

²Del. Rev. Code (1915) c. 117, §40 provides: “Whenever a corporation shall be insolvent, the Chancellor, on the application and for the benefit of any creditor or stockholder thereof, may, at any time, in his discretion, appoint one or more persons to be receivers of and for such corporation, to take charge of the estate, effects, business and affairs thereof, and to collect the outstanding debts, claims, and property due and belonging to the company, with power to prosecute and defend, in the name of the corporation or otherwise, all claims or suits, to appoint an agent or agents under them, and to do all other acts which might be done by such corporation and may be necessary and proper; the powers of such receivers to be such and continued so long as the Chancellor shall think necessary; provided, however, that the provisions of this Section shall not apply to corporations for public improvement.” See also N. J. Comp. Stat. (Cum. Supp. 1911–24) §§47–65.

³In the Matter of an Inquiry Into the Administration of Bankrupts’ Estates (1930) 13, being a report by the Joint Committee of the Association of the Bar of the City of New York, the New York County Lawyers’ Association and the Bronx County Bar Association.
However, even after marshalling and analyzing all of the cases both federal and state in which either the "method of equity" or the "method of bankruptcy" was applied to the affairs of an insolvent or an embarrassed defendant, one still would not have a complete picture of the administration of debtors' estates in the United States. For, in addition to the work of courts of equity and courts of bankruptcy, there are some seventy-four "approved adjustment bureaus" created by local credit associations and sponsored by the National Association of Credit Men, which are functioning actively in various trade centers and which, on the average, are closing a total of about 2,600 cases annually. These cases represent liquidations effected outside of court through the use of a common law or statutory assignment, a deed of trust, a trust mortgage, or some other similar device whereby the debtor conveys his property to a trustee, who administers it for the benefit of creditors. And then, augmenting these extra-judicial administrations by bureaus of the National Association of Credit Men, there are thousands of other compositions with creditors and liquidations of debtors' estates (likewise extra-judicial in character) which are brought about by various private individuals and agencies, some highly reputable, others less so, but for the most part agencies operating for their own financial profit.

It is into this legal-economic world teeming with financially unprofitable business enterprises, ranging all the way from the temporarily embarrassed corner grocer in a small town to the bankrupt brokerage house in lower Manhattan, that the law school graduate, class of 1931, is cast. If he starts the practice of law in one of those gigantic legal establishments perched high in a skyscraper along Wall Street, he may—literally within twenty-four hours—find himself "looking up law" to determine whether a federal court sitting in New York City has jurisdiction to entertain a bill praying a receiver for a Delaware corporation, whose principal office is on lower Broadway but whose assets are scattered through Eastern Pennsylvania, Maryland and West Virginia. The law office may desire to have the bill brought by a simple contract creditor residing in New Jersey, who cannot prove much more than that the defendant is unable to pay its current bills as they fall due and that the corporate assets may be

During the year ending December 31, 1930, the seventy-four bureaus closed 2,650 cases outside of court with liabilities totalling approximately $31,095,000. These figures were furnished by Walter C. Foster, national director of the adjustment bureaus, National Association of Credit Men, with offices at One Park Avenue.
wasted by threatened executions if the court does not act at once and appoint a receiver. And as our erstwhile law school senior enters upon his task, he racks his brain in an effort to recall which one of his many law school courses dealt with the problem of a federal equity receivership bill and the proper court in which to file it.

We have assumed the case of the young man who enters a large New York law office and we have suggested one of several methods by which he may come in contact with the world of business difficulties. But what of the youth who becomes associated with a small law firm, metropolitan or otherwise, or who starts in at once to build up his own practice? This young lawyer may not encounter a business failure within twenty-four hours after beginning his legal life. But sooner or later (surely sooner in these troubled days) he will be called upon to advise a client whose business affairs are no longer prosperous; or, if the debtor is not the client, one of the debtor's creditors may be. The case may be the relatively simple one of the small shopkeeper who has too much unpaid-for merchandise on his shelves which he cannot move immediately, although his creditors are clamoring for payment. This shopkeeper may be technically solvent in the bankruptcy sense—a fact which gives him slight immediate comfort—or he may be so hopelessly insolvent under the definition contained in the Bankruptcy Act that only a speedy, efficient and economical liquidation will save anything from the wreck either for his creditors or for himself. But in either case a serious problem, economic as well as legal, confronts the young lawyer, who may search the notes he took in a two-hour law school course in bankruptcy, perhaps only to find that the rules he learned there somehow or other fail to give a satis-

The most recent casebooks in the field of corporations reveal the fact that their compilers realize that the problems arising out of an equity receivership can no longer be ignored in the classroom. The Supplement to Warren, Cases on Private Corporations (1909), prepared by Professor E. Merrick Dodd, contains a new chapter entitled "Reorganization Through Receivership and Foreclosure", in which eight cases involving either federal or state equity receiverships are set out. These include such important decisions as Hollins v. Brierfield Coal and Iron Company, 150 U. S. 371, 14 Sup. Ct. 127 (1893); Farmers' Loan and Trust Co. v. Lake Street Elevated R. R., 177 U. S. 51, 20 Sup. Ct. 564 (1900); and Re Metropolitan Ry. Receivership, 208 U. S. 90, 28 Sup. Ct. 219 (1908). Professor A. A. Berlé's recently published Cases on Corporation Finance includes a brief concluding chapter on Reorganization, pp. 843-903, which lists some of the best text and periodical literature in the reorganization field, and also reprints the principal documents used in the reorganization of the Cuba Cane Sugar Corporation prior to the receivership of that company in 1929.

See infra note 31.
factory solution to his client's pressing problem as to what course of action to pursue.

It is submitted that the young lawyer (in either of the foregoing situations) is not wholly to blame for his lack of working knowledge. In each case he is confronted with a problem for whose solution he has had no adequate training. The course in "Bankruptcy" in all but a few schools is treated as an unimportant elective, which too often is passed around periodically among the various faculty members and sometimes even falls to the lot of a young and inexperienced instructor. Or, if well taught, this subject usually is presented from one of the orthodox bankruptcy casebooks which regards the liquidation of an insolvent estate as a thoroughly legalistic process. For this approach the compilers of our bankruptcy casebooks should not be too severely criticized. The Act of 1898 and the Supreme Court Rules are framed on the assumption that an administration in bankruptcy is a legal and not a business proceeding, a fact forcibly brought out and as forcibly criticized at the public hearings during the New York Bankruptcy Investigation. As a result of all this, the law student learns some of the more important provisions of the Act and their interpretation. But of those terrific administrative problems that have shaken not only New York City but the entire country during the last half dozen years, he is often ignorant.

Furthermore, a glance through the catalogues of a group of representative law schools reveals the fact that the schools seem to have taken literally the avowed purpose of the Bankruptcy Act, namely, that an administration under its provisions was to be the exclusive method of liquidating an insolvent estate. In other words, most of the law schools seem to assume that what was supposed to happen has happened and that as the "method of bankruptcy" has preempted the insolvency field, it is not necessary to extend instruction in that field beyond the borders of bankruptcy. Meanwhile, out in the commercial

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See, for example, the testimony of Charles H. Tuttle, former United States Attorney for the Southern District of New York, as reported in the New York Herald Tribune, Sept. 13, 1929, at 2.

See Report of the Committee on Bankruptcy Reform of the Merchants' Association of New York (1924); Reports of the Special Committee on Bankruptcy of the Association of the Bar of the City of New York (1923–1925); In the Matter of an Inquiry into the Administration of Bankrupts' Estates, supra note 3. See also Clark, Reform in Bankruptcy Administration (1930) 43 Harv. L. Rev. 1189.

A two-hour, one semester, course in Bankruptcy is the standard offering of most of the schools which give any work at all in insolvency law. Three semester hours appear to be the maximum. See Report of Committee on Curriculum,
community, credit men are straining every effort to keep their creditors out of the bankruptcy court—for they well know that administration costs will consume from one-fourth to one-third of the money that remains in the estate after the "slow moving precdural machinery laid down by the Act" finally reaches the end of its long journey. And in the law practice field, also, we find instances of this avoidance of the bankruptcy court. For the leading law firms which work out refinancing and reorganization plans for giant business enterprises scarcely ever desire a corporate client to "go through bankruptcy"—even though ultimate liquidation is contemplated. If the interference of a court is required at all, what they prefer is the more elastic procedure of the chancery court rather than the fixed and cumbersome procedure of an administration in bankruptcy.

But of the methods used by credit men, either to rehabilitate an embarrassed debtor or to liquidate his assets outside of court, the average law school graduate knows little or nothing; and of the great field of equity receiverships lie may know even less—for lie never had a course covering such material. No, the law school senior steps forth into the world carrying at most only one insolvency tool—that of bank-

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10In the Matter of an Inquiry into the Administration of Bankrupts' Estates, supra note 3, at 8.

11Ibid. at 332–333. But this is not the entire story. Credit men know also that if a business goes through bankruptcy general creditors will average less than ten per cent on their claims. The Statistics of Bankruptcy Proceedings for the fiscal year ending June 30, 1927 [taken from the Rep. Atty. Gen. (1927) at 178] are analyzed in Billig, What Price Bankruptcy: A Plea for "Friendly Adjustment" (1929) 14 CORNELL LAW QUARTERLY 413, at 415 et seg.

12"In the case of an insolvent industrial corporation, bankruptcy has one advantage over an equity receivership, namely, that the trustee in bankruptcy receives title to the property wherever located, thus avoiding the necessity of instituting an ancillary proceeding in every jurisdiction in which the corporation has property. Among the disadvantages of a bankruptcy proceeding over an equity receivership are the necessity of complying with statutory requirements with the resulting inelasticity of procedure, statutory limitations upon the power of the bankruptcy court to permit the continuation of the business, and the impatience of the bankruptcy court to secure an early sale and distribution. In the case of industrial corporations of large magnitude, an equity receivership is much to be preferred to bankruptcy. An equity receivership is no insurance against bankruptcy proceedings, for it is within the power of three creditors to force bankruptcy on an insolvent corporation within four months after the act of bankruptcy which is often involved in an equity receivership." Paul D. Cravath, Reorganization of Corporations, an essay in Some Legal Phases of Corporate Financing, Reorganization and Regulation (1917) 153, at 160.
ruptcy—with which to carve out his legal pathway, in a world struggling with a great commercial crisis. We have on the one hand, a disrupted economic system which has failed to weather the storm and stress of another depression. The ghosts of 1837, of 1857, of 1873, of 1893 and of 1907 haunt us as countless assignees and receivers and trustees in bankruptcy administer “last rites” over hundreds of once prosperous business ventures. We have on the other hand, a group of law schools which—with few exceptions—have failed to meet the challenge of the business world beyond their doors.

Wherein lies the remedy? First of all, a place should be made in the last two years of the law school curriculum for another major course. No sooner is this suggestion made than the protest arises that the last two years are already overcrowded with too many courses, major and minor. The answer is that if the law school intends to fit men for present day practice, it must make room somewhere for adequate training in a field which is clamoring for recognition even as private corporations clamored for more recognition some thirty or forty years ago. Hours are spent lecturing to students on the creation

13The following projects are under way at several law schools, which—among others—are experimenting with a more realistic approach to the study of insolvency law:

Some material on equity receiverships and settlements outside of court was included in the Bankruptcy course taught during the fall quarter of 1930 in the College of Law at Ohio State University. A new course covering the entire field of administering debtors’ estates will be substituted for Bankruptcy at Ohio State in 1931–1932.

The materials as partially outlined in this paper will form the basis of a course on Receivership to be given at Northwestern University Law School during the summer term of 1931 and in the West Virginia University College of Law during 1931–1932.

The Columbia University School of Law offers a course in Creditors Rights which is described as follows in the 1930–31 catalogue: “This course deals with the remedies of the unsecured creditor. The topics considered include judgments, fraudulent conveyances, creditors’ agreements, equity and statutory receiverships, and bankruptcy. The general approach is that of law administration.”

The Yale University School of Law has offered work in Receivership and Reorganization for several years. It is understood that plans are now under way for assembling into a new course the law covering the insolvent debtor.

14“New fields of the law are constantly being opened. There is a constant shift of emphasis. A hundred years ago the important courses were those which dealt with the law of real property and common-law pleading. A course in torts was first introduced in the Harvard Law School in 1870. A separate course on corporations was not regularly given until 1890. Think what a shift of emphasis there has been. Today, in addition to the traditional legal courses, courses are given in the constantly changing law of public-service companies, administrative law, restraint of trade, modern developments in procedural law, criminology,
of various types of business units and the manner in which they should function, once they have been created. But for most students (save those few who have taken the bankruptcy course) this ends the matter. Meanwhile, out in the commercial world, statistics show that each year more than 20,000 of these same units prove unsuccessful and fail to function normally. Certainly, in view of such figures, the student should be given a more adequate knowledge of the unsuccessful units and the methods used in dealing with them.

Next, in working out the content of our proposed course, we should recognize what has been pointed out, namely, that the technique of bankruptcy is not the only one which may be used in administering an insolvent estate. Of equal and sometimes of greater importance, is the technique of "friendly adjustment" (working through an assignment for the benefit of creditors) and the technique of equity (working through a receivership). These latter techniques or methods certainly must be considered in any realistic course dealing with the administration of insolvent estates.

Again, as already intimated, we should not attempt to present these techniques in several two-hour semester courses, but we should combine them into a single course to be called "The Administration of Insolvent Estates" or some similar name. This course should be not merely a course in bankruptcy, followed by a course dealing with as-

\[\text{The following information was taken from (Jan. 10, 1931) Dunn's Review 6:}\]
\[\text{"Exclusive of banks, failures in the United States last year numbered 26,355 comparing with 22,909 in 1929 and liabilities were $668,283,842 as against $483,250,196 in the earlier year. Thus, the numerical increase was 3,446 defaults or 15.0 per cent and the rise in the indebtedness was about $185,000,000 or 38.3 per cent."}\]
signments for the benefit of creditors, and topped off with a third course treating of equity receiverships. But all three of these techniques should be considered briefly in introductory matter at the outset of the course and then studied in detail in connection with each of the successive problems or factors in the case which confront the lawyer. In other words, we should not build the course along the lines of the traditional bankruptcy casebook, but rather let the sequence of subject matter be suggested by certain typical problems or sets of factual phenomena which come before the lawyer—for example, the problem of the debtor, the problem of the creditors, the problem of jurisdiction, and certain problems growing out of the mechanics of administration.

Also, in connection with our consideration of typical problems, we should make an honest effort to instill in students a few fundamental ethical conceptions with respect to the lawyer's duty in administering an insolvent estate. We should do our part at least toward altering the viewpoint, now all too prevalent among certain members of the bar specializing in insolvency law, that the best method of administration is that which brings the largest financial gain not to the creditors, or even to the debtor, but to the lawyers in the case. Members of the bar, otherwise reputable, who consciously would not overcharge a solvent client, too often look upon an insolvent estate as fair prey—and unhappily their views in this respect seem sometimes to be shared by the judge who allows the "fat" fees that are charged to "expenses of administration".

And finally, the approach should be a critical one. The student, for example, should not merely examine the various types of procedure. He should learn the advantages and deficiencies of each type and understand the considerations which make one or another method preferable under the various sets of circumstances.

PARTIAL CONTENTS OF PROPOSED COURSE

INTRODUCTORY MATERIAL

As it is proposed to consider at least three techniques which may be used in administering the affairs of an insolvent or a financially embarrassed debtor, it would seem desirable at the very outset—as already suggested—to give the student a brief summary picture of the operation of each.14 "Friendly adjustment", for instance, is a phrase

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14The purpose of this summary should be to orient the student in the general operation of each plan before he has been set to the task either of reading cases, periodical literature, or other materials. Of course this orientation may take the
new to most law students and even to some lawyers." Yet credit men
know what it means, and they also know all about the organization
which the National Association of Credit Men has built up in order to
put this plan into practice. And, as the "friendly adjustment" scheme
is the least complex of the three techniques, let us start off with a very
simple description of the operation of an assignment for the benefit
of creditors (upon which a "friendly adjustment" is founded) to be fol-
form of preliminary lectures, but as lectures also are time consuming, the practical
solution would seem to lie in the inclusion of a few pages of introductory text
material.

Obviously this is not true in such cities as San Francisco, Los Angeles, Salt
Lake City, Dallas, or St. Paul, where powerful adjustment bureaus affiliated
with the National Association of Credit Men are in operation.

Progressive courts and lawyers not only know of the existence of the "friendly
adjustment" plan, but favor it as a speedy, efficient, and economical means of
administering certain types of insolvent estates. The following quotation uttered
ten years ago states the attitude of a judge whose legal learning did not blind him
to business facts: "I am opposed to the doctrine that the making of a general
assignment [for the benefit of creditors] should bar a discharge [in bankruptcy].
I will tell you why. I do not know whether Mr. Hagar [a previous speaker]
knew that I decided this Feder case in which I held that a general assignment did
not bar a discharge and that decision was sustained by the Circuit Court of
Appeals. Why should the mere making of a general assignment, if nor accom-
panied by some fraudulent purpose, bar a man from his discharge? Why should a
man be forced to go into the federal court, or the creditors, if they do not want
him so to do? What happens every once in a while in general assignments is this:
A body of reputable merchants will get together, have a talk with the failing man
and with each other, and decide that the best way to administer is by a general
assignment and they select an assignee of character and repute, and he takes the
general assignment. In that kind of a case, if no creditor wishes to come to our
court and complain, why should the man be barred? Every once in a while what
happens is that somebody gets three creditors and they petition the alleged bank-
rupt into our court. But we get what they call up in the country 'way wise.'
We do not go on pure academic notions. At least, I think we do not. We come
pretty near knowing after a while which is a general assignment that is made for a
bad purpose by the selection of a friendly assignee, and which is a general as-
signment that is made honestly at the instance of a group of honest merchants;
and, unless there are reasons otherwise of wrong-doing, I do not understand why
a man who avails himself of a state law fairly and honestly should be barred
from his discharge as a bankrupt." Federal Judge Julius M. Mayer, in an ad-
dress before the Association of the Bar of the City of New York, February 10,
1921, reported in 2 LECTURES ON LEGAL TOPICS, supra note 14, 283, at 295.
A description of the nature and scope of this organization is contained in
Billig, What Price Bankruptcy: A Plea for "Friendly Adjustment", supra note 11,
at 426 et seq. and in Billig, Extra-Judicial Administration of Insolvent Estates: A
Study of Recent Cases (1930) 78 U. OF PA. L. REV. 293, 295 et seq. See also BEC-
KMAN, CREDITS AND COLLECTIONS (1924) 390.
To the discussion of "friendly adjustment" may be added an equally brief summary of the part which equity may play in the affairs of an insolvent business unit. The expression "equity receivership" is common enough, even in newspaper parlance, yet there are students who pass through three years of law study without gaining anything except a very vague notion as to the conditions under which a chancery receiver is appointed and what he is supposed to do, once he has been placed in charge of the defendant's property and business.

As to bankruptcy, a few pages of text (rather than a host of cases) will suffice to give the student enough information concerning the machinery of the bankruptcy court so that he can study the succeeding materials with intelligence and with a great saving of classroom time. With this brief summary of available techniques in mind, as well as our ethical and critical approach, the student should be plunged at once into the first big problem of the course—the problem of the debtor.

THE PROBLEM OF THE DEBTOR

The traditional bankruptcy casebook usually opens Chapter I with that clause of Article I, Section 8, of the Federal Constitution, which gives Congress the power to establish uniform laws on the subject of bankruptcies throughout the United States. This is followed by Hanover National Bank v. Moyses, which declares the Act of 1898 to be constitutional. And then comes a brief section of the casebook

19 "In order to secure the approval of the National Association of Credit Men, adjustment bureaus are required to comply with strict regulations covering organization, management, personnel, machinery, policies, protection of clients' interests, care in correspondence, finances, records and supervision by local boards of directors and by the National Association of Credit Men." In Defense of the Nation's Receivables (1927) 9, published by the National Association of Credit Men.

20 At this point the student should read: Mayer, Equity Receiverships, 6 Lectures on Legal Topics, Association of the Bar of the City of New York (1929) 161; Payne, The General Administration of Equity Receiverships of Corporations (1922) 31 Yale L. J. 685; Glenn, The Basis of Federal Receiverships (1925) 25 Col. L. Rev. 434; Byrne, Foreclosure of Railroad Mortgages, an essay in Some Legal Phases of Corporate Financing, supra note 12, at 77; Cravath, Reorganisation of Corporations, loc. cit. supra note 12.

21 A summary outline of bankruptcy procedure such as that contained in Joslyn, Bankruptcy (2nd Student's ed. 1926) is helpful to students at this point.

devoted to the problem of what laws were suspended by the enactment of the National Bankruptcy Act.  

It is not the purpose of this discussion to contend that instruction in such matters as the effect of the National Bankruptcy Act upon certain state insolvency statutes is not valuable to the student. But under the proposed new alignment of materials, it seems more rational to postpone this study until later in the course, after the student is thoroughly familiar with "general assignments for the benefit of creditors" under the common law and state statutes, and after he has considered in detail the "inherent" power of equity to appoint receivers and the extension of this power by state statutes.  

Therefore, instead of following the traditional approach, it is proposed to devote Chapter I of the course materials to a consideration of what can be called at least tentatively "The Problem of the Debtor." And it is hoped that these materials may be developed at least partially along the lines which this problem takes in practice. Accordingly, let us call the first section of Chapter I "The Financial Condition of the Debtor: Herein of the Expression 'Insolvent'."

First of all, the lawyer must obtain exact knowledge of the debtor's financial affairs before he is in a position to advise a course of action. This information is not only often difficult to procure, but unless the lawyer has had some training in accounting terminology and the makeup of financial statements, he may waste considerable time in attempting to understand the real condition of the debtor's business even when he has access to all the necessary books and papers. Consequently, while the lawyer necessarily must depend upon the accountant for the solution of the more complicated financial problems, nevertheless at least a passing acquaintance with the latter's working tools may prove essential.

It is puzzling to determine which is the more practical method to use

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23 See Britton, Cases on Bankruptcy (1928) 1-19; Holbrook and Aigler, Cases on Bankruptcy (2nd ed. 1927) 1-36.

Prof. Williston began his casebook with a brief but excellent "Historical Introduction" followed by the text of the Act of 1898. He then set out in §1 of Chapter I the pertinent clause of Art. 1, §8 and Leidigh Carriage Co. v. Stengel, 95 Fed. 637 (C. C. A. 6th, 1899). §2 of Chapter I he devoted to "Extent of the Powers of the Several States." See Williston, Cases on Bankruptcy (2nd ed. 1915) 1-85.

24 For example, the thought-provoking problems raised by Britton, op. cit. supra note 23, at 18, n. 2, which presuppose such a detailed knowledge of the whole field of insolvency jurisprudence, might well be left for the mature reflection of students who had several months of the course behind them. See infra note 78.
in imparting "accounting" information to students who are at the same time studying the various techniques available for administering an insolvent estate. It has seemed to us that, instead of formal lectures or assigned readings on financial problems, the student might be given some of the same content by incorporating in the materials certain "samples" of current financial history which are contained in some of the "cases" to be used later in the course.

At this point we are concerned primarily with the information we should obtain about the financial condition of the specific debtor—rather than with the technique to be used in solving his problems. The grouping of materials, therefore, should be in the order of complexity regardless of the type of administration used.

We might consider first, for instance, the case of a simple state equity receivership such as is used in Ohio. Several good examples of carefully prepared petitions are to be found in the receivership records at the Franklin County Courthouse in Columbus (filed under the Ohio receivership statute) which set forth in detail the financial condition of the respective defendants. The factual phenomena in these particular papers are simple and therefore excellent for starting the student on his study of the financial angle of the problem. There is also the additional advantage to the student that at the very outset he has not only an opportunity of becoming acquainted with certain terms and language, but also with some of the very papers he will be compelled to draw when he enters practice.

With this background, it will be possible to study in detail several more complicated financial structures. Two specific examples that might be used are the liquidation of the Gray Manufacturing Company (an automobile manufacturing corporation) and the case of J. Z. Horter Company v. Punta Alegre Sugar Company. The case involving the Gray Manufacturing Company was one of the first big liquidations in the automobile industry ever effected outside of court. Liquidated assets of $200,000 and some 425 creditors scattered all over the world were concerned. The Detroit Association of Credit Men, which handled the case, sent out letters to all the creditors for the purpose of acquainting them with the financial structure and condition of the company. These letters, incidentally, would at this point furnish excellent material on the financial condition of the debtor, and they would also serve to give the student a first-hand acquaintance with the method of "friendly adjustment".

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23The complete record of this case was placed at my disposal by Mr. L. E. Deeley, manager of the Adjustment Bureau, Detroit Association of Credit Men.
The Punta Alegre Sugar Company case was a "friendly receivership" begun during 1930 in the United States District Court for the Southern District of New York. Its use is suggested because the bill in that case is typical of the high type of draftsmanship prevailing in the better New York law offices,26 and because it also affords fine material for studying the condition of a Delaware corporation with a fairly complicated financial structure. The bill describes this structure in detail and recites the events leading up to the receivership.

As the subject matter of the course now stands, the student has been given a very brief statement of the three principal methods by which an insolvent estate may be administered, and he has been referred to periodical literature to assist him in gaining a more complete background with respect to these methods. Almost no class time has been devoted to these three techniques (they will be considered in detail later) but instead the lecture hours up to this point have been used in a full discussion of the "financial condition of the debtor" as contained in each of the "samples" previously mentioned. By this time the fact terminology of insolvency should have become part of the student's equipment—such terms as "net worth", "fixed assets", "debtor's exemptions", "accounts receivable", "inventory", "fixtures", and "appraisal", to mention only a few. No opinions of courts of last resort have thus far been included. Rather the student has gleaned whatever he has learned from his general reading and from some of the papers containing the "sample" fact pictures submitted to courts of first resort.

There is at least one term, however, which is encountered almost at the outset of any study of "the financial condition of the debtor" and which, because of its importance, calls for extended treatment. This is the word "insolvent". Like so many other words used in the law, this one does not always mean the same thing. There is a wealth of unexplored material, both case law and statute, illustrating the various uses to which it has been put. For example, where the trustee of a bankrupt corporation seeks in a state court to recover bonds obtained by the defendant from a director "in violation of his fiduciary duty" when the corporation was insolvent, does the state court apply the same test for insolvency as was applied by the bankruptcy court in order to determine whether the corporation was "insolvent" enough to let a petition lie against it in the first place?27 Or where a vendor-

26The receivership bill was drawn in the office of Root, Clark, Buckner & Ballantine, 31 Nassau St., New York City.
wholesaler seeks to rescind an alleged fraudulent sale and to retake goods which the vendee-retailer, while insolvent, transferred to a third party, what test does the court apply in order to determine the "solvency" or "insolvency" of the defendant?28 Or, where a state statute, as in Delaware,29 permits a simple contract creditor to have a receiver appointed for a corporation on little more than the mere allegation that the defendant is "insolvent", does the statute mean the same kind of insolvency as the National Bankruptcy Act of 1867,30 or as the National Bankruptcy Act of 1898,31 or as the Canadian Bankruptcy Act of 1919?32 And even where we have the word "insolvent" defined "mathematically", as it is said to be defined in the Act of 1898,33 are we entirely sure as to the meaning of such words as "property", "fair valuation", and "debts", which go to make up the definition?34

28Pelham v. Chattahoochie Grocery Co., 156 Ala. 500, 47 So. 172 (1908).

New Jersey has a similar statute. See N. J. COMP. STAT. (Cum. Supp. 1911-24) §§47-65; and see Reinhardt v. Inter-State Telephone Co., 71 N. J. Eq. 70, 63 Atl. 1097 (1906).

30Toof v. Martin, 80 U. S. 40 (1871).
3130 STAT. 544, §1 (1898), 11 U. S. C. §1 (1926) (For convenience this will be referred to as the Bankruptcy Act of 1898 hereafter, and will be followed by the code citation to the Code of 1926) provides: "...(15) a person shall be deemed insolvent within the provisions of this title whenever the aggregate of his property, exclusive of any property which he may have conveyed, transferred, concealed or removed, or permitted to be concealed or removed, with intent to defraud, hinder or delay his creditors, shall not, at a fair valuation, be sufficient in amount to pay his debts." 11 U. S. C. §1 provides: "...(11) 'debt' shall include any debt, demand, or claim provable in bankruptcy."

33In In re Bauman, 96 Fed. 946, 947 (W. D. Tenn. 1899) Judge Hammond commented as follows upon the definition of insolvency contained in the Act of 1898: "...the language of the above-quoted section is explicit. There is not the least ambiguity about its meaning. It leaves no room for any construction by implication or otherwise. Obviously, it was intended to give us a rule in mathematics, the terms of which are absolute."

34Britton raises some of these problems in CASES ON BANKRUPTCY, supra note 23, at 69, n. 18: "What is property within the meaning of Bankruptcy Act, Sec. 1, subd. 15 [11 U. S. C. §1]? Is it the equivalent of those interests which pass to the trustee under Sect. 70 [11 U. S. C. §110], and which may be recovered by him under Sections 60b and 67 [11 U. S. C. §§6, 107], or would it include things of pecuniary value, which did not pass to the trustee, such as exempt property.
In order to answer these questions and countless others which may be raised, it is of course necessary for the student to consult a series of statutes, cases, and periodical literature, a part of which has been cited in the footnotes to the preceding paragraph. After the student has read this, he should have gained at least some idea of the account-certain causes of actions in tort or estates in land, such as an estate held by the entitie, which under local law may be exempt from the claims of creditors? *In re* Baumann (D. C. 1899) 96 F. 946. By excluding from the inventory property fraudulently conveyed, does the section by implication require the counting of property which has been transferred under circumstances where it may be recovered by the trustee as a voidable preference, under section 60b, or because of its similarity to a fraudulent conveyance, should preferential transfers likewise be excluded? What fraudulent conveyences are excluded? Those that are such under state decisions or those that are deemed such by the federal court before which the issue is presented? Are all fraudulent conveyances to be excluded, irrespective of whether they may be recovered or not? If the section means only those fraudulent conveyances which may be recovered, does it mean those recoverable under section 67e, the first branch of the section, or the second part of the section or those recoverable under section 70e, or those which, under section 14b, subd. 4 [11 U. S. C. §32] operate to bar discharge? They are not identical. What is the test for determining what is a fair valuation? Would it be such a valuation as a prospective purchaser would put on the property, or such a valuation as an owner would deem fair, or is it such a valuation as it would have, if sold at an execution sale to bargain hunters? If the property involved consisted of a going business, would a fair valuation be that which it would have as a going enterprise, or would it simply consist in a valuation of the property as though unconnected with a going concern? If a business enterprise is assumed to have a fair valuation of X, and shortly thereafter and because of the entry of a number of judgments against it, it had a fair valuation of X-1, and if, at the time of the act of bankruptcy committed subsequently the business had a fair valuation of X-2, and at the time of the filing of the petition and because thereof, it had a fair valuation of X-3, which fair valuation should be taken? The term 'debt' is defined in section 1, cl. ii, in this manner: 'Debt shall include any debt, demand or claim provable in bankruptcy.' Provable claims are defined in section 63 [11 U. S. C. §1031. Hence the term 'debt' as here used 'includes' debts provable under Section 63. But is the term limited to these debts? Might the term 'debt' include debts other than those referred to in section 63, such as certain contingent debts and certain tort obligations not reduced to judgment? See *In re* Bowers (D. C. 1914) 215 F. 617 and note; 13 Mich. Law Rev. 330. Again, the introduction to the quoted definition of a debt reads: 'The words and phrases used in this act and in proceedings pursuant thereto shall, unless the same be inconsistent with the context, be construed as follows... Would there be any possibility that the context, in which the word 'debt' here is used, might require a different meaning for the term?'

The whole question of "valuation" under §1 (15) of the Act of 1898 is considered in Bonbright & Pickett, *Valuation to Determine Solvency under the Bankruptcy Act* (1929) 29 Col. L. Rev. 582.

Such as the financial condition of one who seeks to become a voluntary bankrupt. *Holbrook & Aigler, Cases on Bankruptcy, supra note 23, at 87.*
ing and general business problems which a present day lawyer must understand before he can be of much practical help either to debtor, creditors, or the administrative agents in a case involving a defunct business. The scope of this study of business questions may be as broad as the instructor cares to make it. In fact, under the section "The Financial Condition of the Debtor", may be included those great problems of corporation finance which are involved in the "reorganization" of a business venture which is no longer profitable. As previously noted, some of the preliminary material for such study has been included by Professors E. Merrick Dodd and A. A. Berle, Jr. in their recently published casebooks in the corporate field. 36

But quite obviously, the "Problems of the Debtor" and what should be done concerning his affairs, is not wholly solved even by the most complete knowledge of his financial condition at the time when the lawyer comes into the case. Other factors enter, and these, sometimes as much as his financial condition, will determine by what method the debtor's assets should be administered. Therefore the latter part of Chapter I should include materials for bringing out the following points: (1) What kind of a business unit (if any) is the debtor operating? 37 (2) How large is the business and what is its financial

36 Supra note 5.

37 The question as to what kind of a business unit (if any) the debtor is operating is important in connection with the kind of technique that is finally used in administering his affairs. For instance, the "friendly adjustment" plan is peculiarly adapted to the small merchant insolvency where the proprietor is an individual or perhaps one of two or three partners. Voluntary bankruptcy may be resorted to by "any person, except a municipal, railroad, insurance, or banking corporation..." [Bankruptcy Act §4a, 11 U. S. C. §22], the word "persons" including "corporations,...partnerships, and women..." [Bankruptcy Act §1 (19), 11 U. S. C. §1 (19)]. An involuntary petition in bankruptcy may be filed against "any natural person, except a wage earner or a person engaged chiefly in farming or the tillage of the soil, any unincorporated company, and any moneyed, business, or commercial corporation, except a municipal, railroad, insurance, or banking corporation, owing debts to the amount of $1,000 or over,..." [Bankruptcy Act §4b, 11 U. S. C. §22].

In contrast to the two other techniques, the federal equity courts generally decline to appoint a receiver for an individual who is under no legal disability, particularly if the bill is founded on the "insolvency" of the defendant. In Maxwell v. McDaniels, 184 Fed. 311 (C. C. A. 4th, 1910) the court, at 316, stated the reason for this attitude in the following language: "It is not questioned that when a simple contract creditor of a corporation files a bill against it, alleging its insolvency and praying that the court take charge of its assets through a receiver and distribute them among the creditors, and the corporation and such other defendants as were made parties to the bill answer admitting the facts and consenting to the granting of the relief prayed for, receivers may be ap-
structure?\(^2\) (3) What is the personal character of the debtor (if he is an individual) and how has he behaved toward his creditors?\(^2\)

Take, for example, the third point in the foregoing list. The debtor may be an individual merchant who is insolvent in the bankruptcy sense, who has committed an "act of bankruptcy", and who has several secured creditors and perhaps twenty merchandise creditors. If the creditors are located within a narrow radius, and all are willing to work together and to have the case administered through the agency of a local adjustment bureau affiliated with the National Association of Credit Men, then it might seem that an extra-judicial administration would offer the most speedy, efficient, and economical settlement for all parties concerned.

But this will depend also upon what kind of an "act of bankruptcy" the debtor has committed. The Bankruptcy Act, for instance, enumerates six types of conduct,\(^4\) all of which the debtor must avoid unless pointed and retained in the absence at least of prompt attack upon the jurisdiction by some one in interest entitled to be heard. An individual is not a corporation. The administration of the affairs of an insolvent individual is not a recognized head of equity jurisdiction as is the administration of the assets of an insolvent corporation. The subject-matter in the former case is not one over which the court has jurisdiction. Mere waiver by the defendant of objections otherwise fatal to the capacity of the plaintiff to invoke the jurisdiction in the case of a corporation removes the only obstacle to the granting of the relief desired. In the case of an individual defendant it leaves untouched the most serious difficulty of all, viz., that the subject-matter is not one within the province of the court.\(^6\)

Pennsylvania follows the federal rule. Hogsett v. Thompson, 258 Pa. 85, 101 Atl. 941 (1917). In Ohio, on the other hand, the common pleas courts are liberal in appointing receivers for individuals on petitions brought under §11, 894 of the General Code.

The size of the defendant's business and its financial structure also are important factors in determining the most effective administration technique. The federal equity receivership lends itself best to the large corporation with a complicated financial structure, with property in several states, and with the respective legal relations of the several classes of disputing creditors and stockholders to be determined.

At this point the six "acts of bankruptcy", set out infra note 40, should be studied in detail from the material in one of the standard bankruptcy casebooks. This material should include the Statute of 13 Eliz. c. 5, the early New York Statute, [N. Y. REV. STAT. (1829), Part II c. 7, tit. 3, §§1-5] which was used as a model for much subsequent American legislation on fraudulent conveyances, and the Uniform Fraudulent Conveyance Act. The students should read, in addition, McLaughlin, Amendments of the Bankruptcy Act (1927) 40 HARV. L. REV. 341.

Bankruptcy Act §3, as amended by 44 STAT. 662 (1926), 11 U. S. C. §21 (Supp. 1930) provides: "Acts of Bankruptcy.—(a) Acts of bankruptcy by a person shall consist of his having (1) conveyed, transferred, concealed, or removed, or permitted to be concealed or removed, any part of his property with intent to hinder,
he wishes to expose himself to the danger of having an involuntary petition filed against him, his property liquidated, and the proceeds distributed among his creditors. Some of these six types of conduct may grow out of an inner desire on the part of the debtor to cheat and defraud his creditors,—for example, when the debtor has concealed or fraudulently conveyed property. When the act of bankruptcy is of this nature, there is obviously no problem regarding the type of administration to be used. Bankruptcy is the best method so far devised for dealing with dishonest debtors—the only one of the three methods, in fact, which has the necessary machinery for uncovering property concealed or dishonestly conveyed. The lawyer for creditors in this situation will as a matter of course file an involuntary petition against the debtor. And if the lawyer for the debtor is sufficiently high minded, he should not hesitate to urge the debtor to file a voluntary petition in bankruptcy or to have counsel for the creditors file an involuntary petition against him.

However, not all the acts of bankruptcy enumerated in the Act of 1898 fall within the category of dishonesty. An assignment for the benefit of creditors, for instance, may be in an entirely different class ethically. The debtor, under such circumstances, may be a thoroughly honest man who has made the assignment to a reputable and efficient assignee for the purpose of permitting creditors to participate in his estate at as little administration expense as possible. In this event, and presupposing the elements of our previously stated hypothetical case (an individual debtor, creditors within a narrow radius and all willing to cooperate), there seems no sound reason for administering the estate in bankruptcy. Rather than urge bankruptcy, the debtor's counsel should encourage the assignee to go ahead with the liquidation, and furthermore he should prevail upon lawyers representing creditors to keep the case out of the bankruptcy court.

delay, or defraud his creditors, or any of them; or (2) transferred, while insolvent, any portion of his property to one or more of his creditors with intent to prefer such creditors over his other creditors; or (3) suffered or permitted, while insolvent, any creditor to obtain a preference through legal proceedings, and not having at least five days before a sale or other disposition of any property affected by such preference vacated or discharged such preference; or (4) suffered, or permitted, while insolvent, any creditor to obtain through legal proceedings any levy, attachment, judgment, or other lien, and not having vacated or discharged the same within thirty days from the date such levy, attachment, judgment, or other lien was obtained; or (5) made a general assignment for the benefit of his creditors; or, while insolvent, a receiver or a trustee has been appointed, or put in charge of his property; or (6) admitted in writing his inability to pay his debts and his willingness to be adjudged a bankrupt on that ground."
Apparently, then, the character of the debtor’s acts (honest or dishonest) plays an important part in determining the lawyer’s course of action, be he lawyer for the debtor or for one or more of the creditors. And the attorney who would deal with the situation intelli-
gently must take this factor into account as well as the debtor’s financial condition and the structure of his business. If the debtor has given clear evidence of dishonesty, only one course of action is open; but if he is honest, the type of administration used will then rest upon the efficiency of the respective methods under the circum-
stances of the particular case.

However, it is only after we succeed in turning out lawyers who view the whole process of the administration of insolvent estates as something other than a medium for their own financial gain, that we may expect to find counsel for the debtor studying the problem of the debtor and co-operating with counsel for the creditors in choosing the method of administration which will best fill the needs of the specific case. Then, and then only, will insolvency lawyers urge the debtor to co-operate with his creditors and the creditors to co-operate with the debtor, in order that the administration may be as efficient and inexpensive as possible.

THE PROBLEM OF THE CREDITORS

The second typical factor which enters into the situation before the lawyer considering an insolvency case, is the problem of the creditors. This is not the result of any arbitrary grouping of materials about either a legal or an economic principle, but rather the result of the fact that in actual practice certain happenings or factual phenomena fall naturally around the creditors and their course of action.

When the financial affairs of the debtor become precarious and he reaches the point of “insolvency” (in one of the meanings of that term) and perhaps has committed an “act of bankruptcy”, several alternatives are open to the creditors. Filing an involuntary petition in bankruptcy is not the only course possible. The creditors may grant the debtor an extension on his accounts; or a composition may be worked out, either under court supervision or extra-judicially. Then again the debtor’s business may be operated for a time by the creditors (or by a receiver) and later turned back to him. Or, finally, the debtor’s estate may be liquidated, either under a “friendly adjust-
ment”, in equity, or in bankruptcy.

With the technical requirements which the creditors must meet in pursuing each of these various remedies the student should become
thoroughly familiar through the study of statutes, case law, and perhaps non-legal materials. Let us therefore devote the first part of Chapter II (The Problem of the Creditors) to a consideration of some of these "technical requirements". This section may be divided, first, into the technical requirements which the equity courts, federal and state, impose upon creditors; and, second, into the technical requirements concerning creditors which are found in the Bankruptcy Act and the cases interpreting the Act.

If, for example, it is proposed to work out an equity receivership for the debtor in a federal court, the lawyer steering the course of events must be sure, among other things, that the necessary diversity of citizenship exists between complainant and defendant (for most receiverships involve no federal question); that the claim of the complainant who brings suit is $3,000 or more; and that the complainant, if a simple contract creditor, has exhausted his legal remedy by reducing his claim to judgment and by having execution returned unsatisfied, before invoking the power of the chancellor. If, on the other hand, a petition in involuntary bankruptcy or a receivership under a state statute is contemplated, there are other technical re-

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The question of "consent" receiverships in the federal courts is considered infra at page 572 in connection with the mechanics of the equity court.

4Bankruptcy Act §59 (b), 11 U. S. C. §95, provides: "Three or more creditors who have provable claims against any person which amount in the aggregate, in excess of the value of securities held by them, if any, to five hundred dollars or over; or if all of the creditors of such person are less than twelve in number, then one of such creditors whose claim equals such amount may file a petition to have him adjudged a bankrupt."

4If, for example, counsel decides to bring a receivership bill in a New Jersey state court under N. J. Comp. Stat. (Cum. Supp. 1911–24) §47–65 (the General Corporation Act) the bill should allege that the defendant "has become insolvent and is not about to resume its business in a short time thereafter, or that its business has been and is being conducted at a great loss and greatly prejudicial to the interest of its creditors or stockholders, so that its business cannot be conducted with safety to the public and advantage to the stockholders."
quirements with which the lawyer must be thoroughly familiar and whose importance should be emphasized to the student.

But however important "technical requirements" may be, they constitute only one angle of the creditor situation. The fundamental problem, when finally uncovered, will prove to be the extent of creditor cooperation. Therefore, let us devote the second section of Chapter II first, to materials showing the cause and effect of the non-cooperation of creditors; and, second, to the existing or proposed methods either for limiting the necessity of complete cooperation among the creditors or for effecting such cooperation.

It is common knowledge that in every judicial administration of an insolvent estate, the failure of creditors to cooperate is a source of difficulty. Let us glance for a moment at the situation in bankruptcy. The Act of 1898 was predicated upon the theory of "unlimited creditor control", namely, that when notified of their first meeting, the creditors would assemble to the last man in "town meeting" fashion and would elect a trustee of their own choosing. And thereafter, as the theory went, the creditors were supposed to take a lively interest in the proceedings and to work hand in hand with the trustee in the interest of an efficient administration.

But, in practice, what has happened? In almost every urban community, creditor control of bankrupt estates has become a pure fiction. There has grown up in commercial centers a bankruptcy bar, whose members solicit the claims of creditors in every bankruptcy of any size and, by working the "proxy racket", elect a trustee from their own numbers. Furthermore, they see to it that every member of the trustee's staff, from his counsel down through the custodian, is "friendly" to the "ring". As for the creditors, they well know that a "lawyers' oligarchy" is in control of the case, and they also know that the dividends paid in the average bankruptcy with assets of $5000 or less are generally purely nominal. Therefore, the creditors consider it a poor business proposition to devote much time or energy to participating in the administration and, by their very indifference, they entrench even more strongly the position of those who would exploit the estate for their own interests.

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46 IN THE MATTER OF AN INQUIRY INTO THE ADMINISTRATION OF BANKRUPT'S ESTATES, supra note 3, at 8-9.
47 Ibid. Judge Thacher makes the following comment in his memorandum accompanying the report: "If there is any agency less competent than a court to carry on the business of liquidating an estate, it is a General Town Meeting. The Bankruptcy Act requires the cooperation of both."
48 Clark, Reform in Bankruptcy Administration, supra note 8, at 1195 et seq.
49 Supra note 11.
Let us look next at the method of equity from the creditors’ standpoint. The method of bankruptcy was at least predicated upon the theory that the creditors should control the administration of the estate. The method of equity (certainly under some of the state statutes) is frankly predicated upon no such assumption. In those sections of Ohio, for example, where the statutory equity receivership has all but replaced bankruptcy, certain law firms control the receivership practice; and the creditors well know that the lawyer who brings the bill, the lawyer who is appointed receiver, and the lawyer who is counsel for the receiver may all be members of the coterie that is in power. Creditors know, too, that one of their number who holds a judgment note against debtor D may have placed it in the hands of X, a lawyer, for collection; that X may file this note in Common Pleas Court, thus getting his judgment; and that in the very next proceeding the Court may appoint a receiver for D on a petition drawn by X, alleging either that D is insolvent or is in imminent danger of insolvency, and that his assets will be dissipated in the mad scramble of creditors if a receiver is not appointed at once. Of course D may answer and show cause why a receiver should not be continued in charge of his property; but he rarely does. The more normal course of events is for D either to do nothing, or for him to admit the allegations in the petition and join in the prayer, thus turning the proceeding into a sort of “voluntary bankruptcy” in which he will not get a discharge. As for the other creditors of D, their first knowledge of the receivership may come when they see the notice published by the receiver, asking that claims against the estate be filed at once. In this type of proceeding, as in bankruptcy, the expenses of administration are high, especially in the small cases, and the courts are lenient in granting fees to the receiver and to his counsel as the

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56In Ohio this instrument is called a cognovit note.
57These conclusions are drawn from findings appearing in the study mentioned supra note 1.
58In nine cases, involving for the most part small merchant insolvencies, with liquidated assets of $500 or less, administered in equity during 1927–1928 in Franklin County, Ohio (Columbus), the total expenses of administration consumed, on the average, 92.3 per cent of these assets.
In fourteen similar cases, with liquidated assets of $500 to $1000, the total administration expenses averaged 46.5 per cent of these assets.
In twenty merchant insolvencies, with liquidated assets of $1000 to $2000, the total administration expenses averaged 42.7 per cent; and in thirteen larger cases, with liquidated assets of $2000 to $7000 this average total administration cost was 39.2 per cent.
principal administrative officers. Of course, if the creditors feel that their interests are not being protected, they may intervene and move for the appointment of a co-receiver. But this only increases the administration costs and thus leaves even less money in the estate for the creditors.

The absence in fact of creditor cooperation both in bankruptcy and under a state receivership proceeding has been considered, and the resulting substitution of lawyer control over the debtor's estate for creditor control has been pointed out. Let us next notice, very briefly, some results of a different character, which also may be attributed to the failure of all classes of creditors to work together in effecting a solution for the debtor's financial difficulties. Take, for example, the situation which arose in the leading case of *Northern Pacific Railway v. Boyd* (and in some of the decisions which have followed it), where a corporate reorganization, advantageous to stockholders and bondholders but not to general creditors, was worked out under a federal equity receivership. In this case a general creditor of the old company (or rather one of the old companies involved) appeared after the reorganization plan had been approved by the court and after the corporate property had been sold to the new company, the Northern Pacific Railway. This general creditor sued the Railway on his claim against the old company, and the Supreme Court of the United States held that he could recover. The court said, through Mr. Justice Lamar:

"Corporations, insolvent or financially embarrassed, often find it necessary to scale their debts and readjust stock issues with an agreement to conduct the same business with the same property under a reorganization. This may be done in pursuance of a private contract between bondholders and stockholders. And though the corporate property is thereby transferred to a new company, having the same shareholders, the transaction would be binding between the parties. But, of course, such a transfer by

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63 The combined fees of the receiver and the receiver's counsel consumed, on the average, 50.5 per cent of the liquidated assets in the nine small cases with liquidated assets of less than $500 mentioned in note 52 supra. This average percentage continued to drop in proportion to the increased size of the case until, in the thirteen cases with liquidated assets of $2000 to $7000, it stood at 27.7 per cent.

64 228 U. S. 482, 33 Sup. Ct. 554 (1912).


66 228 U. S. 482, 502, 33 Sup. Ct. 554, 559.
stockholders from themselves to themselves cannot defeat the claim of a non-assenting creditor... There is no difference in principle if the contract of reorganization, instead of being effectuated by private sale, is consummated by a master's deed under a consent decree”.

Thus the Supreme Court, despite the argument of eminent counsel, showed itself ready and willing to protect even a single general creditor who had not consented to the reorganization plan. In so doing, the court paved the way for a certain type of statute which will be considered presently.

Finally, a word should be added concerning what is sometimes the most disastrous result of all those which may flow from the non-coöperation of creditors. Suppose, for example, that a receiver, either state or federal, has been placed in charge of a debtor corporation, perhaps at the instance of a majority of creditors both in number and amount. And suppose further that the corporation is insolvent in the bankruptcy sense and that the receiver is in the midst of liquidating the assets. It will be seen at once that the stage is set for three disgruntled creditors with claims totalling $500 or more to upset the receivership and plunge the corporation into bankruptcy under Section 3a (5) of the Act of 1898. This danger is very real and it becomes even more menacing when the three claims in question have found their way into the hands of some unscrupulous lawyer who will use them to hurl the case into bankruptcy with the hope that he can thus participate in the spoils.

Enough has been said up to this point to show that the failure of creditors to coöperate constitutes an important problem for the insolvency lawyer. The cause and effect of this non-coöperation may be made the basis of many interesting discussions in the classroom. The next task confronting the instructor will be to acquaint the students with the various solutions that have been proposed for overcoming the difficulties involved in the non-coöperation of creditors.

It is worth considering, for instance, how some of the more recent reform movements in bankruptcy would eliminate, or at least modify,

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57 Mr. Francis Lynde Stetson and Mr. Charles Donnelly argued the case for the Northern Pacific Railway.

58 Bankruptcy Act §3, as amended by 44 Stat. 662 (1926), 11 U. S. C. §21 (Supp. 1930) provides: “Acts of Bankruptcy.—(a) Acts of bankruptcy by a person shall consist of [the fact that]...(5)...while insolvent, a receiver or trustee has been appointed, or put in charge of his property.” The student should consult such cases as Greenwood Gum Co. v. Zimmerman, 240 Fed. 637 (C. C. A. 6th, 1917); In re Sedalia Farmers’ Co-op. Packing and Produce Co., 268 Fed. 898 (W. D. Mo. 1919).
the whole theory of unlimited creditor control upon which an administration under the Act of 1898 is founded. The Report of the Merchants Association of New York City advocated the virtual abolition of creditor control in urban communities and the introduction of "official receivers" who would administer estates in bankruptcy in cities of 500,000 population or more. The Report of the New York Bankruptcy Investigation (the Donovan Report) recommended placing the administration of the debtor's estate in the hands of a licensed trustee who would be accountable not to the creditor group as a whole, but to a creditors' committee called "inspectors". This trustee would obtain his license from a newly created national officer to be called a federal bankruptcy commissioner, but the trustee would obtain his appointment to the specific estate from the referee. However, the trustee named by the referee might be supplanted by another licensed trustee if a quorum of twenty-five per cent in number of the creditors so voted at their first meeting. In other words, the Donovan Report worked out a system of semi-creditor control.

Some state statutes, aimed at such situations as that which arose in Northern Pacific Railway v. Boyd, have attempted to modify the rule of that case (requiring the approval of all the creditors to a corporate reorganization if such reorganization is to stand invincible). In Delaware, for example, the General Corporation Law was amended, during the 1927 session of the legislature, to allow the inclusion in the certificate of incorporation of a provision empowering "any court of equitable jurisdiction within the State of Delaware" (upon proper application being made to it) to assemble either the corporate creditors or stockholders (or both), for the purpose of considering any "compromise or arrangement" which might be proposed between the corporation and its creditors, or the corporation and its stockholders. The statute then provides:

"If a majority in number representing three-fourths in value of the creditors or class of creditors, and/or of the stockholders or class of stockholders of this corporation, as the case may be, agree to any compromise or arrangement and to any reorganiza-

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50 Supra note 8, at 7-8. The Report recommended that "trustees should be elected by creditors only when the estate is of the value of not less than Ten Thousand Dollars ($10,000) and that in estates of less amount the receiver shall act as trustee."

60 In the Matter of an Inquiry into the Administration of Bankrupts' Estates, supra note 3, at 43-55.

61 Supra note 54.

62 Del. Laws 1927, c. 85, §5. (Italics are the writers').
tion of this corporation as consequence of such compromise or arrangement, the said compromise or arrangement and the said reorganization shall, if sanctioned by the Court to which the said application has been made, be binding on all the creditors or class of creditors, and/or on all the stockholders or class of stockholders, of this corporation, as the case may be, and also on this corporation."

The theory upon which this statute is predicated is similar to that underlying the recommendations of some of the reform movements in bankruptcy, previously noted. In the first place, both plans would deprive the single creditor or minority group of creditors of certain elements of power which they now possess and both plans in a sense would eliminate the need for the minority creditors' unreserved cooperation with the other creditors. In the second place, the reform movements in bankruptcy would either remove the creditor as a factor in the administration or empower a small representative group of his fellows to act for him. A statutory provisions such as that found in the General Corporation Law of Delaware, would prevent the individual creditor or the minority group of creditors from remaining outside the reorganization and then later attempting to embarrass the reorganized corporation.

While the recommendations of various investigating committees and also certain statutes would solve the creditor problem negatively by eliminating the need for complete cooperation, the creditor organizations themselves offer an entirely different solution. They would solve the creditor problem positively by attempting to bring about more thorough cooperation. The underlying theory here is that no administration of an insolvent estate—whether it be a simple extension agreement, or a corporate reorganization, or a liquidation—will run smoothly either (1) where the administration has been removed entirely from creditor hands, or (2) where the administration is embarrassed by warring factions of creditors. Therefore, before

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63Ibid. 64Billig, op. cit. supra note 11, at 442 and 436. 65"Your committee is firmly of the opinion that the theory of the democratic control of bankruptcy by the creditors is sound, and that no safe substitute for this theory can be found. In the face of proposals from many sources in recent years for the disfranchising of creditors and setting up an official system of liquidation through the courts, the New York Credit Men's Association and the National Association of Credit Men have stood squarely and unequivocally against the elimination of creditors' rights. Your committee is more than ever convinced of the correctness of this position, but it believes that radical changes in the existing methods of administration are necessary to make creditors' control a fact and not a theory." REPORT OF THE COMMITTEE ON BANKRUPTCY OF THE NEW YORK CREDIT MEN'S ASSOCIATION (1930) 7.
passing from the problem of the creditors to other problems in the course, the instructor should acquaint the students with the solution proposed by the credit men, the theory underlying it, and whatever limitations there may be upon the practical application of this theory.

At this point some additional information should be given concerning adjustment bureau methods. The introductory material acquaints the student generally with the functions of the "approved" adjustment bureau and a subsequent chapter will take up this topic in detail. Here it is sufficient to emphasize that these organizations are maintained by creditors to further their own ends, and that, therefore, the creditors have much more immediate incentive to work together in cases controlled by the bureaus than in those controlled by lawyer groups in bankruptcy or in equity. As previously mentioned, the bureau generally will try to administer the estate outside of court under an assignment for the benefit of creditors. When this is possible, the bill for "expenses of administration"—in contrast to bankruptcy generally, to equity receiverships in Ohio and often to federal equity receiverships—will be relatively low, such expenses consuming as little perhaps as fifteen per cent of the liquidated assets. Obviously, then, there will be enough assets left in the estate to make the creditors' participation something more than nominal. This direct financial advantage tends both to interest the creditors in aiding the administration and to cause them to refrain to a considerable degree from dissension in their own ranks.

The instructor should discuss with the students this approach of credit men to the problem of the creditors, and he should analyze the factors which have contributed to its successful use in certain important cases. He should also point out that in cities such as St. Paul the more progressive lawyers recognize the good work which is being done by the local adjustment bureau in inducing creditors to cooperate in working out successful liquidations of debtors' estates, and that these lawyers actually call upon the bureau to serve as assignee in cases in which they represent the debtor. It is important that the student should consider the whole theory of "friendly adjustment" critically in this manner, but with an open mind. For the lawyer of the future—if he would be something more than a collection agent who has passed the bar—must recognize that "friendly adjustment"

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4"Billig, Extra Judicial Administration of Insolvent Estates, supra note 18, at 305 and 313.
5"Discussed in Billig, What Price Bankruptcy, supra note 11, at 428, 430 and 437.
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is taking its place in insolvency even as commercial arbitration (that radical scheme which "robbed the courts of their jurisdiction") has already carved out for itself an important place in another field of the law.

THE MECHANICS OF ADMINISTRATION

A third major problem which faces the lawyer dealing with insolvency involves that group of materials which can be assembled around the mechanics of administration. And it is at this point that the material, already summarily presented at the outset of the course, regarding the different techniques by which an insolvent estate may be administered, should be picked up and studied in great detail. As hitherto presented, the three outstanding techniques were listed in the order of their complexity as (1) "friendly adjustment", (2) equity receivership, and (3) bankruptcy. This order was adopted because it was only desired at that point that the student get a working picture of the three methods so that he could more readily understand the contents of succeeding chapters. But the approach of the present Chapter III should be to emphasize the critical attitude suggested in the introduction. The materials should not be presented here merely to give a more detailed knowledge of three techniques for purposes of comparison. Rather the approach should be that of a constructive critic who is studying the principal prevailing methods in order that he may contribute something to the solution of the great present-day problem—as to what technique can be devised (if any one technique is possible) which will give us the most socially desirable results in the administration of debtors' estates.

With this approach in mind it would seem desirable, first of all, to consider an administration in bankruptcy in all its endless detail. The functions of the referee should be studied thoroughly as well as those of the receiver and trustee. The theory of "unlimited creditor control", upon which the Act of 1898 was predicated, should be analyzed in the light of present day business practice. Questions as to the method and time given for filing claims, the method of appraisal, the method of selling the assets should be gone into. Also some time should be devoted to considering the functions of the various lawyers who participate in virtually every bankruptcy of importance. But the attitude of the class should be a constructively critical one. The students should become acquainted with the Donovan Report, that comprehensive document which was submitted to the United States District Court for the Southern District of New York by a committee of
eminent lawyers after a year of study." Nor would it be amiss to include in the materials some findings of the reports of less official investigations such as those conducted by the Association of the Bar of the City of New York and by the Merchants Association of New York. True, it may be urged that the addition of these materials may extend the course to undue lengths. But if time is lacking, might it not be better to eliminate a consideration of some of the more complicated questions concerning the bankrupt's property for the sake of letting the student know that he is dealing with a system of administration which is far from perfect? If the law really is a profession instead of a business, should not the future lawyers we produce be imbued with something more than the possession of a fund of information uncritically taught?

After a complete and critical study of the mechanics of an administration in bankruptcy, the student will be better able to appreciate why it has been necessary for him to look at other administrative techniques if he is to gain anything except a half knowledge of present-day insolvency law. He is now prepared to consider the method of "friendly adjustment" in a less prejudiced light and to realize that it is the technique which business men built up as a substitute when bankruptcy failed to function efficiently as a method for liquidating the affairs of an insolvent debtor. And in connection with "friendly adjustment", the various documents used by the credit men (trust, deeds, proofs of claims, releases by creditors) should be considered and their legal incidents studied. The functions of the trustee or assignee and those of a creditors' committee should be treated. The appraisal and marketing methods of the "approved" adjustment bureaus should be compared and contrasted with those used by the bankruptcy court. The limitations of the "friendly adjustment" plan should be brought out. In a word, the student should become as familiar with the operation of a liquidation outside of court as he has already become with a liquidation in the bankruptcy court. And, if time permits, he might investigate the Canadian bankruptcy system and learn that the "friendly adjustment" which is still virtually "outlawed" in the United States, has been adopted in principle and clothed with legality as a "voluntary assignment" under the Canadian Act of 1919.

67See In the Matter of an Inquiry into the Administration of Bankrupts' Estates, supra note 3.
68Supra note 8. 69Ibid.
70See Thayer, Bankruptcy Administration in Canada (1929).
Finally, the technique of equity should be gone into from the viewpoint of discovering, if possible, why the chancery courts (especially the federal courts) are still crowded with the receiverships of defunct corporations. This fact is astonishing if the method of bankruptcy is really fulfilling its function in the commercial community. The equity receivership should be studied critically and should be compared with both bankruptcy and "friendly adjustment" in the following respects, among others: (1) ease with which the machinery is set in motion; (2) adaptability of the machinery to handle all types of cases—for example, the case of the debtor whose business is not in need of immediate liquidation; (3) efficiency of the machinery, particularly with respect to the economies of time and the expenses of administration; (4) advantages of the machinery from the standpoint of creditor participation, both in the administration of the estate and in the proceeds derived therefrom; (5) advantage to the debtor, especially in the matter of exemptions and discharge from his liabilities; (6) advantage to the lawyers and other officers in the way of fees allowed.¹

And in connection with this critical study of the method of equity, some consideration should be given to the "friendly receivership" or "consent receivership", a device openly sanctioned by the Supreme Court of the United States almost twenty-five years ago in Re Metropolitan Railway Receivership² and since then used in thousands of federal cases.

As previously noted, the rule of the federal courts had long limited the creditor's receivership bill to a complainant who had exhausted his remedy at law by obtaining a judgment and by attempting to levy execution.³ But the Metropolitan Receivership case extended the rule to include an unsecured contract creditor, provided the defendant admitted the allegations contained in the bill and joined in the prayer for a receiver.

The far-reaching effect of this decision should form one of the major topics for class discussion in connection with the technique of equity. The point should be emphasized that it is now possible for one who is counsel to a corporation harrassed by its creditors, to draft a "friendly" bill (to which the corporation will consent) setting out certain facts and praying for a receiver, and then to have

¹See Annual Report of Special Committee on Equity Receiverships (Bar Association of the City of New York, 1926).
²Supra note 5.
³Supra note 43.
this bill signed and filed in a federal court by an unsecured con-
tact creditor residing in a foreign jurisdiction. The bill will, of
course, contain a prayer for a sweeping injunction to restrain
creditors and stockholders from interfering in any manner with the
defendant's activities while it is in the charge of the receiver; and
the receiver may be one of the corporate officers.

Eminent corporation lawyers approve this type of proceeding as
the only feasible one where counsel seeks to keep the business oper-
ating while a reorganization plan is worked out. On the other
hand, the late Chief Justice Taft, as recently as three years ago, in
Harkin v. Brundage, took occasion to criticize the "friendly receiver-
ship" as contrary to the whole theory of equity.

This and other objections to the "friendly receivership" should
be considered and, as in the case of both bankruptcy and "friendly
adjustment", the limitations of the equity receivership type of ad-
ministration—viewed in its entirety—should be recognized and dis-
cussed.

As a result of this critical approach to the three outstanding
methods available for administering insolvent estates, the student

74It is often customary for the court to name a disinterested third party as a co-
receiver.

75Byrne, op. cit. supra note 20, at 77-78; Cravath, op. cit. supra note 12, at 157-158.

76276 U. S. 36, 48 Sup. Ct. 268 (1928).

77The Chief Justice said in part, at 52, 48 Sup. Ct., at 274: "We do not wish
what we have said to be taken as a general approval of the appointment of a re-
ciever under the prayer of a bill brought by a simple contract creditor simply
because it is consented to at the time by a defendant corporation. The true rule in
equity is that under usual circumstances a creditor's bill may not be brought
except by a judgment creditor after a return of 'nulla bona' on execution. When a
receiver has been thus irregularly appointed on such a bill without objection,
and the administration has proceeded to such a point that it would be detri-
mental to all concerned to discharge the receiver, the receivership has been per-
mitted to continue because not seasonably objected to.” And at 55, 48 Sup. Ct.,
at 275, “The desire of those who represent an embarrassed corporation to seek a
refuge from active and urgent creditors under the protecting arm of an officer
of the court, leads to strenuous efforts to frame a case which may under equity
practice justify a receiver. More than this, circumstances which should have no
influence lead the parties in interest to prefer one court to another in the selection
of the person to be appointed as receiver, with the hope on behalf of those in
charge of the embarrassed corporation that the appointment may fall to one
whose conduct will be in sympathy with, rather than antagonistic to, the previous
management of the corporation, in the hands of which the embarrassment has
arisen. As the Court of Appeals says, there should be no 'friendly' receivers-
ships, because the receiver is an officer of the court and should be as free from
'friendliness' to a party as should the court itself"
will be given the proper background for enabling him as a lawyer to exercise good judgment as to the type of administration he should advise in any case that comes before him.

**THE PROBLEM OF JURISDICTION**

If, after studying the problem of the debtor and the problem of the creditors, and considering the various types of administration possible, the lawyer (be he counsel for the debtor or for the creditors) decides that legal action is necessary, an important question for him to decide is the proper court in which to start proceedings.

The scope of this paper permits nothing more than a bare statement of the problem and a warning as to its complexity. From the teaching standpoint the student should be given thorough instruction in some of the following matters, among others: (1) the relative jurisdiction of the bankruptcy court and the federal equity court;* (2) the relative jurisdiction of a state court and a federal district court sitting in that state, to appoint a general receiver for a domestic corporation;* (3) the effect, if any, of state receivership statutes on the appointment of receivers in the federal courts;* (4) the whole question of ancillary receivers both in bankruptcy and in equity.* As the footnotes to this section indicate, the Reports are filled with interesting cases involving the problem of jurisdiction—

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*Britton's excellent material mentioned supra note 24 can at this point be used to great advantage.


A collateral problem involves the power of a state court at the corporate domicile to appoint a "general receiver" for the corporation after a foreign court had already appointed a general receiver. Jones v. Maxwell Motor Co., 13 Del. Ch. 76, 115 Atl. 312 (1921); Frankland v. Remington Phonograph Corp., 13 Del. Ch. 312, 119 Atl. 127 (1922); Stone v. Jewett, Bigelow & Brooks Coal Co., 14 Del. Ch. 256, 125 Atl. 340 (1924); Manning v. Middle States Oil Corp., supra note 29.


*In the Matter of an Inquiry into the Administration of Bankrupts' Estates, supra note 3, at 59 and 97; 1 CLARK, RECEIVERS (1929) 431.
some of them landmarks in the law—which constantly are consulted in practice but which hitherto have received scant attention in the classroom.

CONCLUSION

This paper has aimed to present in part the contents of a proposed new law school course called "The Administration of Insolvent Estates". The purpose has been merely to sketch the approach in connection with four basic problems rather than to set forth the entire materials at this time. Quite obviously the course does not end with the consideration of the proper court to use in case legal action is contemplated. There remain all those great problems (which we shall make the basis of a future article) that arise after the case is in court, or after it is in the hands of an assignee in case extra-judicial procedure is used. In dealing with these subsequent problems, as we shall point out, the same approach should prevail—an approach thoroughly realistic, constructively critical, and highly ethical.