THE UNIVERSITY OF CHICAGO LAW REVIEW

VOLUME 5

DECEMBER 1937

NUMBER 1

BANKRUPTCY AND REORGANIZATION: A SURVEY OF CHANGES*

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IN THIS and a subsequent article the objectives, history, and present status of the English, Canadian, and United States structures dealing with the liquidation and rehabilitation of financially embarrassed debtors will be examined. The objectives of a sound legal structure in this field are: equitable distribution of the debtor's estate among the creditors; rehabilitation of the debtor; and protection of credit. When the legal structure has been well designed to effect these objectives an economic crisis is not apt to result in appreciable change. This is borne out by the English and Canadian experience. But where the objectives have not been substantially attained the financial strain of an economic crisis will cause experiments in legislation. Such legislation is often temporary in character, hastily conceived, and none too successful. Such has been the experience in the United States.

In England, legislation dealing with the individual and corporate (business entities in general are embraced within the term "corporate") debtor is the product of slow, gradual growth. The early objectives were protection of credit by processes that would reach the fraudulent debtor, but these were gradually broadened to embrace the objectives enumerated above. Economic crises have not produced sudden change in the legislation. Thus the provisions in the Companies Act of 1929 for liquidation and reorganization of companies remain substantially as under the Act of 1908, and the bases of the present English Bankruptcy Act of 1914 are

* This and an article to be subsequently printed in this *Review* were prepared by the authors as reporters to the International Academy of Comparative Law, The Hague, on the liquidation and reorganization legislation in England, Canada, and the United States. The report was read at the Academy's 1937 session.

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those of the Act of 1883.² Careful provisions in the Act of 1914, dealing with discharge and offenses, protect the commercial community from the dishonest and the wastrel debtor. Official supervision results in honest and careful administration and the attainment of the policy of the act. Rehabilitation of the debtor is provided by an allowance to him for the support of himself and his family. So far as applicable the same theories have been applied to the liquidation and rehabilitation of companies, apparently with reasonable success.

In Canada, with the exception of special legislation dealing with farmers, legislation that deals with the rehabilitation and liquidation of debtors is not a product of economic crises. It is the natural evolution in law of a country emerging from provincialism into national stature. Its aim is to bring within its provisions an estate as soon as that estate becomes insolvent, liquidate it under governmental and creditor control, discharge the honest debtor, and protect the community from the dishonest and inefficient debtor. In general, corporations are subject to the Bankruptcy Act. This is a departure from the English Act; it is similar to the American Act. With leave of court insolvent corporations may be liquidated under the Winding-up Act, which is quite analogous to the winding-up provisions of the English Companies Act. Until recently the more important aspects of rehabilitation or reorganization of companies have not been subject to court supervision. The Companies' Creditors Arrangement Act, 1933, and the amendments of 1934 to the Dominion Companies Act do not substantially change corporate reorganization as theretofore practiced. They do, however, give the court more control over the reorganization. Their analogue may be found in the sections dealing with arrangements and reconstructions of the English Companies Act.

In the United States, from the beginning of our nation there has been a conflict between those who support federal rights and those who support state rights. The federal power extends to the "subject of bankruptcies" and clearly is broad enough to embrace the field of liquidation and rehabilitation covered by English and Canadian legislation. But its use has met with determined opposition. Until 1898 we had had three bankruptcy

² When Joseph Chamberlain introduced his bill which was to become the Bankruptcy Act of 1883 he admonished Parliament that in framing legislation two things must be kept in mind: "Those were, firstly, in the honest administration of bankrupt estates, with a view to the fair and speedy distribution of the assets among the creditors, whose property they were; and, in the second place, their object should be following the idea that prevention was better than cure, to do something to improve the general tone of commercial morality, to promote honest trade, and to lessen the number of failures." Senate Doc. No. 65, 72d Cong. 1st Sess., 57 (1932). These have been fairly attained in the English bankruptcy legislation and administration.

acts: the Act of 1800, repealed in 1803; the Act of 1841, repealed in 1843; and the Act of 1867, repealed in 1878. Many believed that state insolvency laws afforded sufficient relief. It was only in times of financial stringency that the federal power over the "subject of bankruptcies" was invoked, and when the crisis had passed the use of the federal power was discontinued. As a result state insolvency laws became accepted, although in what respect they differ from legislation dealing with the "subject of bankruptcies" has never been and can never be definitely stated, for any insolvency law is essentially within the power granted to the federal government. Overlapping and confusion did not result to any real degree until after 1898, because until then federal bankruptcy legislation had been short-lived. In that year the present bankruptcy act was passed as a result of economic stringency, but unlike prior experiences, the Act of 1898, subject of course to change, seems to have become a part of our permanent national law. Prior to the last economic crisis major amendments to the Act were made in 1903, 1906, 1910, 1917, 1922, and 1926; basically the Act remained the same.

In the United States prior to the last depression, generally it was possible to effect an arrangement, as distinguished from liquidation, in three ways: (1) through a voluntary contract entered into between the creditors and the debtor; (2) through formal bankruptcy, either using the composition section of the bankruptcy act, or employing the bankruptcy sale as a means of purchasing the old assets of the debtor, with the creditors and sometimes the debtor himself becoming the purchaser in a new arrangement; (3) through an equity receivership obtained on a creditor's bill, usually consolidated with foreclosure proceedings, terminating in a judicial sale at which the creditors and sometimes the debtor became the purchasers under a new arrangement. Of these three methods, the equity receivership was the most feasible and was most frequently employed. Dissenting creditors could not be bound by a voluntary arrangement in the usual case. The voluntary arrangement was therefore not frequently used save where it was desired to change the rights of stockholders who could be bound by a change in the corporate charter perfected through merger, consolidation, sale of corporate assets or amendment. Creditors who held their claims under a trust indenture, with provisions which allowed majority action to be binding on dissenters, might effect a voluntary arrangement binding on all creditors of the class, but this was a later development and was not frequently employed. Composition proceedings in bankruptcy could not affect secured creditors, and by tradition the consideration given creditors had to be cash or notes and could not

consist of other types of security. The bankruptcy sale carried with it the odium which adheres to the word bankruptcy, and the bankruptcy court was unwilling to permit the proceedings to continue in bankruptcy while an arrangement was being worked out and the debtor's business was being conducted for the benefit of creditors.

The equity receivership was an adaptation of the ancient right of a creditor with judgment and execution returned unsatisfied to gain the aid of equity in reaching the assets of the debtor. In arrangement practice, the receivership was most often actually obtained by the debtor, who procured a friendly creditor to file a bill, to which the debtor consented. Because the creditor often had no judgment with execution returned unsatisfied, the propriety of equity jurisdiction was doubtful, but it was felt that the debtor's consent waived the defect. By procuring a friendly creditor with a claim in excess of \$3,000, who was a citizen of a different state than the debtor, it was possible to have the receivership in the federal courts which were thought more competent to deal with the difficult business problems of arrangements. This caused opposition from the friends of the state courts who charged that the federal equity proceedings were collusive. The federal equity receivership, as opposed to the state court equity receivership, nevertheless developed as the primary means of reorganization. Its development was at first most pronounced in the reorganization of utilities. The federal courts developed doctrines whereby the business of the debtor could be continued under the protection of the court while an arrangement was being worked out. The business could be rehabilitated during this period by the receiver borrowing money on receiver's certificates, which in the case of utilities would constitute prior liens. The United States Supreme Court also developed a doctrine whereby the arrangement under which creditors purchased at the judicial sale had to maintain to some degree the priorities between secured creditors, unsecured creditors, and stockholders, upon pain of having the arrangement later upset by a dissenter charging a fraudulent conveyance.

The equity receivership, however, was inadequate to meet the needs of reorganizers. In the first place dissenting creditors had to be paid their share of the proceeds of the sale in cash. This made reorganization difficult and at the same time was not much protection to dissenters whose cash share was usually less than the cash value of the new securities which would be offered to them under the plan of arrangement. In the second place, the equity receivership usually required ancillary receiverships in every other federal district where the debtor had property. In the third place, the court's control over the plan of arrangement was tenuous be-

cause in theory the court could not control the plan of reorganization save as it was thought to effect the fairness of the sale. There was, therefore, little assurance that the arrangement plan was a fair plan. In the fourth place, since the court's jurisdiction over the plan was tenuous, it was not clear that dissenters might not attack the plan at some later date on the theory that it was a fraudulent conveyance in that stockholders were allowed to participate before creditors were paid in full, or because the priorities between creditors had not been properly maintained. In the fifth place, the receiver appointed was often friendly to the debtor, since the debtor controlled the appointment of a receiver to a large measure by the consent receivership device. A friendly receiver would not discover fraudulent practices perpetrated by the debtor, and would not rout inefficient management. Finally, the equity receivership allowed various financial interests to play a paramount role in the reorganization without much court supervision. The result was that the representatives of creditors were often representatives of financial houses whose basic interests were opposed to the creditors.

The inadequacies of the equity receivership as a means of arrangement were such that agitation for arrangement reform was continuous in the years before the depression. The depression heightened the agitation mainly because it became increasingly difficult to borrow money to pay dissenters their share in cash; and because during the depression there were more dissenters. In addition the tempers of creditors with defaulted securities became increasingly short during the depression with the result that charges of fraud and collusion were prevalent. This threatened the very foundation of the equity receivership which was based, it was said, on the collusive consent of the debtor. The depression also increased the opposition to the practice of appointing friendly receivers who did not discover the fraud that angry creditors were sure existed. The result was that arrangement practice in the United States went through a complete transformation during the depression, and many of the reforms previously urged were adopted.

The changes in arrangement practices may be divided into changes in state court decisions, and changes under state and federal statutes. The state courts during the depression rapidly closed the gap which existed between the equity receivership in the state court and that in the federal court, with the result that some state courts at the end of the depression exercised more control over the plan of reorganization than had the federal courts prior to the depression. The state courts came to this position after many of them had imposed, during the worst days of the depression, what

was in effect a judicial moratoria over the collection of debts. State moratoria legislation was also widespread. A great deal of it was later held unconstitutional but even the unconstitutional statutes helped debtors over the worst periods of the depression. Debtor relief statutes were followed by creditor relief statutes in many states. These statutes provided means whereby a stated majority of creditors could bind the remaining creditors to an arrangement plan under the jurisdiction of the court. Most frequently, however, these statutes were only applicable to businesses traditionally under the control of the state because affected with a public interest, such as banks or insurance companies. New York and Michigan went further. Not only did they regulate arrangements between the holders of real estate securities, but they attempted to regulate the control of the selection of creditor-representatives by financial interests.

The greatest development during the depression was the addition of four reorganization sections to the bankruptcy act. Section 74 was designed to regulate arrangements proposed by unincorporated debtors; section 75 set forth a structure of arrangements for farmers; section 77 and section 77B, the former applying to railroad reorganizations, and the latter to corporate debtors generally, combined the experience of the equity receiverships and the bankruptcy tradition for the most complete arrangements act yet had in the United States. All of these acts gave the court supervision over the plan of reorganization, and all of them allowed a stated majority of creditors to bind other creditors to a plan, and thus eliminated the need for cash payment to dissenters. These acts, however, did not fully adopt the reforms that had been urged. Section 77, aside from a somewhat different provision in section 75, was the only section which made the appointment of a trustee mandatory and set up qualifications as to who might be trustee in an effort to avoid the evils of the friendly receiver. The control which these acts gave the courts over financial houses promoting the reorganization for their own ends was too tenuous. They did, however, increase the jurisdiction of the court and eliminated the evil of widespread ancillary receiverships; and they protected the reorganized company from the attacks of dissenters. Of the four acts, section 74 was the most inadequate since secured debts could not be reduced but only extended under it. All of the acts required that the debtor be either insolvent in the bankruptcy sense, or unable to pay debts as they matured. Sections 77 and 77B were the only sections which allowed creditors to file an involuntary petition for reorganization against the debtor, and as requirements for the petition they preserved the acts of bankruptcy unless it could be shown that a bankruptcy proceeding or equity receivership was pending.

While the reforms accomplished during the depression were a step forward, they were of necessity directed at those defects in the old system which made reorganization impossible during depression times; such as the necessity of cash payment to dissenters. They were deficient in not broadening the court's control over the business agencies which really control reorganization such as the house of issue, the underwriter, the trustee under the indenture, and the paying agent for the debtor. New legislation now pending in the federal congress will do much to remedy this defect. The attempt of much of the pending legislation to place secured claims beyond the reach of the reorganization plan, however, seems economically unsound, and it may be doubted whether the pending legislation will have sufficient control over the debtor's capital structure before the stage of bankruptcy or an inability to pay debts as they mature has arrived. The simplification of the capital structure of corporations and the ability to perfect readjustments prior to insolvency, in either the bankruptcy or the equity sense, seem to be the main requirements of effective arrangement legislation in the United States.

Lastly, it may be pointed out that legislation dealing with the liquidation and rehabilitation of embarrassed debtors is essentially bankruptcy legislation. The debtor is often designated otherwise than as a bankrupt, sometimes merely as a debtor, at other times as an insolvent or assignor. Such escapes have served a useful purpose in avoiding the stigma which the word "bankruptcy" connotes, but it must be clearly understood that the subject of bankruptcies properly embraces any and all relations of debtor and creditor which substantially affect or may affect insolvency or liquidation; in other words it embraces the equitable distribution of the debtor's estate among the creditors, the rehabilitation of the debtor, and the protection of credit. Equitable distribution is effected when the creditors are protected from overreaching on the part of the debtor and protected from like tactics by each other. The individual debtor is rehabilitated when he is accorded sufficient allowances or exemptions to tide him over during the bankruptcy proceeding and is given a discharge from his prior obligations. The corporate debtor is rehabilitated when a new and adequate credit structure is worked out either for the old debtor corporation or for a new company which succeeds to the old debtor's estate. Credit is protected when fraudulent practices on the part of a debtor or creditor are made penal; when the dishonest, the reckless and the wastrel debtor are refused a discharge; and when the power is used to prevent unsound and dishonest credit practices. In the United States the latter power could justify such regulation of the sale of securities and of the security exchanges as Congress, beginning in 1933, has enacted under its powers over

interstate commerce and the mails. It would support legislation regulating the duties and functions of trustees under corporate indentures, and committees for security holders in any kind of debt arrangement. It could be used to require all institutions which may or do materially affect the credit structure, to become federally incorporated for the purposes of subjecting them to uniform accounting practices and honest and legitimate credit dealings.

ENGLISH HISTORY AND EXPERIENCE²

There are three general classes of statutes that must be consulted to get a complete picture of liquidation in England: the Deeds of Arrangement Act, 1914, the Bankruptcy Act, 1914, and the Companies Act of 1929, all as amended. The Deeds of Arrangement Act and the Bankruptcy Act govern liquidation of persons not subject to the Companies Act, nor special liquidation acts.³ The Deeds of Arrangement Act provides for something in the nature of an out-of-court composition or extension, the Bankruptcy Act provides for ordinary bankruptcy liquidation and compositions or extensions as a part of bankruptcy. The Companies Act governs liquidation and reorganization of registered companies, certain unregistered companies, and companies incorporated outside Great Britain carrying on business within Great Britain.

A distinguished commentator has made this observation: "Finality will

² Source material: 1 Halsbury's Statutes of England 567 *et seq.* (1929) for bankruptcy and insolvency statutes, and the continuation volumes, and for discussion thereof to 2 Halsbury's Laws of England 1 *et seq.* (2d ed. 1931); 2 Halsbury's Statutes of England 874 *et seq.* (1929), which deals with arrangements and reconstructions, and winding up of companies under the Companies Act of 1929, and continuation volumes, and for discussion thereof to 5 Halsbury's Laws of England 547 *et seq.* (2d ed. 1931); Williams' Bankruptcy Practice (14th ed. 1932); Stable, Bankruptcy Law and Practice of England, 5 Journal National Association of Referees in Bankruptcy 82 (1931); Donovan Report, 71st Cong. 3d Sess. 170 *et seq.* (1931); Levinthal, Early History of English Bankruptcy, 67 U. of Pa. L. Rev. 1 (1919), 8 Jour. Natl. Assn. of Referees in Bankruptcy 104 (1934); History of Legislation in Bankruptcy, 12 Law J. 229 (1877).

³ Debtor under Deeds of Arrangement Act means "debtor subject to the English Bankruptcy Acts." 2 Halsbury's Laws of England, 432 n. (2d ed. 1931).

§ 1 (2) of the Bankruptcy Act provides: "... the expression 'a debtor,' unless the context otherwise implies, includes any person, whether a British subject or not, who at the time when any act of bankruptcy was done or suffered by him—

- (a) was personally present in England; or
- (b) ordinarily resided or had a place of residence in England; or
- (c) was carrying on business in England, personally, or by means of an agent or manager; or
- (d) was a member of a firm or partnership which carried on a business in England."

Section 126 excludes any registered corporation, partnership or association or company. The Act does apply to limited partnerships, § 127. Estates of deceased persons dying insolvent may be administered under the Act, § 130.

never be reached in any branch of law, but it seems reasonably certain that until an age is reached when the habits of mankind have materially altered, the Bankruptcy Law in England has arrived at a point where development in matters of principle has come to an end. The existing system is in substance the same system which was first introduced by the late Mr. Joseph Chamberlain and which was embodied in the Bankruptcy Act of 1883."⁴ This observation can properly be extended to cover deeds of arrangement and the liquidation of companies. The last economic crisis produced no basic change. Due to the enactment of such laws as the National Health Insurance Act, Old Age Pensions Act, and the Cotton Spinning Industry Act, sections dealing with the trustee's title (Bankruptcy Act) and priorities (both the Bankruptcy Act and the Companies Act) were amended. Amendments were in aid of the policy underlying those laws. The trustee was not to take title to a pension or insurance policy which a debtor had obtained under such laws; and in the liquidation of a contributory, payments to funds established by such acts should have a certain priority, essentially that of other governmental levies and taxes.⁵

THE METHODS OF LIQUIDATION

DEEDS OF ARRANGEMENT

Because of the stigma attached to bankruptcy and because adjudication in bankruptcy carries with it a disqualification to hold a number of public offices, a debtor will generally avail himself of the Deeds of Arrangement Act, if he feels that he can make an adjustment with a majority of his creditors. Under this Act a debtor ("debtor" does not include a company registered under the Companies Act) may make an assignment to a trustee (a) for his creditors generally, or (b) for any three or more of his creditors. The deed to be valid must be registered with the Registrar of Bills of Sale within a short specified time. If the deed of arrangement is for the creditors generally, it becomes void unless within a specified time (which is usually twenty-one days after the registration) it has received the assent of a majority in number and value of the creditors of the debtor.⁶ The registration is an act of bankruptcy which may be availed of within three months, unless it is an assignment for the creditors generally, in which case a dissenting creditor may only treat it as an act of bankruptcy if he acts within one month from the service of the notice of the execution of the deed and creditors' assent.

⁴ Stable, *op. cit. supra*, note 2, at 114.

⁵ See note 8 *infra*.

⁶ See Deeds of Arrangement Act, 4 & 5 Geo. 5, c. 47, § 3 (1914). Section 11 (5) provides that creditors whose debts amount to sums not exceeding ten pounds shall be reckoned in the majority in value but not in the majority in number.

A trustee ordinarily must give security, transmit accounts to the Board of Trade and to creditors. If bankruptcy does not ensue, he proceeds to liquidate the estate in accordance with the deed of assignment.

LIQUIDATION UNDER THE BANKRUPTCY ACT

The Act of 34 and 35 Hen. VIII, c. 4 (1542) is generally said to be the first English bankruptcy act. A statute, however, enacted as early as 1283, 11 Edw. I, Acton Burnel, related to the subject. A merchant was given summary powers without process of pleading for "execution against his debtor, both his body, goods, and lands." Subsequent legislation during the reign of Edward III, which was directed against the Lombards, was designed to make debts of one of the group chargeable to all its members.⁷ But it was not until the sixteenth century when England became a commercial nation that it became necessary for the English common law students to think seriously of bankruptcy legislation. Even then and for many years following, legislation was aimed solely at the fraudulent debtor. In 1649 a distinction between bankruptcy legislation and insolvency legislation came into the law. Such distinction has been obliterated in modern English and in the Canadian legislation, but it continues to plague us in the United States. Here an overlapping occurs between federal legislation on the subject of bankruptcies and state legislation on the subject of insolvencies.

The earliest English Bankruptcy Acts were limited in character, and designed to cure certain specific evils and abuses. New legislation extended these statutes to cover other similar situations for the protection of the growing English commerce and credit. It can, therefore, be said that England has had bankruptcy legislation from 1542 down to the present time. From 1542 on, some forty acts have been passed on the subject of bankruptcy. In 1831 England began an experiment with official liquidation. It set up a separate bankruptcy court and provided for joint administration by official assignees and assignees chosen by creditors. In 1869 at the insistence of the trading community England went back to creditor control; the creditors were to choose the trustee, who was to be supervised by a committee of inspection chosen by the creditors. Abuses arose under such a system similar to abuses which we have experienced in this country, namely, solicitation of proxies by those not vitally interested in the debtor's estate or interested only to a small extent, with the consequent result that bankruptcy administration became controlled by and was manipulated for interests adverse to the real class of creditors. In

⁷ See *History of Legislation in Bankruptcy*, 12 *Law Jour.* 229 (1877), for suggestion that the early statutes referred to in the text should properly be considered bankruptcy legislation.

1883 Joseph Chamberlain's Bankruptcy Act was passed. This act recognized that creditor control had failed and reverted to a system in which official control plays a large part. The Act of 1914 was essentially a consolidation of the Act of 1883, acts amendatory thereto, and other related acts, and not a revision; its theory and basis remain essentially unaltered.⁸

This long legislative history has been valuable source material for legislation in Canada and the United States. The vital differences between the English and American bankruptcy legislation are (1) the English provisions governing discharge and offences result in a developed commercial code of morality designed to give a fair amount of protection to the credit structure, while such provisions in the United States are in an embryonic state of development; and (2) liquidation under close official supervision in England, more or less uncontrolled creditor administration in this country. In both respects the present Canadian legislation is patterned on the

⁸ For the present state of the law, see 1 Halsbury's Statutes of England 567 *et seq.* (1929) which states the law of bankruptcy as of the dissolution of the Sixth Parliament of George 5, May 10, 1929, as amended by 20-21 Geo. 5 c. 25 (1930) (An act to confer on third parties rights against insurers of third-party risks in the event of the insured becoming insolvent, and in certain other events), and as amended by the Law Reform (Married Women and Tort Feasors Act, 25-26 Geo. 5 c. 30 § 1 (d) (1935), which provided that a married woman shall "be subject to the law relating to bankruptcy and to the enforcement of judgment and orders, in all respects as if she were a *feme sole*"), and as amended by Widows', Orphans' and Old Age Contributory Pensions Act, 26 Geo. 5 & 1 Edw. 8 c. 33 § 36 (1) (1936) (on bankruptcy of such a pensioner the pension "shall not pass to any trustee or other person acting on account of the creditors"), National Health Insurance Act, 26 Geo. 5 & Edw. 8 c. 32 § 68 (1936) ("... on the bankruptcy of any person entitled to any benefit, the benefit shall not pass to any trustee or other person acting on behalf of his creditors"), Old Age Pensions Act, 26 Geo. 5 & 1 Edw. 8 c. 31 § 7 (1) (1936) ("... on the bankruptcy of a person entitled to an old age pension, the pension shall not pass to any trustee or other person acting on behalf of the creditors."), Clergy Pensions (Widows and Dependents) Measure, 26 Geo. 5 & 1 Edw. 8 c. 33 § 13 (1936) (similar provision), certain changes in priority of claims were made so that contributions due by a bankrupt would have a stated priority to effect the policy of the National Health Insurance Act, 1936, 26 Geo. 5 & 1 Edw. 8, c. 32 §§ 177, 209 (1936) the Widows', Orphans' and Old Age Contributory Pensions Act, 26 Geo. 5 & 1 Edw. 8, c. 33 § 13 (1) (1936) Cotton Spinning Industry Act, 1936, 26 Geo. 5 & 1 Edw. 8 c. 21 § 19. The priority provisions apply to companies in liquidation.

There are a number of other acts which must be consulted on minor details. Halsbury lists the following: Warrants of Attorney Act, 3 Geo. 4, c. 39 (1822); Warrants of Attorney Act, 6 & 7 Vict. c. 66 (1843); Debtors Act, 32 & 33 Vict. c. 62 (1869); Bankruptcy Disqualification Act, 34 & 35 Vict. c. 50 (1871); Debtors Act, 41 & 42 Vict. c. 54 (1878); Bankruptcy Act, 46 & 47 Vict. c. 52 (1883); Bankruptcy Act, 53 & 54 Vict. c. 71 (1890); Bankruptcy and Deeds of Arrangement Act, 3 & 4 Geo. 5, c. 34 (1913); Deeds of Arrangement Act, 4 & 5 Geo. 5, c. 47 (1914); Bankruptcy Act, 4 & 5 Geo. 5, c. 59 (1914); Administration of Justice Act, 15 & 16 Geo. 5, c. 28 (1925), §§ 22, 29; Bankruptcy (Amendment) Act, 16 & 17 Geo. 5, c. 7 (1926); Economy (Miscellaneous Provisions) Act, 16 & 17 Geo. 5 c. 9 §§ 13-16, 19 (1926); Bankruptcy Rules, S. R. & O. 1914, no. 1824 (1915); Deeds of Arrangement Rules, S. R. & O. 1925, No. 795 (1925). 1 Halsbury, Statutes of England 567 (1929).

English. In neither Canada nor the United States are there provisions corresponding to the English Deeds of Arrangement Act. Provisions in Canada for an "authorized assignment" are somewhat comparable. They, like the English Deeds of Arrangement Act, avoid the stigma of bankruptcy, but the Canadian "authorized assignment" is essentially a voluntary petition in bankruptcy, since the creditors may not block the assignment. To that extent it seems to have been an improvement upon the English Act.⁹

The Canadian and the American Acts exempt farmers and wage earners from involuntary bankruptcy. There is no comparable class protection in England. It is necessary in all three countries that acts of bankruptcy be committed. But under the Canadian Act, acts of bankruptcy have lost most of their practical significance for a debtor commits an act of bankruptcy if he ceases to meet his liabilities as they become due.¹⁰ Both the English and Canadian Acts provide for an allowance to the debtor,¹¹ while in the United States the exemptions vary from state to state, depending upon the law of the state of the debtor's residence as to what property is exempt from execution.

In the scheme of distribution the English Act provides that the trustee's title relates back to the time of the act of bankruptcy on which a receiving order is made against the debtor, "or, if the bankrupt is proved to have committed more acts of bankruptcy than one, to have relation back to, and to commence at, the time of the first of the acts of bankruptcy proved to have been committed by the bankrupt within three months next preceding the date of the presentation of the bankruptcy petition."¹² Persons dealing bona fide with a debtor and with no notice that he has committed an act of bankruptcy are protected. In this respect the English Act differs from both the American and the Canadian, for under the latter acts the trustee takes title to the estate as of the date of the presentation of the petition with the right to invalidate certain preferences, liens, and transfers made or taking effect within a specified time (four months under the

⁹ For discussion of the Canadian Authorized assignment see page 23 *infra*. The Canadian Amending Act of 1921 discussed on page 23 *infra* was more closely patterned upon the English Deeds of Arrangement Act.

¹⁰ See page 20 *infra*.

¹¹ Section 58 of the English Act authorizes the trustee, with the permission of the committee of inspection to make a reasonable allowance for the support of the bankrupt and his family, subject to reduction by the court. Slight exemptions are allowed in the English Act. See Section 38 (2). It exempts the bankrupt's tools, if any, and the necessary wearing apparel and bedding of himself and wife and children to a value not exceeding twenty pounds.

¹² Section 37.

American Act). In attempting an equitable distribution the English Act has this unique provision: "A person having notice of any act of bankruptcy available against the debtor shall not prove . . . for any debt or liability contracted by the debtor subsequently to the date of his so having notice."¹³ Section 36 provides for the postponement of either the husband's or the wife's claims, as the case may be, until other creditors are paid in full. The Canadian Act has a similar but more extensive provision; the American Act has nothing analogous.

MACHINERY AND PROCEDURE FOR LIQUIDATION

In 1831, as we have seen, a separate bankruptcy court was established. At the present time, however, the county courts outside of London and its environs have jurisdiction in bankruptcy; in London and its surroundings the High Court of Justice has jurisdiction. The Lord Chancellor designates certain judges of the High Court to sit in bankruptcy. They compose the Divisional Court in Bankruptcy which hears appeals from county courts. Appeal may with leave be taken from this Divisional Court to the Court of Appeal, but no further. In the London bankruptcy district the registrars in bankruptcy are essentially the bankruptcy judges. From their decisions an appeal goes to the Court of Appeal and with leave may go to the House of Lords. This will occur only in a rare case.

The Board of Trade plays a most vital part in bankruptcy administration. This board is one of the departments of the government comparable to the Department of Commerce in the United States. At its head is the President of the Board of Trade, a cabinet minister holding his portfolio subject to the fortunes of politics; but the staff which carries on the work is permanent, and is made up of civil service appointees. The Inspector General of Bankruptcy, a permanent official, heads the bankruptcy department of the Board of Trade. The bankruptcy department discharges its chief duties through two main divisions, the administrative and the auditing. The official receivers are part of the administrative division and make reports to it. This division in turn is able to render much legal and practical assistance to the official receivers, inasmuch as the chief bankruptcy clerk and his assistants have an extensive and practical knowledge of bankruptcy administration. Difficult legal questions may be referred to the Solicitor of the Board of Trade. The auditing division audits the monthly accounts submitted by the official receivers and the semi-annual accounts submitted by non-official trustees.

The Board of Trade maintains a bankruptcy estates account with the

¹³ Section 30 (2).

Bank of England into which, as a practical matter, all funds derived from bankrupt estates are paid. This achieves centralization of bankruptcy funds; minimizes misappropriations; and gives the Board of Trade an important source of revenue.

Official receivers are officers of the court to which they are attached as well as employees of the Board of Trade. In London and in the large cities they are paid salaries; elsewhere their remuneration consists of fees. They investigate the debtor's conduct and affairs by both private and public examination; make reports relative to the bankrupt's discharge, and in proper cases apply to the court for an order for prosecution of the bankrupt. In "small bankruptcies," hereinafter discussed, the official receiver liquidates the estate; in other cases he rarely becomes trustee but does have custody of the property pending the trustee's appointment. He presides at the first meeting of creditors and through proxies that are quite generally given him plays a large role in the selection of the trustee.

Small Bankruptcies. A small bankruptcy is one in which the assets are not likely to exceed £300 in value or where the debts of the bankrupt do not exceed fifty pounds. These cases are handled summarily by the official receiver who devotes as much care to the proceeding as if it were an important one. The conduct and affairs of the debtor are investigated as minutely as though a big estate were involved. A large bulk of the bankruptcy proceedings come under this head.

Administration of Other Estates. It is not considered good policy to have the official receiver devote his time to the administration of estates exceeding in value £300. A non-official trustee is selected by the creditors, subject, however, to certification by the Board of Trade. The Board will not certify an incompetent person as trustee and as a result chartered or incorporated accountants trained in liquidation are usually elected trustees. Trustees are subject to supervision by a committee of inspection consisting of from three to five creditors chosen by the creditors. The trustee must have the committee's permission in order to do anything of importance, but usually the committees place a great deal of confidence in the trustee and their approval is formal.

Compositions. Before or after adjudication, as in the United States, the debtor may propose a composition or scheme of arrangement. A majority in number and three-fourths in value of the creditors may make an acceptance binding upon all the creditors. If an adjudication in bankruptcy has been made it may be annulled where the composition is accepted.¹⁴

¹⁴ Section 16 (10) provides: "If any facts are proved on proof of which the court would be required either to refuse, suspend, or attach conditions to the debtor's discharge were he ad-

Voluntary and Involuntary Bankruptcy. A debtor may file a petition alleging that he is unable to pay his debts. A receiving order is then made and an order of adjudication may be made at the same time if the petition prays such relief. Normally, however, adjudication is not made until after the first meeting of creditors.

Any creditor or creditors having a liquidated claim for £50 or more may file a petition alleging that the debtor has committed an act of bankruptcy within three months. "The act of bankruptcy most frequently alleged is failure to comply with the bankruptcy notice. In 1928 it was alleged in 78% of the total number of creditor's petitions upon which receiving orders were made. In the preceding years the percentage was slightly higher."¹⁵ The bankruptcy notice is essentially a collection device. It is a notice to the debtor to satisfy a judgment that has been obtained against him within a stated time, usually seven days. The debtor is warned that failure to comply is an act of bankruptcy. The threat is sufficient in many cases to secure compliance.

The involuntary petition in bankruptcy is served on the debtor. Upon the hearing the court may dismiss the petition, make a receiving order against the debtor, or adjourn. "The average period from the date of filing the petition to the date of the receiving order, computed from eighty-five High Court (London) cases, was 69.3 days. Adjournments before the receiving order are granted on the theory that, until the receiving order is made, bankruptcy proceedings are a device by which a creditor may collect his debt. If he consents to an adjournment in order that his debtor may raise funds and pay the debt, an adjournment is proper."¹⁶ In this respect the English Act is a collection device and is dissimilar to both the Canadian and the American Acts. After a receiving order is made the creditors' meeting is held and administration proceeds as outlined above, depending upon whether it is a small or large bankruptcy case. The first dividend is supposed to be within four months of the first meeting of creditors, but as a practical matter dividends are rarely declared within that period.

Costs of bankruptcy administration in England are high, probably more so than in the United States. An efficient and honest administration, however, is secured.

judged bankrupt, the court shall refuse to approve the proposal, unless it provides reasonable security for the payment of not less than five shillings in the pound [25%] on all the unsecured debts provable against the debtor's estate." This subdivision is said to account for the uncommonness of compositions in bankruptcy. Donovan Report, 71st Cong. 3d Sess. 181 (1931).

¹⁵ Donovan Report, 71st Cong. 3d Sess., 184 (1931).

¹⁶ *Ibid.*

CRITICISM AND SUMMARY

The stigma of disqualification attaches to bankruptcy. As a consequence England has the Deeds of Arrangement Act which is properly a subject of bankruptcy. The code of commercial morality protects the community against both the dishonest and the inefficient trader. This protection is its chief asset. Protection is due not only to the provisions of the Act itself but to administration largely under government supervision.

England and Wales, to which the Act applies, are small countries and it might be argued that a machinery for liquidation for such countries would not prove workable in a country as large as the United States. The Canadian Act, however, is patterned upon the English Act in this respect and it appears, as we shall see, to be functioning well.

WINDING UP, LIQUIDATION AND REORGANIZATION OF CORPORATIONS

Liquidation and reorganization of corporations proceed under the Companies Act of 1929.¹⁷ This Act governs registered companies, certain unregistered companies, as a trustees savings bank certified under the Trustees Savings Bank Act (1863), certain partnerships and associations, and companies incorporated outside Great Britain but carrying on business within Great Britain. In summary, the Act governs the great bulk of business entities.

WINDING-UP

The winding-up provisions of the Companies Act govern both (1) liquidation of the company where it is commercially insolvent and (2) the winding up or dissolution of a company where it is desired to terminate business or where the company has failed to comply with corporation law, as making "default . . . in delivering the statutory report to the registrar or not holding the statutory meeting." The winding up provisions are therefore much broader in scope than the bankruptcy or corporate reorganization provisions of the United States. In the United States federal legislation concerns itself with the winding up of companies only when they are insolvent in the bankruptcy sense or unable to meet their debts as they mature. In the United States if a company is to be dissolved because it is terminating business or has failed to comply with its charter

¹⁷ 2 Halsbury's Statutes of England 878 *et seq.* (1929), as amended by the Assurance Companies (Winding-Up Acts (1933-35), 23 Geo. 5, c. 9, 25-26 Geo. 5, c. 35 (acts to provide for winding up of insolvent assurance companies under the Companies Act on petition of the Board of Trade), govern liquidation; Halsbury, *supra* at 874-8, govern arrangements and reconstructions.

or for other such reasons, the winding up will proceed under the laws of the sovereign (usually a state) which granted incorporation.

In England "the winding up of a company may be either—

- (a) by the court; or
- (b) voluntarily; or
- (c) subject to the supervision of the court."¹⁸

If the winding up is either by the court or subject to its supervision, the High Court has jurisdiction and certain other courts have concurrent jurisdiction, as the county court. The Lord Chancellor, with the concurrence of the President of the Board of Trade, is given authority to make rules for carrying into effect the provisions for winding up companies in England, and he, with the sanction of the Treasury, prescribes the fees.

If a company is wound up by the court the procedure is analogous to bankruptcy procedure. There is an official receiver, although he need not be the official receiver attached to the bankruptcy court, and there is a liquidator with powers and duties analogous to the trustee in bankruptcy. A committee of inspection may be appointed and the Board of Trade has general powers of supervision and investigation. An account known as the Companies Liquidation Account, and analogous to the Bankruptcy Account, is kept by the Board of Trade with the Bank of England.

There are two kinds of voluntary winding up: (1) a members' voluntary winding up; and (2) a creditors' voluntary winding up. The first kind applies where the company will be able to pay its debts in full within a period not exceeding twelve months. Here the proceedings are controlled by the shareholders. Where the company is not in such a financial state the proceedings will be controlled by the creditors. In either event the liquidation is essentially an out-of-court liquidation. Sometimes during a voluntary winding up the court is asked to assume supervision. If it does so, the liquidation proceeds in much the same manner as if the winding up had been by the court from the beginning. A number of detailed provisions of the Act, which are applicable to winding up by the court, do not apply, however, where the liquidation is merely under its supervision.¹⁹

Many provisions are applicable to every mode of winding up, such as provisions governing debts provable and priorities, provisions against fraudulent preferences, and provisions relative to offences occurring prior to or in the course of the winding up. The latter deal with offences by officers of the company in complying with the Act, failure to disclose all of the company's property or produce books, "penalties for falsification [§ 272]; frauds by officers of the company [§ 273]; liability where proper

¹⁸ Section 156 (1).

¹⁹ See 5 Halsbury's Laws of England 788, 789 (2d ed. 1932).

books of account have not been kept [§ 274]; responsibility of directors for fraudulent trading by the company [§ 275]; powers of the court to assess damages against delinquent directors or other officers [§ 276]; and the prosecution of delinquent directors, officers or members of the company [§ 277]."²⁰

ARRANGEMENTS AND RECONSTRUCTIONS

Sections 153 to 155 provide a means for rearranging the capital structure of a company, the amalgamation of companies, and the transfer of the assets of one company to a new company. These sections have an analogue in the Canadian Act,²¹ and combine features to be found in our federal reorganization provisions and in state provisions for recapitalization and consolidation of companies. The English sections on arrangements and reconstructions effect the same objective as the federal and the applicable state statutes do without the overlapping incident in this country. Furthermore, insolvency or inability to meet obligations is not a condition to the invocation of these sections. The company in failing circumstances may treat with its creditors and if three-fourths in value of the creditors, or class of creditors, as the case may be, present and voting, agree, and this agreement is sanctioned by the court, it is binding on all the creditors, or class of creditors, as the case may be, and upon the company.

SUMMARY

Economic crises have not in themselves produced much change in liquidation legislation in England. The bases of the present Bankruptcy Act, 1914, are those of 1883; the Deeds of Arrangement Act, 1914, was a consolidation of the law on that subject, but did mark a formal separation from bankruptcy; and provisions in the Companies Act, 1929, for liquidation and reorganization of corporations remain substantially as under the Act of 1908.

CANADIAN HISTORY AND EXPERIENCE²²

BANKRUPTCY

The present Canadian Bankruptcy Act was assented to July 7, 1919, to be effective July 1, 1920. It was based mainly on the English Act of 1883 but did contain provisions taken from other Canadian Legislation, name-

²⁰ 2 Halsbury's Statutes of England 630 (1929).

²¹ See discussion of the Company Creditors' Arrangement Act enacted in Canada in 1933, page 29 *infra*.

²² Citations to the Canadian Act are to the original Statutes of Canada, particularly the Act of 1919 and its amendments, and not to the Revised Statutes, unless otherwise noted.

ly, the Insolvent Act of 1875, the Winding-Up Act of 1906, and various provincial assignments and preferences acts.²³ The Act has been amended and supplemented almost yearly.²⁴ Nevertheless, as is hereinafter pointed out, the Act remains basically the same as when enacted. With the exception of special legislation dealing with farmers, the Canadian Bankruptcy Act is not a product of economic crisis.

In 1867 the British North America Act gave to the Parliament of Canada exclusive legislative authority over "bankruptcy and insolvency."²⁵ Prior thereto there had been provincial legislation dealing with insolvency. The provinces had dealt with the matter along English or French lines depending upon their particular heritage.²⁶ After federation and beginning in 1869 the Dominion had for a time a general bankruptcy law. But this was repealed in 1880 due to unsatisfactory methods of administration and undue legislative tinkering. Aside from winding-up legislation the Insolvency Act of 1875, as amended in 1876 and 1877, was the last Dominion Act on the subject of bankruptcy and insolvency until the Act of 1919.²⁷

Then for approximately forty years each province in the Dominion had its own assignment acts. Under these acts the debtor could make an assignment to an "authorized" trustee who received his appointment from the provincial governor. The legislation was carried out by such trustees under creditor supervision in the form of inspectors. A professional class of trustees grew up which carried on the liquidation business efficiently and at a reasonable charge to the debtor's estate. Defects in the acts were: (1) lack of uniformity, the act of each province being different in both technical and material matters; (2) a debtor could not be compelled to

²³ Duncan, *Law and Practice of Bankruptcy in Canada* 31, n. 5 (1922).

²⁴ For the original enactment see 9-10 Geo. 5, c. 36 (1919). For amendments see 10-11 Geo. 5, c. 34 (1920); 11-12 Geo. 5, c. 17 (1921); 12-13 Geo. 5, c. 8 (1922); 13-14 Geo. 5, c. 31 (1923); 15-16 Geo. 5, c. 31 (1925); 21-22 Geo. 5, c. 17-18 (1931); 22-23 Geo. 5, c. 39 (1932); 24-25 Geo. 5, c. 53 (1934); 25-26 Geo. 5, c. 20, 61 (1935).

²⁵ 30-31 Vic., c. 3, § 91 (21) (1867).

Compare Art. I, § 8, cl. 4, of the Constitution of the United States where Congress is given power only to establish uniform laws on the subject of *bankruptcies* throughout the United States. There had been some doubt as to whether this gave Congress power to pass insolvency legislation; and there had been some attempted distinction in the Canadian provinces between bankruptcy and insolvency legislation. Arguments have been made that laws which free the person are insolvent laws and those which discharge contractual obligations are bankrupt laws; that insolvent laws operate at the instance of the debtor while bankrupt laws operate at the instance of the creditor, and, it is sometimes said, only against traders. See *Sturges v. Crowninshield*, 4 Wheat. (U.S.) 122 (1819). To resolve possible conflict express authority over "bankruptcy and insolvency" was given by the Act.

²⁶ Duncan, *Law and Practice of Bankruptcy in Canada*, c. 2 (1922).

²⁷ *Id.* at c. 3.

make an assignment; (3) a composition or extension could not be made after an assignment; and (4) discharge provisions were lacking.

Mercantile interests pressed for Dominion legislation. H. P. Grundy, K.C., of Winnipeg, acting for the Canadian Credit Men's Trust Association, was in the main the draftsman of the Act of 1919. Mr. Grundy was familiar with the legislation of other nations, particularly of England and of the United States, and he drew upon their liquidation experience and the experience under the early Canadian provincial insolvency laws. The study of the American Act led him to eschew the American court procedure and he accordingly eliminated court procedure as a basic principle of liquidation.²⁸

The Canadian Act of 1919, although amended many times, remains basically as enacted in 1919. Amendments have been made largely to clear up ambiguities; to provide a more workable procedure; and to accord specialized treatment to farmers.

THE INSOLVENT DEBTOR AND HIS CREDITORS

An insolvent is a person "(i) who is for any reason unable to meet his obligations as they generally become due, or (ii) who has ceased paying his current obligations in the ordinary course of business as they generally become due, and (iii) the aggregate of whose property is not, at a fair valuation, sufficient, or, if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his obligations, due and accruing due, thereout."²⁹ Thus the Canadian definition of insolvency is far broader than the American bankruptcy definition, since the latter is limited to the third alternative in the Canadian definition. Until the Amendment Act of 1922 the acts of bankruptcy, while more numerous, were substantially those of the American Act.³⁰ The Amendment Act of 1922, however, added the following as an act: "if he [a debtor] ceases to meet his liabilities [generally]³¹ as they become due."³² This is wholly foreign to the present American Act.

²⁸ Donovan Report, 71st Cong. 3d Sess. 147 (1931). In connection with the "Donovan" investigation of bankruptcy conducted for the U.S. District Court for the Southern District of New York, Robert H. Thayer prepared a "Report of Bankruptcy Administration in Canada." This report based upon investigation of the working of the Canadian Act is extremely valuable and the writers have drawn upon it freely. The article by Greenberg, *The Bankruptcy Law in Canada*, 5 Jour. Nat. Assn. of Referees 119 (1931), has proved helpful.

²⁹ Section 2 (t) as amended.

³⁰ Compare § 3 of the Canadian Act with § 3 of the American Act.

³¹ The word "generally" did not appear in the Amendment Act of 1922 but was added by 13-14 Geo. 5, c. 31 § 3 (1923).

³² 12-13 Geo. 5, c. 8 § 3 (1922). The Amendment Act of 1922 added another act of bankruptcy not particularly material to our discussion.

The collection features of the English Act are absent. In this respect the Canadian Act is patterned more nearly after the American Act.

Building societies having a capital stock, incorporated banks, savings banks, insurance companies, trust companies, loan companies, and railway companies are not subject to the Act.³³ Like the American Act a wage earner or a person engaged solely in farming or the tillage of the soil is not subject to an involuntary proceeding, although such person may avail himself of the voluntary provisions.³⁴ Like the American Congress the Canadian Parliament has seen fit to deal specially with farmers in other respects.³⁵ Thus in 1925 the cost to a farmer of a voluntary proceeding was substantially reduced. A new section, § 8 (c), was added which provided that if the Lieutenant-Governor in Council of any province authorized any officer of the provincial government to act as a custodian and trustee of any person engaged solely in farming or tillage of the soil, such person should be appointed custodian and trustee and should not receive any remuneration therefor. Certain costs incurred by that officer were also to be eliminated. In 1934 the Farmer's Creditors Arrangement Act was passed.³⁶ The Act was apparently a temporary measure designed to tide over farmers during the depression. Its objective and machinery are very similar to § 75 of the American Bankruptcy Act, which deals with agricultural compositions and extensions.³⁷ Unlike the American Act the Canadian Act provides that a farmer may be adjudged a bankrupt on his failure to carry out an approved proposal, provided that failure is not due to causes beyond his control.³⁸ The board which is set up to administer the Act has extensive judicial powers, in that it can force upon both creditors and debtor a proposal which it deems just and proper in the case.

The Canadian Act is like the English Act in its provision for an allow-

³³ Section 2 (k). This is substantially the American provision. 11 U.S.C.A., § 22 (1929).

³⁴ Section 8 (1). Cf. § 4, 11 U.S.C.A., § 22 (1929) (American Act.)

³⁵ 15-16 Geo. 5, c. 31, § 4 (1925) (1929). Costs of custodian in Part III of the General Rules was eliminated.

Section 10 of the Amendment Act of 1925 also amended § 59 of the Bankruptcy Act exempting a farmer from the necessity of keeping books of account and allowing him to trade after knowing himself to be insolvent. Failure to comply with § 59 (b) and (c) by a person non-exempt is ground for refusing, suspending, or conditioning a discharge in Canada.

³⁶ 24-25 Geo. 5, c. 53 (1934). It was amended by 25-26 Geo. 5, c. 20 and 61 (1935). (Chapter 61 provided that the operation of the Act in British Columbia should cease on proclamation.)

³⁷ Section 75 was added to the American Act in March 3, 1933; amended June 7, 1934, June 28, 1934, August 28, 1935.

³⁸ Section 2 (3).

ance to the debtor for the support of himself and his family.³⁹ The American method is to allow the debtor such property as would be exempt from execution under the law of the state of his residence.⁴⁰ Provisions for the distribution of the estate are apt to effect a more equitable distribution than is effected under the American Act. This is true largely because the Canadian Act, like the English, proceeds on the theory that liquidation should take place when the debtor becomes unable to meet his obligations as they mature. Authorized assignments are encouraged, since the stigma of bankruptcy does not attach to such assignments. At first, title to after-acquired property in the case of assignments did not vest in the trustee, while in an involuntary proceeding the trustee took title to such property until the debtor was discharged.⁴¹ This difference of treatment would tend to encourage debtors in failing circumstances to come forward and treat with their creditors. It was, however, discontinued in 1923. The trustee now takes title to after-acquired property in both voluntary and involuntary cases.⁴² Section 48 restricts creditors. It provides that the claims of certain relatives of the debtor and an officer, director, or share-holder of a bankrupt corporation shall be postponed until the claims of all other creditors are satisfied. Provisions governing discharge and offences are more carefully designed than those in the American Act to safeguard the financial community against the dishonest and the wastrel. In so far as they succeed they help to augment the estate to be distributed.

The provisions on the discharge of a bankrupt or assignor⁴³ and on bankruptcy offences⁴⁴ are far more detailed and cover many more matters than similar provisions in the American Act. Unlike the American Act, a discharge may be suspended or conditioned when the debtor's assets are not equal to 50% of his unsecured liabilities, unless he is able to show that such condition "has arisen from circumstances for which he cannot justly be held responsible." Continuation in business after the debtor knows that he is insolvent is one of many facts which justifies a court in refusing, suspending, or conditionally granting a discharge. Other such facts are gambling or rash speculation, extravagance in living, an undue preference, a former bankruptcy or assignment. The general theory underlying the provisions governing discharge and criminal offences is to punish the fraudulent and dishonest and to prevent that type of person, as well as the rash and extravagant person, from again engaging in business as a discharged debtor.

³⁹ Section 21. Cf. § 53 of the English Act, 1914.

⁴⁰ Section 6, 11 U.S.C. § 24.

⁴¹ Section 25 (a).

⁴² 13-14 Geo. 5, c. 31 § 15 (1923).

⁴³ Sections 58, 59, 60, 61, 62.

⁴⁴ Part VIII.

MACHINERY FOR LIQUIDATION

Authorized Assignment. "A great many more liquidations under the Canadian Act are initiated through authorized assignments than through involuntary petitions. In the West 95 to 98% of all bankruptcy cases commence by an authorized assignment. In the East the percentage of assignments is at least 66 $\frac{2}{3}$ % of all cases. When a debtor makes an assignment he is known, not as a 'bankrupt,' but as an authorized assignor, and to avoid the stigma attached to the word 'bankrupt,' debtors, particularly in the West, are willing and anxious to effect an assignment voluntarily. In the large business centers in the East, although this factor does not play as important a part, yet assignments are preferred and more frequent, because a debtor who assigns is in a much better position to effect a composition or extension agreement with his creditors and to retain their goodwill than if the creditors had been compelled to make the initial move themselves by filing a petition."⁴⁵ Any insolvent debtor, except those corporations not subject to the Act, whose liabilities, provable under the Act, exceed \$500 may make an "authorized assignment."⁴⁶ It is essentially what is known under the American Act as a voluntary petition in bankruptcy, but under the American Act no specified amount of indebtedness is requisite for a voluntary petition, although a debtor must owe debts to the amount of \$1,000 before he can be adjudicated an involuntary bankrupt.⁴⁷

The Amending Act of 1921⁴⁸ attempted an anomalous method of liquidation which provided that a debtor could require an authorized trustee to call a meeting of his creditors to effect a composition, extension, or scheme of arrangement before the debtor had been adjudicated a bankrupt or had made an authorized assignment. Provisions for such settlement were essentially the ordinary composition, extension, or arrangement solutions but apparently it was felt that this was more of an out-of-court solution and would be more acceptable to debtors and creditors. If the debtor's proposals were not accepted or confirmed the court might adjudge him a bankrupt or permit him to make an authorized assignment. This method of liquidation was short-lived and was repealed in 1923.⁴⁹ This repeal in 1923 further provided that no composition or extension agreement could be made until after adjudication or assignment. This

⁴⁵ Donovan Report, 71st Cong. 3d Sess. 153 (1931).

⁴⁶ Section 9.

⁴⁷ Section 4, 11 U.S.C.A. § 22 (1929) (American Act).

⁴⁸ 11-12 Geo. 5, c. 17, § 13 (1921). This Act was suggested no doubt by the English Deeds of Arrangement Act.

⁴⁹ 13-14 Geo. 5, c. 31, § 15 (1923).

amendment was due to many complaints, particularly from the province of Quebec, to the effect that "debtors were bribing their creditors and using fraudulent means to force through compositions to avoid being adjudged a bankrupt or an authorized assignor." After the amendment, compositions decreased in number considerably. They now take place in only about one-third of all cases.⁵⁰

The discharge provisions apply equally to authorized assignments and involuntary petitions.

Involuntary Petition. An involuntary petition may be presented by a creditor or creditors holding provable claims in the amount of \$500, provided it is based on an act of bankruptcy which has occurred within six months.⁵¹ The petition may not be withdrawn after presentation without leave of the court,⁵² and the presentation is considered as the commencement of the bankruptcy proceeding.⁵³

Liquidating Officials. An acute problem ever present in liquidation is to determine whether the liquidation shall be essentially under creditor control or governmental supervision. Canada has adopted a middle position. At the first or a subsequent meeting the creditors appoint one or more, but not exceeding five, inspectors.⁵⁴ Inspectors are usually large creditors, but sometimes other persons, such as local individuals, may be chosen for their peculiar knowledge of the estate, or to reduce costs, since inspectors are entitled to traveling expenses. A trustee must procure the written permission of the inspector for every step that he takes in the liquidation of the estate. Such permission cannot be general, but is to be a permission to do a particular thing or things. Inspectors have been compared to a corporate board of directors, and the trustee, to an executive officer thereof. When a trustee has procured the requisite permission he is free to act without court order. As a general rule the inspectors take an active part in the administration of the estate by the trustee, although if the trustee is well-known for efficiency and experience in liquidation matters inspectors follow rather than direct the proceedings.⁵⁵

The original Canadian Act provided for official trustees, individuals or organizations named by the Governor in Council as competent to liquidate an estate either under an authorized assignment or an involuntary proceeding. It was contemplated that the professional trustees which had functioned under the provincial assignment statutes and had proved

⁵⁰ Donovan Report, 71st Cong. 3d Sess. 156-57 (1931).

⁵¹ Section 4 (3).

⁵³ Section 4 (10) as amended.

⁵² Section 4 (9).

⁵⁴ Section 43.

⁵⁵ Donovan Report, *op. cit. supra* note 50 at 154-6.

trustworthy and efficient would be appointed. Official trustee appointments were used, however, as a means of political patronage and many inexperienced and incompetent persons were appointed as official trustees. The Amendment Act of 1923 made rather radical changes in the liquidating personnel. The office of an Official Receiver was established. There was to be one such officer in each bankruptcy district or division. He was to examine the bankrupt or assignor, and he or his nominee was to preside at the first meeting of creditors. At this meeting the creditors were by ordinary resolution to choose any person but the Official Receiver as trustee for the administration of the estate.⁵⁶ The return in 1923 to unofficial trustees did not prove entirely satisfactory. It was said in 1931 that "The chief abuse arising from the provisions of the Act itself results from the existence and operation of fraudulent trustee organizations, who with the assistance of dishonest debtors are able through the machinery of the Act to gain control of estates as custodians and later as trustees."⁵⁷ The same abuse has occurred under the American Act.⁵⁸ The Amendment Act of 1932⁵⁹ provided that no one could act as a trustee who had not been licensed by the Minister of Justice. The public interest was to be considered in issuing the license, which was to be effective for one year, subject to renewal. From such an official panel creditors may select the trustee. The office of superintendent of bankruptcy was created; appointment to be made thereto by the Governor in Council. It is the Superintendent's duty to make reports on trustees, to gather and analyze bankruptcy data, and to make a report relative to the discharge of each debtor and trustee. Like the English Act the Canadian Act now recognizes that

⁵⁶ The Official Receiver is not to be confused with the receiver under the American Act. The American receiver corresponds to the Canadian custodian whose duty it is to take charge of an estate pending the appointment of a trustee. 13-14 Geo. 5, c. 31 (1923). The Canadian officer who corresponds to the American referee in bankruptcy is the registrar in bankruptcy. He is a salaried officer of the court appointed in each province by the Chief Justice of the Supreme Court of that province. "The registrar in bankruptcy often holds other court offices, such as registrar of other courts, etc., but his functions in bankruptcy administration are principally judicial. His chief functions . . . are to sit in chambers as a judge and hear all applications of trustees, creditors, or debtors in administrative proceedings as well as to confirm compositions and grant discharges to both trustees and debtors. (Section 65) is generally interpreted as permitting the registrar to pass upon only those applications which are unopposed. An appeal from a registrar's holding may always be made to a judge." Donovan Report, *op. cit. supra*, note 50, at 149.

⁵⁷ Donovan Report, *op. cit. supra* note 50, at 163.

⁵⁸ Manipulation and control of the bankruptcy machinery to the interest of non-creditors were the chief abuses in the Southern District of New York which led to the investigation, summarized in the "Donovan" Report.

⁵⁹ 22-23 Geo. 5, c. 39 (1932).

the public has a vital interest in the proper administration of bankruptcy legislation and that there must be some public official charged with the duty to see that the Act functions properly. Creditors alone can not be expected to see that advantage is not taken by the unscrupulous debtor.

SUMMARY

An investigation into the functioning of the Canadian Bankruptcy Act revealed that on the whole business men, attorneys, and judges felt that it was functioning well.⁶⁰ The chief abuse discovered then was the fraudulent trustee organization. This abuse, as we have seen, has now been cured.

The Canadian Act is neither a debtor's nor a creditors' act. Its aim is to bring within its provisions an estate as soon as such estate becomes insolvent; liquidate it under governmental and creditor control; and discharge the honest debtor and protect the community from the dishonest and inefficient debtor.

LIQUIDATION AND REORGANIZATION OF CORPORATIONS

Corporations, with the exceptions hereinbefore noted, are subject to provisions of the Bankruptcy Act. No special treatment of corporations has been accorded in the above discussion of the bankruptcy provisions because those are designed in the main to effect liquidation, not reorganization and rehabilitation. The liquidation of a corporation under the Bankruptcy Act proceeds in the same manner as any bankruptcy proceeding.

For a considerable time prior to the enactment of the Bankruptcy Act, Canada had, by its Winding-Up Act, provided for the liquidation of insolvent corporations under court supervision.⁶¹ Court supervision is the distinguishing feature between liquidation under the two acts. The Bankruptcy Act did not repeal the Winding-Up Act, but did provide that, for all corporations subject to the Bankruptcy Act, "the Winding-Up Act shall not, except by leave of the court, extend or apply to it. . . ."⁶² Up until about 1927 leave of court was freely granted, but about that time a reaction against granting leave set in.⁶³

The Winding-up Act extends to corporations that are subject to the Bankruptcy Act, and in addition to such companies as "incorporated

⁶⁰ Donovan Report, 71st Cong. 3d Sess. 165-8 (1931).

⁶¹ For the Winding-up Act see Rev. Stat. of Canada (1927), c. 213, as amended 20-21 Geo. 5, c. 49 (1930), 22-23 Geo. 5, c. 56 (1932), and as further amended by The Companies' Creditors Arrangement Act, 1933, 23-24 Geo. 5, c. 36 (1933).

⁶² Rev. Stat. of Canada, c. 11, § 153 (1927).

⁶³ Fraser, Reorganization of Companies in Canada, 27 Col. L. Rev. 932, 950 (1927).

banks, savings banks, incorporated insurance companies, loan companies having borrowing powers, building societies having a capital stock. . . ."⁶⁴ It "does not apply to building societies which have not a capital stock or to railway or telegraph companies."⁶⁵

Practitioners feel that reorganization and rehabilitation cannot be accomplished under the Bankruptcy Act, nor in the main under the Winding-up Act, which like the Bankruptcy Act, aims at liquidation rather than reorganization. Some reorganizations have occurred, however, under the Winding-up Act. This takes the form of the organization of a new company, which purchases the assets of the debtor corporation and issues its bonds and stock in payment therefor.⁶⁶

Reorganization by Secured Creditors and Shareholders. Incorporation of ordinary commercial companies may be either under the Dominion Companies Act or under the Companies Act of a particular province. "If the company's activities are to be confined to one province, the balance of convenience is usually in favour of obtaining incorporation in that province. If the company proposes to carry on business throughout the Dominion or in several provinces, incorporation under the Dominion Act is preferable, for the reason that the status and powers of dominion companies cannot be destroyed by provincial legislation. . . . The powers of the company and the *rights of the shareholders are*, of course, *governed by the particular Companies Act under which the company is incorporated*. The obligations of the company to its creditors and the holders of its securities are *ordinarily* governed by the provincial law applicable. This is so, both for the dominion and provincial companies, because, under the British North America Act, property and civil rights are within the legislative jurisdiction of the provinces."⁶⁷ But the provincial law yields on the subject of liquidation. If the Bankruptcy Act or the Winding-up Act is invoked, all non-exempt companies, whether dominion or provincial, will be subject thereto, inasmuch as these Acts deal with bankruptcy and insolvency over which the Dominion government has exclusive control. Thus the place of incorporation is important if a recapitalization by shareholders is solely involved, otherwise not.

If the company is not being liquidated, the particular Companies Act, under which incorporation took place, is applicable and will govern a recapitalization by shareholders. Both the Dominion Companies Act and

⁶⁴ Rev. Stat. of Canada, c. 213, § 6 (1927).

⁶⁵ Rev. Stat. of Canada, c. 213, § 7 (1927).

⁶⁶ See Fraser, *op. cit. supra* note 63 at 950.

⁶⁷ *Id.* at 932. (Italics ours.)

the provincial Companies Acts provide means whereby a specified majority of the shareholders may effect a readjustment of their rights.⁶⁸

If proceedings are initiated by or against a corporation, under the Bankruptcy Act, Section 13, as amended in 1923, permits the bankruptcy court to adjust and modify the rights of shareholders.⁶⁹

Before the reorganization of a company, as opposed to liquidation, can be understood the standard provisions of the Canadian corporate mortgage must be described. It contains two provisions not commonly found in American mortgages: (1) a floating charge provision; and (2) majority provisions, whereby a stated majority of the bondholders may affect their rights and the rights of the minority bondholders.⁷⁰

These features are similar to those commonly inserted in English trust deeds. The floating charge gives the bondholders an immediate equitable charge upon the corporate property, present and future, subject to the right of the corporation to deal with its property in the ordinary course of business. The company is quite generally given power to effect ordinary commercial loans with priority over the equitable charge. When default under the mortgage has occurred the floating charge becomes crystallized upon the corporate property. As a consequence unsecured creditors can gain little by the initiation of liquidation proceedings; the trustee in bankruptcy or the liquidator under the Winding-up Act would take the property subject to this all-inclusive and paramount floating charge.

The majority provisions give a stated percentage of bondholders the right to take effective action and bind themselves and the minority bondholders. Such provisions commonly found in Canadian mortgages give the majority the power, by extraordinary resolution, to effect a plan of reorganization and such other powers as are commonly given, not by the American corporate mortgage but by American bondholders, to committees formed to represent them in reorganization proceedings.

If no thoroughgoing reorganization is necessary, but only partial re-

⁶⁸ For the Dominion Companies Act see Rev. Stat. of Canada, c. 27, §§ 144, 145 (1927), as amended by 20-21 Geo. 5, c. 9, § 37 (1930), 24-25 Geo. 5, c. 33, §§ 122, 123 (1934). (Three-fourths of the shareholders or class of shareholders, as the case may be, present and voting at the meeting called therefor may, subject to approval by the court, make a binding compromise or arrangement concerning the status of such class.)

⁶⁹ 9-10 Geo. 5, c. 37, § 13 (1919), as amended by 13-14 Geo. 5, c. 31, § 15 (1923); Rev. Stat. of Can., c. 11, § 21 (1927).

⁷⁰ For treatment of the Canadian corporate mortgage, a form of floating charge, and a good discussion thereof, as well as discussion of majority provisions, see Fraser, *Reorganization of Companies in Canada*, 27 Col. L. Rev. 932, 934 *et seq.* (1927), on whom the writers have drawn freely for Canadian corporate reorganization materials.

organization, a specified number of bondholders may accomplish this by requiring the trustee to call a meeting, and voting at that meeting to make certain modifications in their rights.⁷¹

If extensive scaling down of fixed charges and the obtaining of new capital is necessary, reorganization will normally be effected by judicial sale. The trustee will initiate foreclosure proceedings. A receiver and manager (who is the same person) will be appointed to take charge of and manage all the property comprised in the mortgage which will, by virtue of the floating charge, be all of the corporate property. Bondholder's committees will be formed and deposits solicited. The formality of public sale will be gone through with, but if the bondholders' committee has been successful in securing deposits there will be no one to bid against it. Unlike the American bondholders' committee it will not put in a bid but will take steps to effect its plan of reorganization. Since a stated majority may bind the minority no cash is needed to buy off dissenters and the plan can then be put into effect. In some of the provinces it was necessary to secure the court's approval of the plan as well as the master's confirmation if a cash transaction was not involved.⁷²

No revolutionary legislative changes have been made. The Companies' Creditors Arrangement Act was passed in 1933,⁷³ and the Dominion Companies Act was amended in 1934.⁷⁴

The Arrangement Act applies to all corporations, "except banks, railway or telegraph companies, insurance companies and trust companies organized under or governed by the Trust Companies Act, and loan companies organized under or governed by the Loan Companies Act."⁷⁵ The purpose of the Arrangement Act was to facilitate compromises and arrangements between companies, both provincial and dominion, and their creditors. The Canadian corporate mortgage features are not limited by the Arrangement Act, but it is in extension of their rights.⁷⁶ The necessity

⁷¹ "Instances of modifications effected by the above procedure are the postponement or reduction of sinking fund requirements; the extension of the maturity of the bonds either with or without terms as to increasing the interest rate where market conditions or the company's position make immediate refunding operations undesirable or impossible; permission to the company to purchase property subject to lien ranking ahead of the bonds; permission to the company to sell the assets to a new company subject to the existing bond mortgage; release of the mortgaged assets in exchange for new securities; authorization to the trustee to release part of the mortgaged premises either on terms or unconditionally; waiver of minor defaults." Fraser, *op. cit. supra* note 70 at 944.

⁷² *Id.* at 942.

⁷³ 23-24 Geo. 5, c. 36 (1933).

⁷⁴ 24-25 Geo. 5, c. 33, §§ 122, 123, 124 (1934).

⁷⁵ See § 2 (b).

⁷⁶ See § 7.

for a judicial sale, however, is dispensed with. But action by bondholders and other creditors is subject to court control.

The purpose of the amendment to the Dominion Companies Act was further to facilitate compromises and arrangements between dominion companies and shareholders.

The processes of corporate liquidation and reorganization have been brought under increased court supervision, but aside from that they seem to have remained essentially the same.

SUMMARY

Canadian methods of reorganization prior to the economic crisis were not essentially different from those of the United States.⁷⁷ The chief difference was due to the power of the majority of Canadian bondholders to bind the minority and their control over the assets of the corporation by virtue of the floating charge. That is a more extensive power than bondholders have in America, although, after the reorganization proceeding commences, their committees obtain, by solicitation and deposit, an extensive and direct power over depositors, and a large bargaining power with non-depositors. That difference still distinguishes present reorganization proceedings in Canada and the United States. In both countries there has been a trend toward more court supervision and control.

It is difficult to tell (1) whether the bondholders in Canada have abused their extensive power over corporate assets; and (2) whether they have been imposed upon by their committees. A distinguished commentator took the position in 1927 that neither abuse seemed present.⁷⁸ Since there is more court supervision today the danger of abuse seems further minimized, but there is no machinery governing bondholders' committees. As subsequently pointed out in the discussion of American reorganization, bondholders' committees have abused their power in this country. Legislation is pending to correct such abuses.⁷⁹ Whether it is needed in Canada today is not yet apparent.

⁷⁷ Cf. Swaine, *Reorganization of Corporations, Certain Developments of the Last Decade*, 27 Col. L. Rev. 901 (1927) an article companionate to Fraser's, *op. cit. supra* n. 70 which deals with American reorganization; see also this paper, *infra*, dealing with American corporate reorganization and liquidation.

⁷⁸ See Fraser, *op. cit. supra* note 70.

⁷⁹ Representative Lea has introduced the "Committee Act of 1937," H.R. 6968, 75th Cong. 1st Sess. (1937), designed to regulate the solicitation of proxies, deposits, and assents in connection with reorganizations, voluntary readjustment and debt arrangements, and to prevent committees from overreaching those whom they purport to represent in the reorganization proceeding.

AMERICAN HISTORY AND EXPERIENCE

Article I, § 8, cl. 4, of the Constitution gives Congress the power "to establish a uniform Rule of Naturalization, and uniform Laws on the subject of bankruptcies throughout the United States." Nowhere in our fundamental law is the "Subject of Bankruptcies" defined.

The Articles of Confederation had contained no mention of power in the central government to regulate commercial practices among the states. The lack of commercial unity among the states and the inability of the Federal Confederate Government to deal properly with interstate commercial practices was a motivating force toward the establishment of a stronger Federal Government. The state insolvency laws had proved inadequate, and were important causes contributing to the disunity of the mercantile structure. There were delegates to the Constitutional Convention in 1787 who were familiar with the English bankruptcy legislation and its method of operation, and with the various colonial laws on the subject. But their abilities were not drawn on until a late date in the Constitutional Convention, when the matter of federal control of bankruptcies first came up. Charles Pinckney was the author of the first draft of the bankruptcy clause. It read that Congress should have power "to establish uniform laws on the subject of bankruptcies and respecting the damages arising on the protest of foreign bills of exchange." The subject was then regarded as it had been in England for over two hundred years and during the middle ages on the Continent, as a regulation of commerce which, if not a part of the law merchant, was closely related thereto. Madison was shortly to comment: "The power of establishing uniform laws of bankruptcy is so intimately connected with the regulation of commerce and will prevent so many frauds where the parties or their property may lie or be removed into the different States, that the expediency of it seems not likely to be drawn into question."⁸⁰ The promotion of commerce by a wise use of the bankruptcy power in protecting credit relations is evident.⁸¹ It, therefore, becomes important to note that the grant of the bankruptcy power in its final form, although related to commerce, was not included in clause 3, which gives to Congress the power "to regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." From that it is fair to infer that the draftsmen did not wish to restrict the bankruptcy grant as they had done the power over commerce. Congress was to have an all inclusive power, through the

⁸⁰ *The Federalist* no. 42; and see Senate Doc. no. 65, 72d Cong. 1st Sess. 50 (1932).

⁸¹ See *supra* note 1.

bankruptcy grant, to enact any legislation *reasonably framed and related to* the subject of bankruptcies, which in turn is indissolubly linked to commerce and credit. The United States Supreme Court, by a long line of decisions, has affirmed the power. Only in its 5-4 decision holding the Municipal-Debt Readjustments Act unconstitutional as an infringement of state sovereignty has it definitely limited the power: a decision legally and economically indefensible.⁸²

If, in addition, it is remembered that the first English Acts, as well as the early American Acts, were designed for the protection of the commercial community; that insolvency was not an element in those laws, although that element has been drawn into the modern legislation, it can be seen that the Constitutional grant of power over the *subject of bankruptcies* embraces the entire field of debtor-creditor relationships for the purpose of equitable distribution of a debtor's estate, rehabilitation of the debtor, and protection of the credit structure against anything materially contributing toward its impairment.⁸³ Judge, later Justice, Blatchford, commented: "It cannot be doubted that Congress in passing laws on the subject of bankruptcy is not restricted to laws with such scope only as the English laws had when the Constitution was adopted. The power given must, indeed, be held to be general, unlimited, and unrestricted over the subject."⁸⁴

THE ACTS OF 1800, 1841, 1867

Story thought the colonies and states never had any laws that could technically be called bankruptcy laws. Pennsylvania, however, had

⁸² The decision is *Ashton v. Cameron Co. Water Imp. Dist. No. 1*, 31 Am. B. R. (N.S.) 96, 56 S.Ct. 892 (1936), criticized by the writers in the revision of Gilbert's *Collier on Bankruptcy* 1555-7 (4th ed. 1937). In speaking of the bankruptcy power Mr. Justice Cardozo in the *Ashton* case said: "The history is one of an expanding concept. It is, however, an expanding concept that has had to fight its way. Almost every change has been hotly denounced in its beginnings as a usurpation of power. Only time or judicial decision has had capacity to silence opposition." Warren, writing a short time before the *Ashton* case, commented in this manner on the power: "... until the decision on May 27, 1935, in the *Frazier-Lemke* Act case, no development under the Bankruptcy Clause of the Constitution has ever failed of support by the Supreme Court." Warren, *Bankruptcy in the United States History* 9-10 (1935). The *Frazier-Lemke* Act decision to which he refers held invalid one subsection of Section 75, which deals with Agricultural Compositions and Extensions, on the ground that it was not reasonably framed, and thus deprived the secured creditor of property without due process of law. Since that decision the subsection was amended and has been sustained as constitutional by the United States Supreme Court. *Wright v. Vinton Branch of Mountain Trust Bank of Roanoke, Va.*, 57 S. Ct. 556 (1937). The problem is discussed in *Constitutional Law—Due Process and the Frazier-Lemke Acts*, 35 Mich. L. Rev. 1130 (1937). For the new municipal bankruptcy act see Public Act no. 302, 75th Cong. 1st Sess. (1937).

⁸³ Cf. Kreft, *What Is the "Subject of Bankruptcies?"*, 6 Temp. L. Q. 141 (1932).

⁸⁴ *In re Reiman*, Fed. Cas. No. 11673 (1874).

passed "An Act for the Regulation of Bankruptcies" in 1785. In addition, Pennsylvania, like most of the other states, had insolvency laws. These laws were not uniform; nor did they furnish adequate coverage. In some states, such as Massachusetts and Connecticut, for instance, the insolvency laws dealt only with a deceased debtor's estate. The main inadequacy of the state insolvency laws, however, was the inability to give a discharge which would be effective in other states.

At the beginning of our national history, speculation in government scrip, in the shares of new corporations, in land, and the large commercial losses due to our relations with France produced such financial stringency that some national legislation became necessary. The Act of 1800 was the answer. It closely resembled the English and Pennsylvania statutes. It was a temporary measure expressly limited to five years and was repealed in 1803. It contained no voluntary provisions and applied only to traders, merchants, and brokers. The acts of bankruptcy were those by which a debtor attempted to put himself or his property beyond the reach of his creditors. Insolvency was not an element of an act of bankruptcy. The bankrupt was given a certain percentage of his assets, provided the estate paid certain specified percentages to the creditors. In addition the commissioners in bankruptcy could make such allowances to him as was necessary for the support of himself and family. The honest debtor who complied with the provisions of the Act was entitled to a discharge after the commissioners had certified to his compliance, provided two-thirds in number and in value of the bankrupt's creditors (creditors for less than fifty dollars were not counted) signed or consented to the allowance of the discharge. Thus the first American law dealt with discharge as the English had done under the practice as developed under the law of 1705.

Dissatisfaction with the Act was due to the difficulty of travel to the more or less remote and unpopular federal courts; to the small dividends that had been paid, although little more could be expected since most of the debtors proceeded against were already in jail; and because some unscrupulous debtors had been able to use the Act to their advantage. Then, too, the agricultural classes had been opposed to bankruptcy legislation from the first. With the return of prosperity, the agricultural opposition and the dissatisfaction with the working of the Act combined to effect a repeal.

There was agitation from time to time for the enactment of a new bankruptcy law. "In 1824, for example, Daniel Webster introduced and strongly supported a bill for a bankruptcy law designed to supplant the 'twenty-four different and clashing systems' of the States. President

Adams recommended the passage of a law in 1825.⁸⁵ But the next legislation did not come until 1841. Under the Act of 1841, involuntary proceedings were limited to cases where the debtor put himself or his property beyond the reach of his creditors. Voluntary proceedings, however, were open to all debtors. This was attacked as unconstitutional on the ground that a law which permitted voluntary proceedings was not a bankruptcy but an insolvency law,⁸⁶ but voluntary proceedings have come to be regarded as an essential part of our Act. Any debtor who surrendered his property and complied with the orders of the court could obtain a discharge. Creditor control was eliminated. Unlike the Act of 1800 which provided for the election of a trustee by creditors, the Act of 1841 did not provide for meetings of creditors but did provide that the court would appoint a trustee. The Act of 1841 was largely a product of financial stringency, and like the Act of 1800 was short-lived. It was repealed in 1843. Its chief contribution to the legislation which we now have was its provisions for discharge and voluntary proceedings.

Financial stress produced by the Civil War brought on the enactment of legislation in 1867. As we noted, the Act of 1841 abolished distinctions between traders and other persons so far as voluntary proceedings were concerned. The Act of 1867 went further and abolished the distinction entirely. Voluntary proceedings were limited to debtors owing at least three hundred dollars and no voluntary bankrupt could be granted a second discharge unless in the second proceeding dividends of at least seventy percent were paid or three-fourths in value of the creditors assented to a lesser amount. The consent of creditors was required for a discharge where the estate paid less than fifty percent, unless a stated majority in number and value of his creditors assented to a smaller dividend. Subsequently in 1874 the fifty percent dividend requirement for discharge was abolished in involuntary proceedings, and only a thirty percent dividend or the consent of one-fourth the creditors holding one-third in amount of the claims was required in voluntary proceedings. Composition provisions were also added. A debtor could effect a composition without being adjudicated a bankrupt. Here we have the first escape in American legislation from the stigma attaching to bankruptcy.

One of the most important features was the provision that the failure to pay commercial paper for a period of fourteen days⁸⁷ by a banker, merchant, or trader was an act of bankruptcy for the purpose of involuntary proceedings.

⁸⁵ Senate Doc. No. 65, 72nd Cong. 1st Sess. 51 n. 6 (1932).

⁸⁶ *Id.* at 51.

⁸⁷ In 1874 the time was extended to forty days.

Repeal was partly due to some abuses on the part of courts in appointing trustees in addition to the trustee or trustees elected by the creditors; but numerous and excessive fees were the main causes. It was effected in 1878 by majorities in the Senate and the House of six to one and five to one, respectively.

THE ACT OF 1898⁸⁸

While measures for repeal of the Act of 1867 were pending many people realized that a national bankruptcy law was needed. Although they were not strong enough to prevent the repeal they immediately began agitation for new legislation. The Boston Merchants Association obtained Judge Lowell of Massachusetts in 1881 to draft a bill. He sought to protect credit by provisions along English lines. The offences enumerated and the grounds for discharge were substantially those now forming a part of the English and Canadian laws. Creditor consent to a discharge was eliminated. In this feature he anticipated English legislation of 1883.

His most important changes over the Act of 1867 were in the administrative provisions that had given rise to so much objection. The fee system for referees was to be abolished; referees were to receive salaries of two thousand dollars and allowances for their expenses. He followed the English law by providing that creditors should appoint a committee to advise and supervise the trustee, who under such supervision was given a free hand in administration.⁸⁹ He further provided that in each circuit, judges should appoint a supervisor in bankruptcy. His duties would be to examine into the administration of bankruptcy proceedings, to advise the referees and trustees in administrative matters, to report to the courts any misconduct on the part of trustees and to make quarterly reports to the circuit courts covering the entire field of administration. Here, too, he anticipated the English Act of 1883 which established a board of trade with comparable duties, and the Canadian Amendment Act of 1932 which created the office of superintendent of bankruptcy.

The Lowell Bill introduced into Congress in 1881 was opposed by certain classes which felt that their interests would be subserved by no bankruptcy legislation and by those who felt that legislation was needed but that the Lowell Bill was not the proper remedy. Senator Ingalls of Kansas sponsored a substitute bill known as the Equity Bill. Creditor

⁸⁸ The writers have drawn extensively for the historical material on The Report of the Attorney General on Bankruptcy Law and Practice, 72nd Cong. 1st Sess. Sen. Doc. No. 65, 58 *et seq.* (1932).

⁸⁹ The Act of 1867 had similar provisions with certain limitations. They never seem to have been used.

control was to be entirely eliminated; proceedings were to be in the district courts sitting in equity and subject to such rules as they should develop. His bill had one important effect upon the Act of 1898. It contained, for the first time in the history of bankruptcy legislation, the definition of insolvency as an insufficiency of assets at a fair valuation to meet the debtor's liabilities. This definition was bitterly attacked by Senator Hoar:

"The Lowell bill adopts the only definition of bankruptcy which is practicable and which has proved itself to the experience of mankind, and that is the inability to pay debts in the course of business. The committee's bill, on the other hand, provides that the man is only to be deemed insolvent, to be a subject of bankruptcy jurisdiction, when the entire value of his property, whether it is capable of being realized within 1 year or within 10 years, exceeds the amount of his indebtedness.

Consider, in the first place, how impossible of practical ascertainment is the fact you propose as your test. You require at the threshold of every application in bankruptcy that the court shall go into an investigation of the value of every debt, bad debt or good debt, the value of every interest, contingent or absolute, in property, the value of all expectations of every sort which are the property of the debtor, ***"⁹⁰

Because of the opposition which the Lowell Bill was facing, various commercial interests secured Colonel Torrey, an attorney of St. Louis, to draft a new bill. In general he followed the substance of the Lowell Bill. The arrangement, chapter headings, and most of the phraseology of the Act of 1898, however, were Colonel Torrey's. His chief omissions were: (1) elimination of the supervisor in bankruptcy; (2) displacement of provisions for creditors' committees by the requirement that the trustee should collect, liquidate, and distribute the estate under the directions of the court. New features which he added were: (1) that the United States Attorney, when directed by the judge on a creditor's application, should attend the first meeting of creditors and publicly examine the bankrupt, and attend a hearing on the bankrupt's discharge and oppose it unless satisfied from the bankrupt's examination that there were no grounds therefor; and (2) that in every case the court should publicly examine the bankrupt. By these new features the public interest was to be protected as under the English Act of 1883, but without setting up new machinery.

In 1894 Representative Baily of Texas introduced a bill of a temporary character and one that was not well worked out. It did, however, contain an interesting suggestion. The administration was to be through assignments under the state laws, the debtor applying to the federal court only for his discharge. This notion deserves consideration today. It might be made the basis for summary bankruptcy in this country: that is, liquida-

⁹⁰ Sen. Doc. No. 65, *op. cit.* *supra* note 88 at 60, 61.

tion of small estates, say of \$1,000 assets, might be left to the state assignment laws, subject to some supervision by the federal bankruptcy courts, while estates with greater assets could be administered in federal courts from the outset.

In 1898, however, Congress enacted the Torrey Bill, modified by several judiciary committees of the House and the influence of various substitute bills. The Torrey Bill was signed by President McKinley on July 1, 1898.

There have been a number of efforts made to repeal the Act, largely by those who feel that bankruptcy accompanied by discharge has been made too easy for the fraudulent and the wastrel debtor.⁹¹

Prior to the last economic crisis the Act was amended in 1903, 1906, 1910, 1911, 1915, 1916, 1917, 1922, 1925, and 1926.⁹² These amendments have not altered the basic features of the Act of 1898. The acts of bankruptcy, the discharge, and the criminal provisions have been strengthened to some extent. The acts of bankruptcy are: (1) fraudulent transfer, (2) preferential transfer, (3) and (4) preference through legal proceedings, (5) general assignment for the benefit of creditors or a receivership, and (6) written confession of bankruptcy. Insolvency is not an element of acts (1), (6), and so much of (5) as deals with a general assignment, but solvency at date of petition is a defense to a proceeding based on act (1). These acts are substantially those of the Canadian Act as it stood until amended in 1922, when it was there provided that it was an act of bankruptcy for a debtor to fail to meet his liabilities as they become due. Proceedings under the American Act must be begun within four months after the commission of the act. Provisions as to who may become bankrupts are analogous to the Canadian provisions. "Any person, except a municipal, railroad, insurance, banking corporation, or a building and loan association" may become a voluntary bankrupt. Under this provision, unlike the Canadian Act, no specific amount of liabilities is required. "Any natural person, except a wage earner or farmer, any unincorporated company, and any moneyed, business, or commercial corporation (except a municipal, railroad, insurance or banking corporation, or a building and loan association) owing debts to the amount of \$1000 or over, may be adjudged an involuntary bankrupt. . . ."⁹³ Insolvency as an element of bankruptcy, we have noted, is the excess of liabilities over assets at a fair valuation.

⁹¹ *Id.* at 64.

⁹² For detailed analysis of the Act of 1898 including amendments listed in text and the amendments of 1932, 1933, 1934, 1935, and 1936 see the writers' revision of Gilbert's *Collier on Bankruptcy* (4th ed. 1937).

⁹³ Section 4, 11 U.S.C. § 22 (1929).

The administration of the estate is conducted by the federal courts of bankruptcy, largely through referees. In theory, trustees are to be selected by creditors, appointed by the referee, but thereafter subject to the directions of the court. An investigation into the bankruptcy practice in the Southern District of New York, which embraces the metropolitan area of New York City, has shown rather conclusively that creditor control is apt to be only a myth in practice.⁹⁴ To meet the abuses which had arisen there the judges of the Southern District of New York appointed a reputable bank as standing receiver and made it practicable for that bank to be chosen as trustee unless the creditors actually desired another. But by Act of June 7, 1934, Congress, apparently because of political reasons, provided that the court must apportion the appointment of receivers and trustees to prevent a person from having a monopoly of such appointments.⁹⁵ Bankruptcy administration remains subject to abuse by the solicitation of proxies and the resulting control of the proceeding by those not vitally interested in its administration. Creditor control has broken down in this country.

Procedure for supervision by appeal is not clearly defined and hence is wasteful. This is due to the theoretical distinction between (1) controversies arising in bankruptcy, supposedly between the estate and third persons, and (2) administrative proceedings in bankruptcy which supposedly affect only those actually parties to the procedure.

The trustee takes title as of the date the petition is filed. The bankrupt's after-acquired property is not subject to the proceeding. The criminal provisions and the grounds for which a discharge may be refused are less numerous than those in the English and Canadian Acts and are not so apt to protect the commercial community.

In his message to Congress in 1932 President Hoover tersely pointed out the importance of adequate bankruptcy legislation to the business community and the course which legislation should take:

"The number of cases in bankruptcy has steadily increased from 23,000 in the fiscal year 1921 to 53,000 in 1928 and to 65,000 in 1931. The liabilities involved have increased from \$171,000,000 in 1921 to \$830,000,000 in 1929 and to \$1,008,000,000 in 1931, and the losses to creditors have increased from \$144,000,000, in 1921 to \$740,000,000 in 1928 and to \$911,000,000 in 1931. The increases are therefore obviously not due to the economic situation, but to deeper causes.

A sound bankruptcy system should operate—

First, to relieve honest but unfortunate debtors of an overwhelming burden of debt;

⁹⁴ See Donovan Report, 71st Cong. 3rd Sess. (1931).

⁹⁵ 11 U.S.C. § 76a (1929).

Second, to effect a prompt and economical liquidation and distribution of insolvent estates; and

Third, to discourage fraud and needless waste of assets by withholding relief from debtors in proper cases. . . .

The present bankruptcy act is defective in that it holds out every inducement for waste of assets long after business failure has become inevitable. It permits exploitation of its own process and wasteful administration by those who are neither truly representative of the creditor nor the bankrupt.

Except in rare cases it results in the grant of a full discharge of all debts without sufficient inquiry as to the conduct of the bankrupt or of the causes of failure. It discharges from their debts large numbers of persons who might have paid without hardship had the law discriminated between those overwhelmed by misfortune and those needing only temporary relief and the opportunity to deal fairly with creditors.

The bankruptcy act should be amended to provide remedial processes in voluntary proceedings under which debtors, unable to pay their debts in due course, may have the protection of the court without being adjudged bankrupt, for the purpose of composing or extending the maturity of their debts, of amortizing the payment of their debts out of future earnings, of procuring the liquidation of their property under voluntary assignment to a trustee; or, in the case of corporations, for the purpose of reorganization.

The act should be amended to require the examination of every bankrupt by a responsible official and a full disclosure of the cause of his failure and of his conduct in connection therewith for the consideration of the court in determining whether he should have his discharge.

The discretion of the courts in granting or refusing discharge should be broadened, and they should be authorized to postpone discharges for a time and require bankrupts, during the period of suspension, to make some satisfaction out of after-acquired property as a condition to the granting of a full discharge.

The choice of the liquidating personnel should be limited to competent individuals or organizations after careful consideration by the courts of their qualifications and ability to maintain an efficient and permanent staff for the conduct of the business. Compensation for such services should be upon a scale which will attract trained business organizations. Competent officials should be continuously charged with the observance of the administration of the law and charged with the duty to suggest to the courts and to Congress methods for its improvement. The present statute is susceptible of improvement to eliminate delay in its cumbersome processes, much of which results from a confusion of judicial and business functions."⁹⁶

It can be seen that his recommendations are along English lines. The New Deal bankruptcy legislation has only proceeded in part along English lines. Liquidation thereunder is largely under court supervision. The new sections on compositions and extensions, reorganization of railroads engaging in interstate commerce, corporate reorganizations, and municipal debt readjustments⁹⁷ did, however, attempt to take over and conserve

⁹⁶ Sen. Doc. No. 65, p. xi, xii (1932).

⁹⁷ The municipal debt readjustment provisions have been declared unconstitutional, but new legislation has been enacted. See note 82 *supra*.

the estates before they had become insolvent in the American bankruptcy sense. To this extent and to the extent that they provided new machinery that was much needed for liquidation they have been an improvement.

Legislation is now pending in Congress to revise and integrate the Bankruptcy Act of 1898 as amended through 1936.⁹⁸ The draftsmanship of the proposed legislation is clearly an improvement. That legislation attempts to prevent some of the abuses which have occurred under "strict bankruptcy," in corporate reorganizations, and in compositions and extensions. But it fails to provide necessary protection to the credit structure in dealing with the non-voluntary, non-corporate debtor, inasmuch as it clings to the notion that insolvency means excess of liabilities over assets as a fair valuation. An understanding of the defect of pending legislation, however, is impossible without an understanding of the method of arrangements existing in this country prior to the depression and the changes in the method of arrangements wrought during the depression.‡

⁹⁸ This bankruptcy legislation popularly known as the Chandler Bill, because it has been so ably championed by Congressman Walter Chandler, was first introduced on May 28, 1936, as H.R. 12889, reintroduced on April 15, 1937, as H.R. 6439, and again on July 28, 1937, as H.R. 8046. It represents the careful and considered work of several years. It has passed the House and if finally enacted will represent a distinct improvement. Representative Lea has also introduced the Committee Act, H.R. 6968, and Senator Barkley has introduced the Trust Indenture Act, S. 2344, measures which in one form or another are necessary for the improvement of reorganization practice. The Chandler, Lea and Barkley bills are examined in the subsequent article. While the writers will have some criticism of these measures, it is not to be doubted that, if properly integrated and revised in some particulars, they represent a forward step of great importance.

‡ The changes in reorganization practice in the United States and proposed federal legislation will be dealt with in a second article to be printed in the next issue of this *Review*.