

## BANKRUPTCY LAW AND PEACEABLE SETTLEMENTS OF BUSINESS FAILURES

A remarkable feature of the financial stringency of last year and its resultant industrial depression, from which we are now happily emerging, was the comparatively little increase of litigation over mercantile failures occasioned thereby. Naturally it would be thought the courts would have become clogged with a multitude of insolvent estates, as one business house after another became involved in financial difficulties. On the contrary, it was remarked with surprise that in most sections of the country there was by no means any great increase in litigation concerning mercantile failures. Such a condition is decidedly unprecedented. It was not so during the industrial depression of 1893. During that depression the courts were crowded with insolvency litigation.

The chief causes of the exceedingly satisfactory condition during the present period are to be found where commonly they would not be looked for, namely, first, in the existence of a National Bankruptcy Act, prohibiting the giving of preferences by insolvent debtors and annulling levies of legal process on insolvent estates by creditors; and, second, in the existence of well developed organizations of credit men and kindred associations throughout the country, who have been acting under the wing of the bankruptcy law, in bringing about settlements and commercial readjustments out of court in cases of failure.

The last report of the committee on bankruptcy laws of the National Association of Manufacturers contains some striking observations on the relation of the bankruptcy law to the recent panic. That report says:

“During the miniature reign of financial terror in the last ten weeks of 1907 the National Bankruptcy Act of 1898 stood guard over the business interests of the country. It counseled patience, tolerance, balance. Many thousands of worthy men were saved by it who, if it had been absent, would have been forced into insolvency and ruined. By heading off all summary seizures of the debtor's property by legal process, this law gave him time to realize on his outstanding accounts, allowed him a chance to get accommodation from the banks, and thus cleared the way for him to gradually meet all his obligations, or to meet all that was possible for him to meet. The old time incentive for any particular creditor to rush in ahead of all the others and get an attachment on

the debtor's property being absent, the old time temptation for the debtor to grant special favors to any creditor being lacking, and the old time opportunity for the dishonest debtor to make fraudulent transfers of his property being removed, the law granted a square deal to all the creditors, enabled the debtor to lay his affairs candidly before all of them, and gave all of them an interest in permitting him ample time to make the best possible settlement with them. Under the protection of this beneficent statute the debtor escaped needless harassment, his estate was saved from the vexatious litigation and heavy court expenses of the days immediately previous to its enactment, and in the vast majority of instances all the creditors obtained one hundred cents on the dollar. In this way the area of the financial disturbance was narrowed, the destruction was materially diminished, and the return of business confidence and the renewal of prosperity will be hastened."

Likewise the last report of the National Association of Credit Men contains interesting testimony to the same effect. In this report the committee says:

"In connection with this part of the committee's work its attention has frequently been called to statements in which the Bankruptcy Act has been made to appear as an instrument for the propagation of fraud. Such statements should not go unchallenged, evidently being made at random and without a true knowledge of existing conditions. Your committee asserts without fear of contradiction that commercial fraud will always exist with or without a Bankruptcy Act upon the statute books of the country, and further asserts that no remedy at law has ever before been given to creditors so far-reaching as the present law in the opportunities it affords for stamping out fraudulent practices.

"In closing, your committee expresses the opinion that the existence of a Bankruptcy Law upon the statute books had a far-reaching and most salutary effect in the early fall of last year [1907] when every sign indicated that the country was on the verge of a disastrous and widespread financial panic. The law undoubtedly stayed the hand of many an anxious creditor who, unable to secure a preference to himself, joined in extending help to his embarrassed debtor, thus tiding over many a deserving business man."

The last decade has witnessed the growth of a new force in the credit world, the growth of various large associations of merchants, manufacturers and also of credit men, having for their common objects not only the spreading of better acquaintance and the interchange of ideas among business men of the particular cooperation among creditors in case of a debtor's failure, the promoting of frankness on the debtor's part towards his creditors, and the instituting of prosecutions of fraudulent debtors and the

stamping out of fraudulent practices. These organizations in the various lines of industry and in various fields—among some of the most powerful of which are the National Association of Credit Men and the National Association of Manufacturers, etc., from whose minutes the extracts above given were taken—number their members now by the thousands and form a quiet but powerful force in the larger commercial communities. Besides their other functions, almost all these organizations take up the practical subject of the giving of trade credits, and the legal matters incident thereto. They lobby for the enactment of better laws in relation to commercial dealings. Finally, whenever a merchant becomes insolvent at once their special bureaus become active; creditors are called together, the debtor is brought before them, explanations are demanded, and then follow discussions of the best way to minimize the loss and to extricate the parties if possible from the common disaster. Most of these associations have standing committees whose duties are to investigate business failures, to take action in cases of fraud, and in other cases to devise possible settlements of the estates in a manner economical and advantageous to all concerned. The value of the movement among business men can hardly be overestimated. It marks a decided step forward in business morals and behavior. It looks toward peace and rational conduct in the emergency of business failure.

All this has been rendered possible, as will readily appear, solely through the existence of the Federal Bankruptcy Law. The distinctive feature of Bankruptcy Law, other than its celerity of procedure and its drastic examinations of bankrupts and others, is the protection it throws about the insolvent estate, to prevent its depletion. Its peculiar object is the protection of the insolvent debtor's estate from seizure by one creditor to the exclusion of other creditors, and from the giving of preferences therefrom by the debtor to one creditor over another. Its underlying theory evidently is that, so long as a merchant is solvent he is doing business on his own money and may do with as he will, but the moment he becomes insolvent he ceases to be doing business on his own money—he has spent his own—and is beginning to do business upon his creditors' money. From this premise it necessarily follows, in theory, then, that the remaining assets in the debtor's hands are the property of his creditors, for whose benefit he merely holds them. The law does not say so in very words, but in the philosophy of the law and in economics some such

theory must certainly lie at the basis of the peculiar protection thrown about the insolvent fund by the Bankruptcy Law. Therefore it is that the debtor, when he becomes insolvent, is prohibited by the Bankruptcy Law from making transfers to one of his creditors of more than that creditor's proportionate share; that is to say, it prohibits "preferences," by permitting their recovery from the creditor preferred—if bankruptcy follows within four months. Thus it is, also, that the law renders nugatory the seizure under legal process by one creditor of any part of the insolvent estate within the same limited period before bankruptcy. These are the only rights and remedies conferred by the Bankruptcy Law that are peculiar, and they are conferred precisely in order that insolvent estates may be administered for the creditors as a whole and not be given over to one or two who may be preferred by the debtor or who may resort to legal process before others.

This explanation of the objects and operation of the Bankruptcy Law makes plain how essential to the successful action of these great organizations of business men in their work of amicable adjustment of failing debtor's affairs is the existence of the law. During those periods in our history when we have had no Bankruptcy Law, mutual confidences between debtors and creditors were impossible and likewise was impossible any cooperative action among creditors themselves. Insolvency always meant lawsuits. If one creditor had suspicion that a debtor was about to fail, immediately such creditor would rush to court and levy an attachment or execution. Then would begin a mad race for precedence between executions, attachments, etc.—between the sheriff, receiver, assignee and mortgagee—to see which one would get possession of the debtor's property first, the receiver frequently finding upon arrival that he was forestalled by the sheriff under a levy or by some preferred mortgagee or assignee placed in possession by the debtor. In those days there was no possibility of cooperation among creditors, no incentive to a frank recital by a debtor to his creditors of the true condition of affairs, no chance for peaceable adjustment. Each creditor was eyeing the others, ready at a moment's notice to rush in ahead of them. It was the unmitigated reign of the "Survival of the Fittest."

Under the stern rule of the Bankruptcy Law, however, this wild scramble for precedence has ceased and cooperation among creditors has become the order of the day. This change was

particularly manifest during the financial depression just passing. Instead of creditors rushing to the courts, instead of debtors giving preferences, debtors and creditors alike have assembled in meetings, and there the debtor's books have been examined, his resources been inquired into, he and his creditors have consulted together; and in numberless cases, readjustments of his affairs have been effected upon a basis satisfactory to all, without court proceedings and with mutual good will.

Utopians have pictured to us a society where the laws were so plainly written and plainly just, so truly in harmony with the mutual well being of the community and individual, that they were self operating, having the common assent and appreciation of all. Such is coming to be, in a partial degree, at any rate, the recognized relation of the Bankruptcy Act to the business community. The Bankruptcy Law has been in quiet but efficient operation all the time in the midst of the commercial failures of the last year, staying the hand of the creditor from the effort to gain advantage over his fellows and bringing about a rational and business-like settlement of affairs between the debtor and his creditors; yet, during all that time the courts have not been called upon materially to increase their operation on this account, so certain and well recognized are the prohibitions of the Bankruptcy Law.

The true place of National Bankruptcy Law in the community has been little understood by the people at large; although it is true that the different associations of business men of the country have been most widely awake and keenly appreciative of its influence and operation, through whom a more adequate conception of its benefits to the commercial world is gradually being developed.

The Bankruptcy Law is commonly considered to be merely a temporary law, devised for enactment at periodical intervals, with the object of freeing the accumulation of insolvent debtors from the burden of their debts; but such is a wholly inadequate idea of the place and function of Bankruptcy Law. Indeed, release from debts was no part of the original bankruptcy jurisprudence of England, from which our own was derived, but was an incident added in the course of later development. Bankruptcy jurisprudence was half as old as it to-day, and it is now, as a system of jurisprudence, nearly four hundred years old, before there was any thought in it of granting debtors a discharge from their debts; and then discharge was only granted on the condition that the

debtor had honestly and faithfully turned over all his assets and disclosed all his transactions to his creditors. The object of Bankruptcy Law in the beginning was solely the protection of the creditor. It began when men began to do business on credit. It arose out of the necessities of the credit system and has developed as that system has developed; and to-day is its chief bulwark and stay.

In our own country it was part of the original concept of the framers of our Constitution itself that bankruptcy laws should be the subject of National, not State, Legislation. Not as an afterthought, not in any of the amendments of the Constitution, but in the very First Article of the body of the Constitution, itself—indeed, in the eighth clause of the First Article of the Constitution—it was provided that “Congress shall have power to enact uniform laws on the subject of bankruptcies throughout the United States.” It was seen even at that early period to be essential to the stability of business and commerce that the subject of insolvent estates should be controlled by Congress, by the general government. This was one of the things concerning which there never was any doubt. Whatever doubt there was about Slavery, about States Rights, about Interstate Commerce, etc., etc., there never was any doubt that the administration of insolvent estates was a subject peculiarly proper for Congress to control under uniform laws throughout the entire country.

To these two forces working together, the Bankruptcy Law and the associations of business men mentioned working under its protection, we may expect, so it seems, still further progress in the direction of sane and sensible action in regard to insolvent debtors and of rational and friendly adjustment of their affairs.

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