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The New Bankruptcy Rules: Relices of the Past as Fixtures of the Future

Jonathan M. Landers

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By Jonathan M. Landers*

Change is coming to bankruptcy-land. For a normally lackluster subject area, developments in these first years of the decade of the 70's have been startling. In March of 1971, the Advisory Committee on Bankruptcy Rules published a draft of proposed rules with a promise of additional rules for the Chapter proceedings;[1] that promise has already been partially fulfilled with publication of rules for Chapter XIII, Chapter XI, and Chapter X cases in September 1971, October 1972, and December 1972 respectively.[2] And in late 1971, the prestigious Brookings Institution published its long awaited study (or more properly, indictment) of the bankruptcy system. The Brookings conclusion was harsh and blunt:

> This assembly of administrative and fiscal error and confusion has become an accepted way of professional life for the personnel of the bankruptcy courts, their supervisors, the district court judges, and members of the bankruptcy bar. The problems are so pervasive and so interlocked that partial solutions are not acceptable. The mess is too bad to tinker with. We need a new bankruptcy act, a new organizational structure, a new personnel system, a new method of financing, and new records and procedures.[3]

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1. ADVISORY COMMITTEE ON BANKRUPTCY RULES, PRELIMINARY DRAFT OF PROPOSED BANKRUPTCY RULES AND OFFICIAL FORMS UNDER CHAPTERS I TO VII OF THE BANKRUPTCY ACT (Mar., 1971). The *Draft* contains the Proposed Rules themselves, the Official Forms, and the Advisory Committee's Note to each of the Rules. In subsequent notes, I will employ the following citation forms: (1) Rule —, (2) Official Form No. — and (3) *Advisory Committee's Note to Rule* —, at —.

2. ADVISORY COMMITTEE ON BANKRUPTCY RULES, PRELIMINARY DRAFT OF PROPOSED BANKRUPTCY RULES AND OFFICIAL FORMS UNDER CHAPTER XIII OF THE BANKRUPTCY ACT (Sept., 1971); ADVISORY COMMITTEE ON BANKRUPTCY RULES, PRELIMINARY DRAFT OF PROPOSED BANKRUPTCY RULES AND OFFICIAL FORMS UNDER CHAPTER XI OF THE BANKRUPTCY ACT (Oct., 1972); ADVISORY COMMITTEE ON BANKRUPTCY RULES, PRELIMINARY DRAFT OF PROPOSED BANKRUPTCY RULES AND OFFICIAL FORMS UNDER CHAPTER X OF THE BANKRUPTCY ACT (Dec., 1972).

3. D. STANLEY, M. GIRTH, *et al.*, BANKRUPTCY: PROBLEM, PROCESS, REFORM 4 (1971) [hereinafter cited as STANLEY & GIRTH]. Although

We may soon expect the report of the blue-ribbon Commission on the Bankruptcy Laws of the United States established by Congress in 1970 to "study, analyze, evaluate and recommend changes to [the present Bankruptcy Act] in order for such Act to reflect and adequately meet the demands of present technical, financial and commercial activities."[4] Recently, the Commission's authority and appropriation were renewed for an additional year after it reported considerable progress and the likelihood of an expeditious conclusion.[5] Presumably, its report will be followed by legislative proposals and the concomitant committee hearings, reports, and congressional debates, advice from those interested in the proposed legislation, law review articles, and symposia designed to acquaint the bar with the fast moving developments.

Since the bankruptcy bar has never been accused of being in the forefront of legal reform, and since bankruptcy is an area which many practicing lawyers eschew through fear or ignorance, it may be tentatively concluded that this recent foment is evidence of fairly widespread dissatisfaction with the existing bankruptcy system. Bankruptcy law is governed by the Bankruptcy Act as supplemented by General Orders promulgated by the Supreme Court, local bankruptcy rules promulgated by various district courts, and by a variety of unwritten procedures which seem to have the force of natural law. This "bankruptcy law" has three separate dimensions: (1) substantive provisions which regulate the rights and obligations of the bankrupt, trustee in bankruptcy, and secured, priority, and unsecured creditors; (2) "administrative" provisions for collecting and liquidating the assets of the bankrupt, distributing the proceeds to creditors, and insuring that the bankrupt realizes the benefits of the Act; and (3) a procedural mechanism for resolving essentially adversary proceedings between the trustee and third parties when litigated before the referee. For convenience, these substantive, administrative, and procedural provisions are scattered in a hodge podge throughout the Act; the administrative and procedural provisions are interspersed among the general orders.

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the Brookings Institution formally disclaims responsibility for the study (*id.* at viii), it was conducted and carried out as a Brookings Institution project. *See id.* at vii.

4. S.J. Res. 88, 91st Cong., 1st Sess. (1969), *codified in* 11 U.S.C. at 2055 (1970) (annot. preceeding § 1).

5. *See Hearings on H.R.J. Res. 1006 Before a Subcommittee of the House Comm. on the Judiciary*, 92nd Cong., 2d Sess. (1972).

The Federal Rules of Civil Procedure have appeared to many as a model of procedural efficiency. Not surprisngly, it occurred to some that bankruptcy procedure could be streamlined and modernized if the same type of rules drafting expertise was applied to bankruptcy procedure. It was in 1959 that the Advisory Committee of Civil Rules of the Judicial Conference appointed an Advisory Committee on Bankruptcy Rules. Although the Committee initially contented itself with revisions of the General Orders and Official Forms, it later turned to a comprehensive code of bankruptcy procedure. Its efforts in this direction were spurred by legislation enacted in 1964 which removed the requirement that bankruptcy rules be consistent with the provisions of the Bankruptcy Act, and authorized procedural rules which would supercede inconsistent statutory provisions.[6] The Committee's report, consisting of proposed rules, official forms, and commentary, was issued in March of 1971.

This Article will evaluate the proposed rules governing the "administration" of bankrupt estates. Initial consideration will be given to the authority of the Advisory Committee to promulgate bankruptcy rules and the scope of that authority. Second, an examination will be made of the rules in the light of both the needs and problems which confronted the draftsmen and the available scope of the rulemaking power. The goal of this Article is not to provide a summary of the new rules or an outline of their main features, a task already performed by others.[7] Rather, the goal is to evaluate the rules as proposed solutions to problems encountered in administering the bankrupt's estate.

I. THE BANKRUPTCY RULES—AUTHORITY AND SCOPE

A. The Substance-Procedure Approach to Rulemaking Authority

The constitutional authorization for Congress to establish a federal court system, coupled with the necessary and proper clause of article I, section 8 of the Constitution, has been held to authorize Congress to prescribe rules of procedure for the fed-

6. 28 U.S.C. § 2075 (1970).

7. *See* Herzog, *The Impact of the Proposed Bankruptcy Rules on the Court*, 45 Am. Bankr. L.J. 363 (1971); Kennedy, *The Proposed Bankruptcy Rules and Official Forms*, 46 Am. Bankr. L.J. 53 (1972); Treister, *A Practicing Lawyer's Primer on the Proposed New Bankruptcy Rules*, 45 Am. Bankr. L.J. 343 (1971). Mr. Treister, Referee Herzog, and Professor Kennedy are all members of the Advisory Com-

eral courts.[8] Since *Sibbach v. Wilson & Co.*[9] it has been clear that Congress might delegate all its power to regulate procedure to a court, and specifically to the Supreme Court. Whether Congress could delegate the power to prescribe the substantive rules for decision is academic; each of the rules authorizing statutes has contained a limitation similar to that in the Rules Enabling Act forbidding the impairment of "any substantive rights." And so the dichotomy: Congress regulates substance; the court-promulgated rules regulate procedure.

This facile formula floats easily off the tongue, but unfortunately provides little guidance for draftsmen who are uncertain whether a particular matter is substantive or procedural. The Supreme Court has been less than helpful in articulating a governing standard. In *Sibbach*, the Court made the conclusory contribution that a rule was procedural and therefore within the rulemaking power of the Court if it "really regulates procedure, —the judicial process for enforcing rights and duties recognized by substantive law and for justly administering remedy and redress for disregard or infraction of them."[10]

Sibbach involved the familiar Rule 35 providing for physical examinations. Interestingly, Mrs. Sibbach had not argued that the rule was substantive in the sense that it did not regulate procedure. Rather, she argued, and the four dissenters would have held, that the rule was of such importance that it was beyond the rulemaking power of the Court. However, there seems little doubt the dissent would have held the rule valid if it had been enacted by Congress. The dissent therefore rejected, or at least qualified, the basic substance-procedure dichotomy in determining federal rulemaking power. It recognized a third category of nominally procedural rules which are of such importance as to not be within the Court's delegated rule making power.

The Court's next efforts were equally unenlightening. Both Rule 4(f) providing for service of process in another district in the state, and Rule 54(b) which authorized the trial judge to enter judgment on one of several claims in an action (to permit an early appeal under the finality rule) were sustained with con-

mittee which drafted the rules. Surprisingly, there appears to have been no other commentary. For a background on the rules, see Gignoux, *A Progress Report on the New Bankruptcy Rules*, 44 REF. J. 13 (1970).

8. *See, e.g.*, Wayman v. Southard, 23 U.S. (10 Wheat.) 1, 43 (1825).

9. 312 U.S. 1 (1941).

10. *Id.* at 14.

clusory statements that they were within the rulemaking power of the Court.[11] Justices Frankfurter and Harlan dissented as to Rule 54(b) on the ground that the rule abrogated, at least in part, the finality requirements of section 1291 of the Judicial Code. It is not clear whether they regarded the rule as substantive, as procedural but not within the delegated rulemaking power, or as procedural but in derogation of the requirements of section 1291. If it is the last, then it is difficult to understand their argument since the Rules Enabling Act specifically provides for the supercession of inconsistent statues, which would presumably include section 1291. It is possible, however, that the dissent regarded section 1291 as defining the "jurisdiction" of the Court of Appeals, and therefore not subject to change by rule.

The most recent foray into this area was *Hanna v. Plumer*,[12] where the Court was content to hold that Rule 4(d), which authorized service of a summons and complaint by leaving copies at defendant's home with a responsible person, was procedural because it regulated practice. Without a detailed analysis of the scope of rulemaking power, *Hanna* made two further observations. First, a broad dictum resolved any uncertainty over the scope of rulemaking power by suggesting that Congress had delegated the full extent of its consitutional power to regulate procedure to the Court. Second, the Court recognized that while many matters could be readily classified as substantive or procedural, there was an "uncertain area" containing those which were "rationally capable of classification as either." Matters falling within this uncertain area were said to be subject to regulation as "procedure."[13] It is no wonder that the decision has been widely interpreted as a virtual carte blanche to the draftsmen of procedural rules.[14]

11. Mississippi Publishing Corp. v. Murphree, 326 U.S. 438 (1945) (Rule 4(f)); Cold Metal Process Co. v. United Eng'r & Foundry Co., 351 U.S. 445 (1956) (Rule 54(b)).

12. 380 U.S. 460 (1965).

13. *Id.* at 471-72. Several decisions prior to *Hanna* had recognized such an "uncertain area" and had suggested either explicitly or implicitly that this area was subject to regulation by court-made rule. *See* Lumbermen's Mut. Cas. Co. v. Wright, 322 F.2d 759, 764 (5th Cir. 1963); Monarch Ins. Co. v. Spach, 281 F.2d 401 (5th Cir. 1960); Iovino v. Waterson, 274 F.2d 41, 46-48 (2d Cir. 1959), *cert. denied*, 362 U.S. 949 (1960); D'Onofrio Const. Co. v. Recon Co., 255 F.2d 904, 909-10 (1st Cir. 1948); Sampson v. Channell, 110 F.2d 754, 756-57 & nn. 4, 5, 7, 128 A.L.R. 394, 398-99 & nn. 4, 5, 7 (1st Cir.), *cert. denied*, 310 U.S. 650 (1940). *Cf.* 2 J. MOORE, FEDERAL PRACTICE ¶ 1.04[2] (2d ed. 1970).

14. *See* Green, *Highlights of the Proposed Federal Rules of Evi-*

While one may be critical of the federal cases as according excessive power to rules draftsmen, at the expense of Congressional control over substance, the results of state efforts to regulate the bounds of judicial rulemaking are even less auspicious. Compounding the problem faced by the federal courts in distinguishing substance and procedure are differing state constitutional and statutory provisions allocating power among governmental branches, and variances as to whether, and the extent to which, the judicial rules are subject to legislative review. The few attempts which have been made to provide guidelines defining the scope of judicial rulemaking power have been notoriously unsuccessful. The most common verbal formulation attempts to distinguish between rules which govern the just and efficient conduct of the lawsuit from those which regulate the subject matter for decision.[15] Agreement on tests, however, has not stopped bickering concerning application of the test to particular facts. Widespread disagreements over whether rulemaking authority extends to rules on venue, discretionary granting of attorney's fees, standards for directing verdicts, statutes of limitation, personal jurisdiction, class actions, discovery, provisional remedies, appeals, and injunctions in labor disputes, provide visible evidence of the failure of the bright line approach.[16]

However, the draftsmen of the bankruptcy rules did have the benefit of recent consideration of the scope of rulemaking authority by the authors of the recently promulgated Federal

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dence, 4 GA. L. REV. 1, 6, 10, 14-15 (1969); Miller, *Federal Rule 44.1 and the "Fact" Approach to Determining Foreign Law: Death Knell for a Die-Hard Doctrine*, 65 MICH. L. REV. 613, 746 (1967); Weinstein, *The Uniformity-Conformity Dilemma Facing Draftsmen of Federal Rules of Evidence*, 69 COLUM. L. REV. 353, 356, 357 (1969). Curiously, however, commentators have not objected to the delegation *qua* delegation. Rather, almost to a man, they have reflected upon possible damage to the fragile federal-state relationships protected by the *Erie* doctrine and have lamented what appeared to be federal intrusion into an area of state power. *See, e.g.*, McCoid, *Hanna v. Plumber: The Erie Doctrine Changes Shape*, 51 VA. L. REV. 884 (1965).

15. *See* Joiner & Miller, *Rules of Practice and Procedure: A Study of Judicial Rule Making*, 55 MICH. L. REV. 623, 629, 635 (1957); Riedl, *To What Extent May Courts Under Rule-Making Power Prescribe Rules of Evidence?*, 26 A.B.A.J. 601, 604 (1940).

16. The pertinent cases and differing considerations are discussed in C. CLARK, CODE PLEADING § 9, at 42 & n.116 (1947) (citing early authorities); Joiner & Miller, *supra* note 15, at 644-53; Kaplan & Green, *The Legislature's Relation to Judicial Rule-Making: An Appraisal of Winberry v. Salisbury*, 65 HARV. L. REV. 234, 253 (1951); Levin & Amsterdam, *Legislative Control Over Judicial Rule-Making: A Problem in Constitutional Revision*, 107 U. PA. L. REV. 1, 15-17, 21-22 (1958).

Rules of Evidence.[17] While some commentators were uneasy about rulemaking in such controversial areas of quasi-substantive rules as dead man's statutes, presumptions, and evidentiary privileges,[18] most of this uncertainty had dissipated by the time the draftsmen got down to work in earnest, following the decision in *Hanna v. Plumer*. The commentary on the Rules reveals virtual unanimity that such quasi-substantive rules were within the scope of the evidentiary rulemaking power.[19] Rather, the disputes involved *Erie*-type questions of the potential intrusion of federal evidence rules into areas of state substantive power: some urged a deference to state evidentiary rules notwithstanding federal power, while others felt no pangs about prescribing federal rules which were inconsistent with state rules.[20] Their apparent uniformity on the power question has obvious overtones for defining the scope of bankruptcy rulemaking.

B. Bankruptcy Rulemaking and the Substance —Procedure Dichotomy

The failure to articulate a workable substance-procedure delineation is particularly troublesome when attention is turned to bankruptcy rulemaking. In addition to rules governing substance and procedure there is a third category of bankruptcy rules which might be called administrative, *viz.*, rules governing

17. Both the Senate and House have recently passed legislation which would delay the effectiveness of the Federal Rules of Evidence. *See* text accompanying notes 153-54 *infra*. Justice Douglas had previously dissented from the adoption of the Rules on the ground that they were not within the authority delegated by the Rules Enabling Act to regulate "practice and procedure." Order Prescribing Federal Rules of Evidence, 56 F.R.D. 184, 185 (1972) (Douglas, J. dissenting). *See generally* 2 J. Moore, *supra* note 13, ¶ 1.04 [1], at 213-15 & n.13; 5 *id.* ¶ 43.03.

18. *See* Joiner & Miller, *supra* note 15, at 650-51; Riedl, *supra* note 15, at 605.

19. *See* authorities cited in note 14 *supra*; Wright, *Procedural Reform: Its Limitations and Its Future*, 1 Ga. L. Rev. 563, 571-74 (1967). *See also* Degnan, *The Law of Federal Evidence Reform*, 76 Harv. L. Rev. 275, 294-96 (1962); Levin & Amsterdam, *supra* note 16, at 22-24. The House of Representatives in delaying indefinitely the effectiveness of the Rules, expressed some doubt whether such evidentiary rules were within the scope of the authority delegated by the Enabling Act. 119 Cong. Rec. H 1723, H 1724, H 1727, H 1729 (daily ed. Mar. 14, 1973) (remarks of Reps. Smith, Hungate, Holtzman, Moorhead).

20. *Compare* Weinstein, *supra* note 14, at 363-73, 376, *and* Wright, *supra* note 19, at 571-74, *with* Green, *supra* note 14, at 10-17. *See also* 119 Cong. Rec. H 1727-28 (daily ed. Mar. 14, 1973) (remarks of Rep. Holtzman).

the collection of the bankrupt's assets, the administration of his estate, and the distribution of the bankrupt estate among administration expenses, priority creditors, secured creditors, and general creditors. In some cases an administrative matter may evolve into a contested proceeding, as when a creditor objects to the bankrupt's discharge, or refuses to turn over the bankrupt's property to the trustee, or where there is a question regarding the proper amount of a creditor's claim. Regardless of any participation by a party in interest, there are a great many matters of an administrative nature which must be prescribed in administering the estate.

Apparently the Congress was oblivious to any deviation from prior delegations of rulemaking authority when it granted the Court rulemaking power in bankruptcy. Section 2075 of the Judicial Code, which sanctions the promulgation of the bankruptcy rules, tracks the language of the Rules Enabling Act[21] which authorized the civil rules by permitting the Court to promulgate "the forms of process, writs, pleadings, and motions, and the practice and procedure under the Bankruptcy Act." The language itself—"writs, pleadings, and motions"—bespeaks of rules for litigation and not administration. Thus, even assuming a workable substance-procedure distinction for litigation-related matters, it remains unclear whether (1) Congress has the power to delegate *all* administrative rulemaking as being within the "procedural" category, and (2) if not, which standard separates those administrative areas which cannot be the subject of rulemaking from those which are. For example, could the Rules specify the circumstances under which the bankrupt may be discharged? Or, could they provide that the trustee would be appointed by the court in all cases? This problem is compounded because the Rules will supercede inconsistent statutes. Although other grants of rulemaking authority have had similar supercession provisions,[22] the bankruptcy rules represent the first instance of pervasive supercession of governing provisions of the Act. The four *Sibbach* dissenters might be more than a little uneasy about this feature.

When the bankruptcy draftsmen undertook to define the scope of their rulemaking authority, the Advisory Committee faced uncertainty over the substance-procedure dichotomy, a lack of clarification in enabling legislation, and the need to draft rules for the first time in this new "administrative area." As a

21. 38 U.S.C. § 2075 (1970).
22. *See id.*

result, the Committee adopted an attitudinal test which narrowly construed the scope of the Committee's authority in recognition of their status as nonelected draftsmen appointed by judges who similarly do not stand for election to public office. For example, Professor Kennedy, Reporter for the Advisory Committee, has noted that the substance-procedure question came up frequently and that the "general disposition of the Committee was not to press to the outermost reaches of the authority granted but rather to defer to congressional judgment and power in cases of doubt."[23] To be sure, such an approach is not without precedent. Professor Wright has stated that one reason for the widespread acceptance of judicially formulated rules has been the essential conservatism of the draftsmen and the limited change which has in fact been proposed. Indeed, he has noted that the much heralded Federal Rules were not really an innovative code, but simply a compilation in one document of the best features of prior federal and state procedural codes.[24]

This "arguably substantive therefore for Congress" approach (to paraphrase Mr. Justice Harlan) was an improper standard for the draftsmen to adopt. First, it ignores both the teaching of *Hanna* and the approach of the draftsmen of the evidence rules which called for a broad construction of the enabling authority to embrace matters in the "uncertain area" between substance and procedure as well as matters clearly procedural. Second, much of the authoritative discussion concerning rulemaking powers of courts is in the context of areas of exclusive judicial rulemaking authority not subject to legislative correction. When such is the case, there is good reason to narrowly circumscribe the area not subject to control by the elected representatives of the people.[25] In the case of the bankruptcy rules, however,

23. ADVISORY COMMITTEE ON BANKRUPTCY RULES, *supra* note 1, at xxxv-xxxvi; Kennedy, *supra* note 7, at 57; Seligson, *The New Bankruptcy Rules,* 76 COM. L.J. 383, 384 (1971). Mr. Treister, another member of the Committee, saw the matter somewhat differently; he termed the Committee's approach with the indicated scope of its authority as "rather bold." Treister, *supra* note 7, at 343.

24. Wright, *supra* note 19, at 574-77, 578-79; *cf.* Weinstein, *supra* note 14, at 373 (should avoid rulemaking on issue of privilege since opposition to provisions proposed may cause downfall of entire set of proposed rules). *See also* Wolf v. Barkes, 348 F.2d 994, 996 (2d Cir.), *cert. denied,* 382 U.S. 941 (1965) (rule preventing settlements of derivative suits without court approval does not apply to settlement by corporation; contrary result might raise questions of an improper intrusion into the area of substantive rights), criticized at Comment, 70 HARV. L. REV. 1526, 1530-31 (1966).

25. *See* Kaplan & Green, *supra* note 16, at 253 & n.80.

Congress has authorized the rules and the supercession of inconsistent statutes, and can presumably veto any or all of the proposed rules.[26] Third, many cases supporting a hesitant approach involved additional considerations of federalism and a deference to state power under the *Erie* doctrine, thus causing the courts to interpret the permissible area of federal regulation more narrowly.[27] No consideration of federalism is involved in bankruptcy rulemaking. Fourth, unlike civil practice generally, or rules of evidence, bankruptcy is an acutely specialized area beyond the ken of many lawyers, let alone the average legislator. Consequently, there is more basis for rulemaking by experts in bankruptcy than in the areas of procedure or evidence. In this sense, an analogy to the delegation of rulemaking authority to expert administrative agencies may be pertinent. The analogy is particularly apt in light of the Brookings' proposal which would place bankruptcy adjudication in the hands of an administrative agency. And with two exceptions, widely regarded as aberrations,[28] there have been no federal cases which have invalidated a delegation of broad power to an administrative agency.

Moreover, such a hesitant approach is somewhat out of place in the decade of the seventies. Whether or not it was justified in an era characterized by suspicion of the judiciary and exultation of the legislative branch of government is academic. "Lawmaking" by nonlegislative bodies—whether judicial or administrative —is infinitely more acceptable today than it was more than a quarter century earlier when the procedural reform movement was in its infancy. Further, the specialized nature of bankruptcy practice, the widespread cries for reform, and the publicized deficiencies call for broad-based procedural innovation.

This may in fact be a situation when half a loaf is worse than none. As already noted, in 1970 Congress created a commission to study the Bankruptcy Act. The relationship between the area of study of the Bankruptcy Commission and the bankruptcy rules, then presumably nearing completion, was left in the dark. Several supporters of the legislation authorizing the

26. *See* 28 U.S.C. § 2072 (1970).

27. *See* Cohen v. Beneficial Loan Corp., 337 U.S. 541 (1949); Ragan v. Merchants Transfer & Whse. Co., 337 U.S. 530 (1949).

28. *See* A.L.A. Schechter Poultry Corp. v. United States, 295 U.S. 495 (1935); Panama Ref. Co. v. Ryan, 293 U.S. 388 (1935). These opinions "do not embody the effective law." 1 K. DAVIS, ADMINISTRATIVE LAW TREATISE § 2.06, at 101 (1958). For a recent decision upholding a broad delegation, see Arizona v. California, 373 U.S. 546 (1963).

commission noted the existence of the Advisory Committee on Bankruptcy Rules and its activities but gave no indication of what the relationship between the two groups would be.[29] For example, would the bankruptcy study commission exclude study of procedural reform and accept the work of the Rules Committee, or would the two overlap? Presumably, the rules would be superfluous if some possible alternatives to the present bankruptcy administration were adopted. For example, the Brookings' proposal for an administrative agency, and other proposals for a corps of professional bankruptcy officers, would make many of the rules dealing with administrative matters obsolete.

However, the main danger is not that the work of the Advisory Committee will be rendered useless. It is instead that the Bankruptcy Commission may defer to the recommendations of the Rules Committee in toto even though the Rules Committee has admittedly failed to fully occupy the procedural field. A situation could develop where the Rules Committee had not proposed certain reforms or changes because it felt that it lacked the requisite authority and the Bankruptcy Commission subsequently refused to consider changes because of a deference to the Rules Committee in the area of procedural rulemaking. Moreover, even if the Bankruptcy Commission were disposed to consider procedural reforms which the Advisory Committee felt it could not propose, it would have no means of identifying the "open" areas since the Advisory Committee has not distinguished reforms which were rejected "on the merits" from those which were rejected because they were more properly the subject of legislation. If the Rules Committee in fact left a sub-

29. *See Hearings Before a Subcommittee of the House Committee on the Judiciary on S.J. Res. 88*, 91st Cong., 1st Sess. 11, 24 (1969) (statements of Hon. Ernest C. Friesen, Jr., Director of the Administrative Office of the United States Courts and Hon. Edward Weinfeld, United States District Judge). There is some suggestion in both statements that the bankruptcy rules were to fully occupy the procedural field. For example, Mr. Friesen stated that the rules would "supplant every procedural section of the Act," and Judge Weinfeld suggested that the Bankruptcy Commission would have the procedural rules and could "concentrate on the substantive provisions" of the Act. However, the statements are too cryptic to draw any meaningful conclusions. In the hearings on the renewal of the Bankruptcy Commission's appropriation, Professor Kennedy replied to a question about the relationship of the rules to the work of the Commission by stating that the rules covered "procedural provisions," and that there would be "close articulation" between the rules effort and the work of the Commission. *Hearings, supra* note 5, at 25. *See also* Jackson, *Bankruptcy Administration—Bringing it Into the Twentieth Century*, 75 COM. L.J. 159, 166 (1970).

stantial area of procedural rulemaking alone because of questions about the scope of its authority, then perhaps it would have been preferable to defer the entire matter of procedural change to the Commission, with its results to be presumably incorporated into legislation, thereby avoiding any possible objections to court-made rules. Unfortunately, partial reform is often sufficient to take the edge off demands for reform, merely changing appearances but leaving the basic problems still unsolved.[30]

In sum, the draftsmen of the Bankruptcy Rules started with a substance-procedure test which gave little or no clue to the extent of the rulemaking power in the area of rules governing the administration of the bankrupt's estates. The draftsmen filled the void by adopting an attitudinal preference for a narrow construction of their authority. Such a construction was inconsistent both with *Hanna* and with interpretations of the same problem in connection with the drafting of the Rules of Evidence. Moreover, the construction was based on precedent in other areas which ignored the specialized nature of the bankruptcy process. Finally, the construction adopted by the draftsmen could have unforeseen consequences because of a prior failure to allocate responsibility for procedural reform between the Rules Committee and the Bankruptcy Commission. It would be unfortunate if the Advisory Committee passed the ball to the Commission on the ground of lack of power, only to find that the Commission decided to accept the Advisory Committee's work to "avoid duplication of effort" and to "avoid infringing on the sensibilities of hard working and conscientious men."

In the next section, the rules themselves will be examined and evaluated. In that connection, it will be seen that in some cases meaningful procedural reform was inhibited by the draftsmen's limited conception of the scope of their authority. However, it will be observed that in other cases the draftsmen have not faithfully observed this limitation on their authority. For example, some rules appear to deviate without explanation from the theory of rulemaking restraint articulated by Professor Kennedy.

II. THE NEW RULES: ARE THEY REALLY "NEW"?

Before turning to specifics I think it only fair to state my overall evaluation. The draftsmen have acted largely as editors of the present statute and General Orders rather than as inno-

30. *See* Furness, *The Time is Now*, 4 TRIAL, Aug.-Sep., 1968, at 17.

vators of new procedures for administering bankrupt estates. Duplicative provisions have been consolidated; senseless provisions have been eliminated; terminology has been cleaned up. Cosmetic changes have also been proposed, such as increasing the apparent prestige of the referee's office—to be accomplished in no small part by changing his title to Bankruptcy Judge, and perhaps permitting him or her to don the judicial robe. Real reform, however, remains an ephemeral goal. The typical case will grind along much as it did before.

The method I have adopted in evaluating the new rules is as follows: I have considered the various steps in a typical bankruptcy proceeding chronologically, recognizing, of course, that they may not occur in the specified order in all cases. In each case I have attempted to identify the salient features of the existing procedure, identify any deficiencies, and evaluate the solution of the proposed rules. Moreover, it should be noted that it is somewhat misleading to speak generally about bankruptcy proceedings. Slightly more than 90% of bankruptcy cases involve nonbusiness bankruptcies, and in 85% of the cases there are no assets available to creditors.[31] Procedures which may be well suited to a large estate involving many creditors and substantial assets are not necessarily best for cases which involve the distribution of a few hundred dollars to creditors. However, aside from a few special rules applicable to no-asset cases, the small asset case proceeds in much the same way as one involving the distribution of several million dollars. Where appropriate, therefore, it may be necessary to focus on a particular type of bankruptcy case to evaluate the rule.

A. Commencement of the Proceeding

1. *Jurisdiction and Venue*

Proposed Rule 116 would authorize a bankruptcy proceeding to be filed in any district in which the bankrupt has his residence, domicile, or principal place of business, and, in the case of a corporation, at its principal place of business or at the location of its principal assets. The rule also provides for free transferability—regardless of whether venue was originally proper[32]—to

31. All of the statistics set forth herein and not further identified are based on Administrative Office of the United States Courts, Table of Bankruptcy Statistics (1971). This report covers distributions in cases terminated during the fiscal year ending June 30, 1969.

32. If none of the factors supporting venue were present, the court would lack subject matter jurisdiction. *Advisory Committee's Note to Rule 111*, at 22.

other districts when required "in the interest of justice and for the convenience of parties." The rule implements sections 2a (1) and 32 of the Act which although cast in jurisdictional terms had been held to be venue provisions.[33] In one respect, Rule 116 is somewhat narrower than section 2a (1) of the Act in eliminating residence or domicile as a basis for corporate venue, and somewhat broader in authorizing corporate venue at the location of the corporation's principal assets. In addition, Rule 116 (a) (4) would authorize a petition by or against an "affiliate" of the bankrupt to be filed in the same court. An affiliate is defined to include a subsidiary, parent, or person directly or indirectly having 25% voting power. The likelihood that such affiliates will have financial difficulties which are inextricably interwoven with the bankrupt makes this an eminently sensible provision. Nevertheless, this clear expansion of venue over affiliates is recognized by the draftsmen to go beyond the liberal venue provisions of Chapter X contained in section 129 of the Act.[34]

The stimultaneous expansion and contraction of venue provisions is of significance because prior draftsmen of procedural rules have been more than a little uncertain about their authority to prescribe rules governing venue. For example, Rule 82 of the Federal Rules of Civil Procedure specifically eschews any "construction" of the rules to expand venue in an apparent recognition that venue is a substantive matter and beyond the pale of judicial rulemaking.[35] While one cannot quarrel with the obvious attempt of the draftsmen to place the locus of bankruptcy at the center of corporate activity, the bankruptcy draftsmen evidently resolved this troublesome question of altering venue provisions by rule without so much as a peep.

Proposed Rule 117(b)(4) builds on the venue provision to specifically authorize the joint administration of the estates of the bankrupt and its affiliate; such authority was previously based on the decided cases.[36] The draftsmen realize that joint administration must be distinguished from a consolidation of assets and liabilities of affiliated and related parties, which is said to be based on "substantive considerations." However, the ready

33. *See, e.g.*, Bass v. Hutchins, 417 F.2d 692, 694-95 (5th Cir. 1969); *In re* Eatherton, 271 F.2d 199 (8th Cir. 1959).

34. *Advisory Committee's Note to Rule 116*, at 35-36.

35. *See* Joiner & Miller, *supra* note 15, at 649; Levin & Amsterdam, *supra* note 16, at 17. None of the commentary by those involved in drafting the rules considered the Committee's resolution of the authority issue worthy of mention. *See* authorities cited at note 7 *supra*.

36. *See Advisory Committee's Note to Rule 117*, at 40.

authorization of joint administration, considered in conjunction with the absence of specific authority in the past, may encourage the "small" additional step of consolidation, especially if the trustee finds complicated inter-company transactions, inadequate records, or that joint administration has already resulted in a de facto consolidation. This procedural change thus may have subtle substantive overtones in that future bankruptcy courts considering consolidation may not be as discriminating in future cases as they have been in the past.[37]

2. Adjudication

Under the new rules, the filing of a voluntary petition remains substantially the same and presents no significant problem; filing constitutes an automatic adjudication that the petitioner is a bankrupt.[38] However, involuntary petitions remain problematical; several of the proposed rules regulating involuntary petitions seem destined to continue, and perhaps increase, the current unpopularity of the involuntary route.

Under the Bankruptcy Act, involuntary petitions must be initiated by three creditors (one if the bankrupt has fewer than 12 creditors) with claims of $500 or more, and must allege a basis for venue, the existence of debts of $1,000 or more, the debtor's status as a person who may be subject to adjudication, and an act of bankruptcy.[39] Proposed Rule 104(c) requires that the alleged act of bankruptcy be stated with sufficient particularity to permit identification of the transaction involved, thus preventing creditors having only a suspicion that an act has taken place, but lacking hard evidence, from alleging the acts in statutory terms and filling in the gaps through discovery.

The "act of bankruptcy" concept is justified because it identifies those cases where creditors may be prejudiced by dismemberment of the estate or by nonbankruptcy procedures which frustrate the scheme of distribution in bankruptcy, or cases where the bankrupt is in fact insolvent.[40] However, the first

37. *See In re* Flora Mir Candy Corp., 432 F.2d 1060, 1062 (2d Cir. 1970) ("consolidation . . . is no mere instrument of procedural convenience . . . but a measure vitally affecting substantive rights"). For examples where consolidation was directed, see Chemical Bank N.Y. Trust Co. v. Kheel, 369 F.2d 845 (2d Cir. 1966); Sampsell v. Imperial Paper & Color Corp., 313 U.S. 215 (1941).

38. Bankruptcy Act § 18f, 11 U.S.C. § 41(f) (1970).

39. Rule 104.

40. *See* J. MACLACHLAN, HANDBOOK OF THE LAW OF BANKRUPTCY §§ 62-70 (1956); Treiman, *Acts of Bankruptcy: A Medieval Concept in*

three acts—fraudulent conveyances, preferences, and judicial liens—are most effective when concealed or "done quietly." Creditors who do not know of the act or simply have vague suspicions are still in need of the Act's protection. Consequently, it may be argued that creditors should be able to commence an involuntary proceeding without proof of one of the specific acts, and should instead be afforded an easier route such as a showing of insolvency in the equity sense. Much the same reasoning applies to the requirement of three petitioning creditors; if the purpose of the act of bankruptcy doctrine is to identify cases involving potential danger to creditors, one creditor should suffice. The provision of the Bankruptcy Act requiring three petitioning creditors and an "act of bankruptcy" reflects an uneasy compromise on the basic policy issue of the desirability of permitting involuntary petitions.

The Advisory Committee apparently believed that any change in the "act of bankruptcy" provisions was beyond the scope of its rulemaking power because changes would tend to encourage or discourage involuntary petitions.[41] This hesitancy leaves these provisions in a state of uncertainty: on one hand involuntary petitions remain authorized, while on the other the existing provisions prevent the bringing of involuntary petitions in instances where they appear most justified as a matter of policy. Had the Committee construed its power broadly, as suggested, it could have considered the efficacy of the present provisions in serving their intended purposes, and suggested alternatives. However, even with a limited conception of its authority, the Committee could have ameliorated the creditor's present burden in bringing involuntary petitions by allowing notice pleading or some form of pre-petition discovery proceedings.

Proposed Rule 104(b) codifies the established case law, holding creditors who have participated in an act of bankruptcy (other

Modern Bankruptcy Law, 52 HARV. L. REV. 189 (1938); Note, *"Acts of Bankruptcy" in Perspective*, 67 HARV. L. REV. 500 (1954). Under the bankruptcy laws of foreign jurisdictions, bankruptcy may be invoked when the debtor is insolvent in the equity sense or if the debtor has ceased to pay his debts. 1 W. COLLIER, BANKRUPTCY ¶¶ 3.02, 3.03 (14th ed. 1971) [hereinafter cited as COLLIER]. The American Act has opted for the debtor's control over his destinies despite insolvency. *See* Cook v. Tullis, 85 U.S. (18 Wall.) 332, 340 (1873); Wilson v. City Bank, 82 U.S. (17 Wall.) 473, 486 (1873) (act does not cover *all* cases of insolvency; in great majority of cases, debtor has opportunity to try to recover without bankruptcy).

41. *See* ADVISORY COMMITTEE ON BANKRUPTCY RULES, *supra* note 1, at xxxvi; Kennedy, *supra* note 7, at 59 n.3.

than certain assignments and receiverships) estopped from acting as petitioning creditors. Here, the draftsmen seem oblivious to a possible problem. Generally, although courts "make law" by virtue of individual decisions and the force of stare decisis, the codification of this law becomes a substantive matter beyond the power of judicial rulemaking.[42] The authoritative basis for codifying this doctrine of estoppel is not apparent.

The rules carry forward the traditional provisions governing proof of solvency: The bankrupt still has the burden of pleading and proving his solvency on the day of the petition as a defense to the first act of bankruptcy.[43] The creditor will retain the burden of proving insolvency as an element of the first, second, third, and fifth acts of bankruptcy.[44] However, the creditor's burden will be somewhat alleviated by Rule 114 which requires the bankrupt to produce his records and accounts and submit to an examination on solvency either at or prior to the hearing if the court so orders. Although trial of the involuntary petition may be before the referee, the bankrupt retains his right to a jury trial under section 19a of the Act. But the jury trial will be conducted by the referee[45] unless trial before a district judge is demanded or provided for by local rule.

If an involuntary petition is dismissed, Rule 115(e) provides for awarding costs, including attorney's fees, to respondent. The draftsmen purport to find authority for an award of attorney's fees in General Order 34 which allows "the same costs . . . [as] . . . in a civil action," and section 69b of the Act which authorizes a recovery of attorney's fees out of the bond posted by a petitioner who has procured the appointment of a preadjudication receiver or marshal to take charge of respondent's property. General Order 34 does not authorize attorney's fees, and while it may be difficult as a practical matter to separate damages arising from the appointment of a receiver from those caused by the filing of the involuntary petition itself, the Act makes no provisions for recovery of damages which result from the filing of an involuntary petition.[46] Instead, section

42. *See* Washington-Southern Navigation Co. v. Baltimore & Philadelphia Steamboat Co., 263 U.S. 629, 635 (1924) (rules cannot "abrogate or modify the substantive law"); Winberry v. Salisbury, 5 N.J. 240, 248, 74 A.2d 406, 410 (1950).

43. Rule 113.

44. 1 COLLIER ¶¶ 3.109[2]; 3.208[2]; 3.306; 3.505[2].

45. Rule 115(b)(1).

46. *See* J. MULDER & L. FORMAN, BANKRUPTCY & ARRANGEMENT PROCEEDINGS 49 (1971).

69b is analytically similar to the recovery authorized under the bonds which must be posted by creditors who seek attachments, injunctions, or other provisional remedies. In this connection, it has been argued that, since the authorization of an award of attorney's fees is a substantive provision which acts to deter litigation, it should not be the subject of judicial rulemaking.[47] While the Advisory Committee may be correct in its view that the above rules govern attorney's fees, it is not clear that this result may be reached under the Committee's own theory of rulemaking restraint. Moreover, in the discussion above, we noted the Committee's belief that changes in the act of bankruptcy doctrine—which could encourage or deter involuntary petitions—were beyond its power. It is not clear why the rule on attorney's fees, which may very well deter such petitions, should be treated differently.

3. *Filing of Petition and Schedules*

Initial proceedings in voluntary bankruptcies (and involuntary proceedings after adjudication) will remain virtually unchanged under the new rules. The bankrupt must still file a petition together with schedules showing his debts and property, and a statement of affairs. These may be filed simultaneously, but, if the bankrupt files his petition with a list of his creditors, an additional ten days is allowed for filing the other schedules and a statement of affairs.[48] The bankrupt must either pay the filing fees or apply for leave to pay in installments.[49]

4. *Dismissal of Petitions*

In the past, a debtor has often found himself prejudiced by a holding that, since an earlier dismissal of his case was on the merits, it barred a future discharge of debts which could have been discharged at the time of the dismissed proceeding.[50] Pro-

47. *See* Wright, *supra* note 19, at 570; *cf.* Hanna v. Plumer, 380 U.S. 460, 477 (1965) (Harlan, J., concurring). *See also* Note, *Use of Taxable Costs to Regulate the Conduct of Litigants,* 53 COLUM. L. REV. 78 (1953) (arguing *inter alia* that increasing taxable costs may deter frivolous litigation); *cf.* John S. Westervelt's Sons v. Regency, Inc., 3 N.J. 472, 70 A.2d 767 (1949) (taxation of costs including attorney's fees is procedural matter subject to regulation by rule); Levin & Amsterdam, *supra* note 16, at 15-16.

48. Rule 108(b).

49. Rule 107; Official Form No. 2. The Supreme Court has recently held the required payment of filing fees to be constitutional. United States v. Kras, 93 S. Ct. 631 (1973).

50. *See, e.g.,* Perlman v. 332 West Seventy-second Street Co., 127

posed Rule 120 regulates dismissals by requiring notices to creditors and a hearing and by providing that the dismissal is without prejudice unless otherwise specified. Presumably, the referee can protect the bankrupt against unforeseen res judicata effects of the dismissal, and creditors can protect themselves by appearing at the hearing.

B. THE PRINCIPLE OF CREDITOR CONTROL: FIRST MEETING OF CREDITORS AND ELECTION OF TRUSTEE

It is said that a bankrupt's estate belongs to his creditors, and therefore that creditors ought to control the bankruptcy proceeding.[51] Among the corollaries of creditor control are creditor selection of the trustee and notification to creditors of major events in the course of the bankruptcy. Accordingly the proposed rules provide that the court will convene the first meeting of creditors between ten and thirty days after adjudication. Although the creditors must have been given at least ten days notice of the first meeting,[52] the form of notice prescribed gives them virtually no information about the amount of assets, the number and amount of claims, whether there is likely to be a dividend, or the amount of their claims as scheduled.[53]

F.2d 716 (2d Cir. 1942). For this reason, debtors have generally been advised not to pay the filing fee in installments. *See* Treister, *Some Thoughts About Filing Bankruptcies*, 36 L.A. BAR BULL. 304, 329 (1961); *Advisory Committee's Note to Rule 120*, at 43-44. However, the 1970 amendment to section 17b of the Act makes it clear that debts can be discharged if they were scheduled in a prior proceeding which was dismissed for failure to pay filing fees *if* the dismissal was without prejudice. It is thus still up to the debtor to see that it is so dismissed.

51. *Advisory Committee's Note to Rule 208*, at 75 ("Creditor control is a basic feature of the Bankruptcy Act."); Seidman, *The Creditors' Voice in Election of Trustees*, 75 COM. L.J. 238 (1970). This broad statement is somewhat surprising in light of the generally critical appraisal of creditor control by one member of the Advisory Committee. Seligson, *Creditors' Control of Bankruptcy Administration and Legislation Relating Thereto*, 17 AM. J. COMP. L. 48, 54, 56 (1969); *Hearings Before a Subcommittee of the House Committee on the Judiciary on S.J. Res. 88*, *supra* note 29, at 44 (Referee Bare) ("Creditor control . . . has long been recognized as a myth."); Clark, *Reform in Bankruptcy Administration*, 38 HARV. L. REV. 1189, 1193 (1930).

52. Rule 203(a)(1).

53. Official Form No. 12, as applied to a typical bankruptcy, might read as follows:

[Caption]

To the bankrupt, his creditors, and other parties in interest: XYZ Corporation of 1234 North Street, New York, New York, having been adjudged a bankrupt on a petition filed by it on January 2, 1973, it is ordered, and notice is hereby given, that:

1. The first meeting of creditors shall be held at Room 201, U.S.

Creditors are presumably left to their own devices to collect information in the interim.

The prescribed form of notice has also been criticized as incomprehensible to wage earners, consumers, tenants, and kindred groups of "unsophisticated" creditors. Such persons do not ordinarily consider themselves creditors. The confusion may be compounded if the bankrupt's corporate name appearing on the notice is different from the name under which it is commonly known.[54] The notice does not inform unsophisticates of the need to consult an attorney, of location where they can obtain the proper form for filing claims, of the possibility that the first meeting may be adjourned without notice to them, or of the fact that the first meeting may be their only formal chance to examine the bankrupt or to otherwise particpate in the bankruptcy proceedings. References to "adjudication," "dischargeability," "stays" under Rules 401 and 601, "elect[ing]" the trustee, and

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Courthouse, Foley Square, N.Y., N.Y., on February 1, at 10 o'clock a.m.;

2. The bankrupt shall appear by its president before the court at that time and place for the purpose of being examined as provided by the Bankruptcy Act; and

3. March 15, 1973 is fixed as the last day for the filing of objections to the discharge of the bankrupt.

4. March 15, 1973 is fixed as the last day for the filing of a complaint to determine the dischargeability of any debt pursuant to § 17c (2) of the Bankruptcy Act.

At the meeting the creditors may file their claims, elect a trustee, elect a committee of creditors, examine the bankrupt as permitted by the court, and transact such other business as may properly come before the meeting.

As a result of this bankruptcy, certain acts and proceedings against the bankrupt and his property are stayed as provided in Bankruptcy Rules 401 and 601.

If no objection to the discharge of the bankrupt is filed on or before the last day fixed therefor as stated in subparagraph 3 above, the bankrupt will be granted his discharge. If no complaint to determine the dischargeability of a debt under clause (2), (4), or (8) of § 17a of the Bankruptcy Act is filed within the time fixed therefor as stated in subparagraph 4 above, the debt may be discharged.

In order to have his claim allowed so that he may share in any distribution from the estate, a creditor must file a claim, whether or not he is included in the list of creditors filed by the bankrupt. Claims which are not filed within 6 months after the above date set for the first meeting of creditors will not be allowed, except as otherwise provided by law. A claim may be filed in the office of the undersigned bankruptcy judge upon an official form prescribed for a proof of claim.

Dated: January 15, 1973.

John Jones,
Bankruptcy Judge.

54. *See* Schrag & Ratner, *Caveat Emptor—Empty Coffer: The Bankruptcy Law Has Nothing to Offer*, 72 COLUM. L. REV. 1147, 1170, 1180 (1972).

"allow[ance]" of claims can hardly be expected to be comprehensible to even educated nonlawyers, let alone "unsophisticated" creditors. While the number of bankruptcies involving such individuals is probably small, the referee should have no difficulty in spotting such cases from the petition and schedules. The draftsmen should therefore have provided for some alternate and more informative form of notice in situations involving substantial numbers of "unsophisticated" creditors.[55]

The one important exception to the "no information" policy is proposed Rule 202(b) which provides that creditors will be notified if it appears from the schedules that there will be no assets to pay a dividend and that creditors need not file claims. Since this notice will by definition require information contained in the schedules, the rule should have required that the court await receipt of the schedules before sending notice.[56] Moreover, because of the importance of the inclusion of such a statement to creditors, it should be mandatory rather than optional as provided by Rule 202(b).

1. Electing the Trustee

Other than an examination of the bankrupt—which will usually be perfunctory because the referee does not investigate the bankrupt's affairs and the trustee has not yet been installed—the major activity at the first meeting will be the election of the trustee. Proposed Rule 207 provides for the election of the trustee by majority vote "in number and amount of claims" of creditors entitled to vote. Secured or priority creditors can vote only insofar as their claims exceed the security or the allowed priority. Claims of under $100 are excluded from computing the majority in number of creditors; and relatives, affiliates, former officers, directors, stockholders, or others with materially adverse interest are excluded from voting. The $100 exclusion is an increase from the $50 provided by section 56 of the Act. The purported reason for the change is to avoid domination by proxy solicitors who seek to reap rewards via administration expenses.[57] However, the change could have an obvi-

55. Although Professor Schrag and Mr. Ratner offer trenchant criticism of bankruptcy procedures as applied to consumers, their article inexplicably does not even mention the Proposed Bankruptcy Rules. *Id.* However, it should be noted that many of the problems which they have perceptively identified will remain under the Rules.
56. *See* Rule 108.
57. *See Advisory Committee's Note to Rule 207*, at 69.

ous effect in the admittedly rare case where there is a group of well organized small creditors.[58] It is not clear on what basis the draftsmen doubted their authority to change the requisite number of petitioning creditors but yet were confident of their authority over rules governing trustee selection. Perhaps the rationale is that they have greater authority over the rights of creditors *inter se,* than the rights of creditors vis-a-vis the debtor.

In order to vote, creditors must have filed claims at or before the first meeting, the referee having authority to provisionally allow claims for the purpose of voting.[59] While the notice of the meeting does specify that the trustee will be "elected," it does not suggest or imply that the creditor must take specific action to qualify to vote.[60] The unsophisticated creditor—be he a consumer or small businessman—will be understandably irate if he comes to the meeting only to find that he cannot effectively participate because he failed to comply with claim-filing requirements of which he was unaware.

If the trustee is not elected or fails to qualify, proposed Rule 209 requires the referee to appoint a trustee. The rule also grants the referee the authority implicitly conferred by section 2a(7) of the Act to disapprove an elected trustee "for ineligibility or other good cause," and to appoint the trustee instead. But such disapproval must be "based on a substantial reason appearing in the record." Some persons may be excluded solely upon a showing that they are members of a class which is thought to have a sufficient adverse interest to the estate to warrant exclusion per se. Thus, assignees and receivers who must account to the bankruptcy court for their stewardship, former officers, directors, and attorneys for the bankrupt, collection agencies, and those elected with the direct or indirect assistance of the bankrupt are barred from serving.[61] Other candidates may be

58. Professor Schrag and Mr. Ratner regard even the $50 minimum as an invidious discrimination against the poor. Schrag & Ratner, *supra* note 54, at 1175. Moreover, the increased availability of legal services to the poor and the increased number of governmental agencies representing consumers may make such cases involving cohesive groups of creditors with small claims more common. *Id.* at 1176-82.

59. Bankruptcy Act § 56a, 11 U.S.C. 92(a) (1970). This provision will be incorporated in Rule 207(a).

60. See the Official Form at note 53 *supra.* In fact, the notice states that creditors have six months to file claims, thus suggesting that there is really no reason to file promptly.

61. *See generally* 2 COLLIER ¶¶ 44.06-.10; Seligson, *supra* note 51.

shown to be dishonest or subject to an inherent conflict of interest. Absent such proof, the creditors' choice will rarely be disapproved.[62]

2. Limitation of Proxy Solicitation

The major advance in the trustee selection rules is restriction on the solicitation of proxies which will enable the holder to cast the creditor's votes for the trustee of his choice. The purpose of proposed Rule 208 is to avoid control by persons "whose principal interest is not in what the estate can be made to yield to the unsecured creditors but in what it can yield to those involved in its administration or in other ulterior objectives."[63] To that end, it permits solicitation only by creditors (including attorneys and agents for creditors),[64] duly elected creditors' committees, or bona fide nonprofit trade associations. Specifically excluded from solicitation are receivers, persons specifically excluded from voting for the trustee (because of potentially adverse interests to the estate), attorneys, and transferees for collection. The holders of any proxy, as well as any solicitor or forwarder, must (1) make full disclosure of the circumstances of the solicitation, and in particular must allege that no consideration was paid or promised the proxy-giver, and (2) must disclose any agreement for compensation to be paid to the trustee or others, or for the appointment of an attorney, accountant, or other employee of the estate.

The efficacy of these rules to stop abuses in the selection of the trustee may be questioned. The rules do not purport to limit solicitation; they simply designate groups or persons who can legally solicit.[65] No provision prevents informal arrangements

62. *See Advisory Committee's Note to Rule 209*, at 79; *In re* Peerless Mfg. Co., 416 F.2d 57 (7th Cir. 1969) (referee's order refusing to allow election on ground that one candidate was disqualified because of lack of experience and potential conflict of interest reversed; referee must hold election, and if candidate elected, hold hearing on issue of competence). Many of the cases containing language appearing to give creditors almost unlimited power over trustee selection are instances where the referee overruled the creditors' choice merely to appoint one of his cronies. *See In re* Lenrick Sales, Inc., 369 F.2d 439 (3d Cir.), *cert. denied*, 389 U.S. 822 (1967); *In re* Thomas, 263 F.2d 287 (7th Cir. 1959).

63. *Advisory Committee's Note to Rule 208*, at 75; *see* 2 COLLIER ¶ 44.10; *In re* Eloise Curtis, Inc., 388 F.2d 416, 419 (2d Cir. 1967).

64. This result is reached by virtue of the definition of "creditor" in section 1(11) of the Act to include duly authorized agents and attorneys. Bankruptcy Act § 1(11), 11 U.S.C. § 1(11) (1970).

65. *See* Seligson, *supra* note 23, at 386-88.

beforehand which have the same result as formal solicitation and the grant of a written proxy.[66] The practice in some districts by which all creditors tacitly agree to allow the creditor with the largest claim to determine the trustee[67] is not proscribed under the rules. Finally, the rules would allow a few bankruptcy law "specialists" to garner as clients the lion's share of creditors' claims so that the firm speaks with one voice in electing the trustee, even though nominally representing different creditors.[68] This is not to say that the draftsmen of the rules have not done the best they could. It suggests instead a more basic problem, a problem that cannot be resolved by forbidding solicitation to some and requiring full disclosure by others. Indeed, one experienced referee has noted the failure of local court rules, upon which Rule 208 was modeled, to effectively cope with the evils of solicitation.[69] It is not clear how placing the ineffective procedures within a new set of bankruptcy rules will cure the malady.

3. Creditor Selection of Trustee: An Evaluation

Furthermore, there is serious question whether power to elect the trustee should repose in creditors in either small or large cases. The principle of creditor control appears based on two premises: first, that creditors will ultimately receive the proceeds of the bankrupt estate and therefore ought to control the collection and distribution of the bankrupt's assets;[70] second, that creditors will in fact take an interest in the bankruptcy proceeding. Unfortunately each of these premises is wanting.

The first justification assumes that bankruptcy is solely a creditors' remedy. In fact, at least an equal objective of the bankruptcy proceeding is to benefit debtors by guaranteeing a discharge, a fresh start, and relief from the predations of greedy and stubborn creditors. Moreover, it is assumed that the inter-

66. *See* Schrag & Ratner, *supra* note 54, at 1174.
67. *See* STANLEY & GIRTH 78, 123.
68. *See id.* at 78, 122-23 (on a given day the following trustees were "elected" in one court: *X, Y, Y, Z, Z, Z*; *X* and *Z* were law partners); Cowans, *An Agenda For Bankruptcy Reformers*, 43 REF. J. 3, 50-51 (1969); Clark, *supra* note 51, at 1199 & n.27. For example, in *In re* Construction Supply Corp., 221 F. Supp. 124 (E.D. Va. 1963), one attorney representing six different creditors nominated himself for trustee.
69. *See* Herzog, *Bankruptcy Tomorrow*, 45 AM. BANKR. L.J. 57, 68-69 (1971). Referee Herzog proposed his own "solution" which differs substantially from Rule 208.
70. *See id.* at 67.

ests of all creditors are similar, and thus that control and active participation by some creditors benefits all. This hegemony among creditors simply does not always exist. Some creditors may desire a fast liquidation, others a thorough investigation and prosecution of all possible claims; some are vindictive, while others seek rehabilitation.[71] This proposition is especially doubtful in cases where the largest and most influential creditors are subject to attack for their dealings with the bankrupt[72] by other less involved creditors. Finally, the principle of creditor control assumes that there is no social interest in prompt rehabilitation of the debtor and no judicial interest in the efficient conduct of the bankruptcy proceeding. In sum, the creditors' interest is only one of many that should be represented in the administration of the bankrupt estate.

The second justification is that creditors as the potential recipients of any funds accumulated will take an active interest in the administration of the estate. The converse of this stake-in-the-venture approach is that creditor interest will parallel a dividend that is problematical or minimal. This justification then assumes that in a substantial number of cases there will be sufficient funds in the estate to stimulate creditor interest. The actual facts reveal an entirely different picture. In 1969, the last year for which figures are available, 85% of the cases were either no asset or nominal asset cases. In the remaining 15%, cases in which some assets were available, unsecured creditors (including both priority and general creditors) received 10% of their claims; general creditors received less than 8% of their claims. No figures are available to pinpoint the number of cases in which at least one general creditor received a substantial recovery of $1,000 or more, but the number would probably be no more than 1 or 2%.[73]

71. This has been explicitly recognized in Chapter X cases where there is much more court control and much less creditor control. *See, e.g.*, Bankruptcy Act §§ 156, 216(7), 221, 11 U.S.C. §§ 556, 616(7), 621 (1970). (Court appoints trustee; the court can "cram down" reorganization plan on dissenting secured creditors if the plan fairly protects their rights).

72. *See* Weil v. Neary, 278 U.S. 160, 168 (1929); *In re* Anson Mercantile Co., 185 F. 993 (N.D. Tex. 1911) (trustee was an employee of creditor who had allegedly received preferences); Clark, *supra* note 51, at 1199; *cf. In re* Process-Manz Press, Inc., 369 F.2d 513, 520 (7th Cir. 1966), *cert. denied*, 386 U.S. 957 (1967) (by time of petition, bankrupt had become alter ego of creditor); J. MacLachlan, *supra* note 40, § 96, at 85 & n.2.

73. Approximately 92% of all bankruptcies are personal bankruptcies, and 8% are business bankruptcies. Since almost all business bankruptcies have some assets, we may assume that the 15% of asset cases in

The conclusion that there is generally little creditor incentive to participate is confirmed by the only reported studies of the matter, as well as by the frequent observations of referees and active bankruptcy practitioners.[74] The Brookings Report concluded that creditors rarely participate in a bankruptcy proceeding. Most creditors probably felt as did one creditor who said that "their time was better spent in creating new business than in participating in formalities that usually yielded little or no return."[75] One early study in preinflationary days found that three-fourths of all meetings of creditors were not attended by any creditors.[76] The vast majority of creditors do not prove their claims.[77] Especially in smaller cases, creditors have responded to their designated role with almost complete indifference.

Moreover, it is the basic disinterestedness of creditors in the unsightly mess of bankruptcy which has spawned the widespread practice of claims solicitation which, as suggested above, is inherently impossible to control in the small cases where creditors lack an incentive to participate in the bankruptcy proceedings. If creditors do take an active interest in small bankruptcies it is often not out of beneficence but to utilize the bankruptcy proceeding to "encourage" the bankrupt to pay up or to "teach him a lesson." The practical inability of the referee to separate the genuinely concerned creditors from those with more base motives may make the bankruptcy court an unwilling partner to the latter.

4. The New Rules and Trustee Selection

Aside from the new restrictions on proxy solicitation and the raising of the minimum amount of claims to be counted in

bankruptcy are comprised of approximately 8% business cases and 7% nonbusiness cases. Of the business cases, about three-fourths have assets of at least $1,000, or a total of 6% of all bankruptcy cases. STANLEY & GIRTH 127. Of the nonbusiness asset cases, about 14% have assets of at least $1,000, or about 1% of all bankruptcy cases. *Id.* at 88. Since only about 7% of all bankruptcy cases have total assets of at least $1,000 it appears reasonable to assume that a much smaller number of cases permit dividends to general creditors (after administration expenses) of $1,000.

74. *See, e.g.*, 2 COLLIER ¶ 44.06, at 1648; Cowans, *supra* note 68, at 50-51; Herzog, *supra* note 69, at 66-67; Seligson, *supra* note 51, at 54.

75. STANLEY & GIRTH 77; *accord*, Clark, *supra* note 51, at 1193-94.

76. *Strengthening of Procedure in the Judicial System*, S. Doc. No. 65, 72d Cong., 1st Sess. 31 (1932).

77. *See generally* STANLEY & GIRTH 127; Clark, *supra* note 51, at 1194 & n.17; Herzog, *supra* note 69, at 67-68; Lee, *Possible Alterna-*

the majority in number of creditors from $50 to $100, the above rules make no changes in trustee selection. The draftsmen should, however, have addressed themselves to two basic questions. First, should the selection process be changed, and second, if so, what power did the draftsmen have to make the changes?

In answer to the first question, the factors already enumerated, when coupled with the generally critical appraisal of trustee performance, which will be discussed in the next section, indicated that serious consideration be given to changing the selection process. If changes were to be made, the draftsmen could have completely changed the process by placing responsibility for selecting the trustee either in the hands of the referee, a panel of referees, a panel of judges, or by adopting random selection from an "approved panel." Alternatively, the rules could have retained creditor selection but have given the referee somewhat greater power than he now has to disapprove the creditors' choice.

The need to place rigorous controls on trustee selection is already reflected in judicial doctrines which virtually exclude certain categories of persons from serving as trustees.[78] But, in all cases, a creditor has an inherent conflict of interest with the trustee. The trustee is supposed to investigate the affairs of the bankrupt, including his relations with creditors. Often this investigation will concentrate on the bankrupt's financial relations with its largest creditors. Yet it is precisely these largest creditors who have the most "votes" and the greatest incentive to participate in the proceedings and elect the trustee. It is difficult to imagine a creditor-elected trustee actively investigating his own benefactors. And, while this problem affects all bankruptcies, it is particularly likely to occur in larger bankruptcies where the bankrupt may have large potential claims against some creditors.[79] The creditor who participates actively in

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tives to the Present System of Bankruptcy Administration, 45 AM. BANKR. L.J. 149, 150-54 (1971). As a result, the few creditors who do file may receive substantial dividends. Herzog, *supra* at 89.

78. *See* text accompanying note 61 *supra*.

79. *See, e.g., In re* Freeport Italian Bakery, Inc., 340 F.2d 50 (2d Cir. 1965) (trustee filed exaggerated claims and failed to press claims of the estate against relatives); *In re* Lurie Bros. Inc., 267 F.2d 33 (7th Cir. 1959) (trustee elected by votes of creditors who had allegedly received preferences); *In re* Construction Supply Corp., 221 F. Supp. 124, 127 (E.D. Va. 1963); *In re* Autocue Sales & Distrib. Corp., 148 F. Supp. 685 (S.D.N.Y. 1957) (trustee elected by votes of creditors who were defendants in lawsuits instituted by bankrupt); *In re* N.S. Dalsimer &

electing the trustee to preserve a preference or fraudulent transfer has an adverse interest which the rules foster and protect. The Act was amended more than thirty years ago in order to prevent creditors from opposing an involuntary petition on the ground that creditors only did so to preserve a preference or other voidable transfer.[80] It is not clear that creditors have demonstrated greater purity in trustee selection. In a day when conflicts of interest are so jealously guarded against in other areas, creditor election of the trustee remains a relic of the past. Under the proposed rules it will be a fixture of the future.

It is impossible to determine whether the draftsmen failed to identify trustee selection as a problem because (1) they thought there was no problem "on the merits"; (2) they were insensitive to the problem; or (3) they thought any solution was beyond the scope of their rulemaking authority. As already noted, (1) or (2) do not appear to be justified and, if (3) applies, we again see an unfortunate instance of the Committee's inability to effectuate the needed reforms because of an unduly narrow conception of its authority. The trustee is the key person in the administration of the estate for both creditors and the bankrupt. Recognizing inadequacies in the basic selection process and then claiming impotence has to raise questions about the reform effort.

5. *The Rules on Solicitation—Some Unfortunate Byproducts*

As previously noted, the rules regulate proxy solicitation by excluding from solicitation persons other than creditors, duly elected creditors' committees, and bona fide nonprofit trade associations. Recently, however, a new phenomenon has appeared. In a few cases, poverty agencies or governmental units have attempted to organize groups of small creditors to exer-

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Co., 56 F.2d 644, 646 (S.D.N.Y. 1932); *In re* Scott, 53 F.2d 89 (W.D. Mich. 1931); Schrag & Ratner, *supra* note 54, at 1174. The "conflict of interest" problem is exacerbated by a series of decisions by the Second Circuit that a trustee cannot be disqualified unless there is an actual, as distinguished from a potential, conflict of interest. *See, e.g., In re* Freeport Italian Bakery, Inc., *supra* at 54. Since one of the functions of the trustee is to uncover the existence of adverse claims, how is it possible to determine whether there is an "actual" conflict of interest at the time of selection?

80. *See In re* Jack Kardow Plumbing Co., 451 F.2d 123, 129-30 (5th Cir. 1971) (if creditors' jurisdictional attack succeeded and petition was dismissed, payments within four months of petition would be immunized from attack).

cise some leverage in trustee selection.[81] Under the new rules a consumer creditor represented by a legal aid attorney will presumably be allowed to solicit in the same manner as an attorney representing any other creditor. On the other hand, a governmental unit or an agency which is not serving as legal counsel is not within the classes of permitted solicitors and presumably will be precluded from solicitation. While the draftsmen of the rule did not appear to contemplate such a result in their attempt to prevent profiteering, it is not clear how it can be avoided.[82]

6. *No Asset Cases*

Proposed Rule 211 carried forward the practice of permitting the court to dispense with a trustee if the bankrupt has no non-exempt property and the trustee is not elected by the creditors. The Brookings Report demonstrated that despite this authority trustees were appointed in a substantial number of no asset cases.[83] In addition, the implication of the rule is that if there is some non-exempt property—as there must be in so-called nominal asset cases—a trustee must be appointed.[84] In cases where the estate is nonexistent or small and the bankrupt's examination at the first meeting of creditors reveals that it undoubtedly will remain small, the effort involved in appointing such a trustee and proceeding through the motions of administration is unwarranted. Moreover, since the trustee's fee cannot possibly compensate for the work involved, the referee often may appoint the same individual in more lucrative cases as a sort of *quid pro quo* for his past "service."[85] No reason appears for not designating a court officer as trustee in such no asset and low asset cases. His sole function would be to collect property (if any) and make distributions to creditors; the court could always appoint a trustee if any serious problems were encountered.

81. *See* Schrag & Ratner, *supra* note 54, at 1176-82.

82. In *In re* Vigilant Protective Systems, No. 71 B 729 (S.D.N.Y., petition filed July 27, 1971), the court avoided the problem by finding that the local anti-solicitation rule applied only to attorneys. Schrag & Ratner, *supra* note 54, at 1180. It is doubtful that such a construction will be possible under the Rules.

83. STANLEY & GIRTH 77.

84. A "nominal asset" case is one in which the available assets are insufficient to satisfy administration expenses, and there is therefore no distribution to creditors.

85. *See* STANLEY & GIRTH 79, 192.

C. THE TRUSTY TRUSTEE AND THE ADMINISTRATION OF THE BANKRUPT'S ESTATE

Primary reliance for the proper administration of the bankrupt's estate is placed on the trustee in bankruptcy. However, the existing system has never completely determined the respective roles and relations of the trustee and creditors on the one hand, and the trustee and referee on the other. Put generally, to what extent are actions of the trustee subject to the whims of other creditors and the supervision of the referee, and to what extent do the other creditors or the referee have the power to substitute their judgment for that of the trustee.

There is no a priori answer to this problem. Theoretically, the referee could play an active role in the day-to-day administration of the bankrupt's estate, or could serve only as a "judge" in instances where a party questioned the trustee's actions. The role of creditors could also range from taking an active part in policy making decisions to passive participation in the bankrupt's affairs after designation of the trustee. But the most important facet in any system of administration is that the respective roles of the trustee, the referee, and the creditors be clearly defined, and that responsibility clearly placed on one or another party.

At the outset, one critical observation is in order. The present brankruptcy system does not place responsibility on either the trustee or the referee because of doubts about the ability of either to do the job adequately. If this criticism is true, then simply parceling out their responsibilities does not eliminate the problem. If there is an inadequate selection process, lack of adequate compensation, an excess of responsibilities, or too little help, these causes should be attacked directly. In overview, however, it begs the question to assert that certain institutional constraints on trustees and referees are necessary because such officers do not perform properly.

1. *Deposits of Funds*

Section 47a (1) of the Act charges the trustee with collecting the estate and liquidating all nonmonetary property. Proposed Rule 605(b) provides for bank deposit of the funds collected. The Advisory Committee's Note suggests that the trustee "will ordinarily place the money . . . in a deposit payable on demand by check in order to permit prompt payment of dividends." Since dividends are generally not paid until the estate is closed and only after administration expenses are determined,[86] it would appear that the funds should more often be kept in an interest paying account. It is not difficult to maintain both accounts paying interest and checking accounts in the same bank, and transfer takes only a few minutes. The use of non-interest bearing accounts for months or years simply because dividends may at some point be paid is a clear waste of the estate's assets and a windfall to the banks.

2. *Sales of Property; Assumption of Contracts; Abandonment of Property*

Proposed Rule 606 continues the practice of requiring an appraisal and notification to creditors where property of the bankrupt is to be sold although both may be dispensed with by court order.[87] The trustee has the power to assume an executory contract pursuant to section 70b of the Act. Proposed Rule 607 requires that he file a statement within 30 days of his qualification listing the executory contracts assumed, and requires court approval of the assumption "whenever possible." Finally, Proposed Rule 608 authorizes the trustee with court approval to abandon burdensome property or property with no net realizable value.[88] The rule does not require a hearing, but if the court orders one, notice must be given to creditors unless the court directs otherwise.

These are perfect examples of the failure of both the Act and the rules to place the locus of responsibility for important administrative functions on the trustee, the creditors, or the referee. Where notice of a sale or abandonment of property has been given to creditors, they are free to claim at some later point that the trustee should have done better, the trustee is free to assert that the creditors should have objected and the referee should not have approved the sale or abandonment, and the referee can suggest that he approved the sale or abandon-

86. While Rule 308 provides that dividends shall be paid "as promptly as practicable," in many cases there should be no dividends until the estate is wrapped up. *See* text following note 139 *infra.*

87. Both appraisal and creditor notification are designed to insure that the property is sold at an adequate price, and, in a sense, they are overlapping; to the extent the property is sold at or above the appraised value there is less need for creditor participation.

88. The trustee previously had this power. *See* V. COUNTRYMAN, CASES AND MATERIALS ON DEBTOR AND CREDITOR 420 (1964); Note, *Abandonment of Assets by a Trustee in Bankruptcy,* 53 COLUM. L. REV. 415 (1953).

ment on the basis of the trustee's recommendation and in the absence of creditor opposition. And where no notice has been given to creditors it is easy for the referee and trustee to engage in mutual buck passing.

In essence, the failure to fix clear responsibility for decision making results from a built-in distrust of the trustee as the most logical receptacle of this authority. The word "trustee" has a reassuring ring, suggesting a conscientious, conservative individual going about the business of managing the bankrupt's estate. However, widespread doubts about the process of selection,[89] coupled with dissatisfaction about actual trustee performance[90] have apparently led to this trifurcated concept of responsibility. Such an allocation, or rather, non-allocation of responsibility, creates the additional problem of turning the referee into a super-administrator and pro tanto identifies him with the interests of the estate rather than as an impartial arbiter. Creditors litigating before such an individual may justifiably have doubts concerning his objectivity.[91]

The better view is that responsibility should be clearly placed on the trustee to obtain an adequate price for estate assets, to assume executory contracts, and to abandon burdensome property. All that should be required is the filing of a statement of the action taken with the court; notice to creditors should be dispensed with. Court approval should be required only in cases where the asset being sold, contract being assumed, or property being abandoned involves a substantial portion or commitment of the assets of the estate or is likely to have a major effect on the assets available to creditors.[92] And even then, court approval should not rest on the court's own evaluation of the sensibility of the action taken but rather upon whether the trustee has in fact made a sufficiently careful investigation to justify the proposed action. Finally, where the trustee's actions are questioned at some later point, a creditor should not be allowed to hypothesize that the trustee could have sold the assets at a better price, obtained a more favorable contract, or eked some value out of the abandoned property. Instead, the

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89. *See* text accompanying notes 57-77 *supra.*

90. *See* text accompanying notes 96, 127-30 *infra.*

91. *See* Treister, *Bankruptcy Jurisdiction: Is It Too Summary?*, 39 S. CAL. L. REV. 78, 85-88 (1966).

92. Another area requiring approval might be the abandonment of real estate; this being necessary to avoid later litigation on the marketability of title. *See Advisory Committee's Note to Rule 608*, at 188.

issue should again be whether the trustee made a sufficiently careful inquiry to justify his decision.

But the emphasis here is not on the issue of who should have the primary responsibility, but rather that the Act and the rules fail to place responsibility on anyone. It is worth stressing that if one is hesitant about placing the responsibility upon the trustee because of doubts about his ability, the remedy is to obtain better performance rather than to divorce him of the responsibility.

3. *Sale of Property Free of Liens*

Proposed Rule 606 (b) (3) provides that the trustee must commence an adversary proceeding against the lien holders if he seeks to sell property free from liens. In essence, this means that the trustee must commence the action by complaint, there must be a hearing, etc. As a matter of substantive law, however, the trustee has the right to sell property free of liens and other interests, and transfer the lienor's interest to the proceeds, except where the value of the property does not exceed the amount of the lien.[93] The Rule 606 (b) (3) procedure appears to require the trustee to justify the sale even before the possibility of any objection arises. The substantive law would seem to require only that the trustee give a simple notice of sale. The rule should have provided that an objecting lienor could commence an adversary proceeding to enjoin the sale, but that the sale could proceed as scheduled in the absence of any objection.

4. *Preservation of Voidable Transfers*

Various sections of the Act authorize the trustee to preserve voidable liens and voidable transfers for the benefit of the estate. Proposed Rule 611 provides that the trustee must commence an adversary proceeding joining all other persons with interests in the property in order to preserve such liens or transfers. Here again the substantive law gives the trustee a right to preserve the avoided lien or transfer unless other parties in interest can demonstrate that such preservation would be inequitable.[94] The trustee should therefore be able to take

93. *See* 4A COLLIER ¶¶ 70.97, 70.99.

94. The right to preserve is given in apparently absolute terms by the following sections of the Act: §§ 60b, 67a(3), c(2), d(6), 70e(2); 11 U.S.C. §§ 96(b), 107(a)(3), (c)(2), (d)(6), 110(e)(2) (1970). De-

advantage of his substantive right by simply filing a notice of his intention to preserve the lien or transfer. An objecting party in interest should have to initiate action to enjoin the attempted preservation.

5. Investigation of the Affairs of the Bankrupt

One of the major functions of the trustee is to investigate the affairs of the bankrupt to insure that all assets have been located and all avoidable transfers identified.[95] The investigation should begin, not end, with the statement of affairs and schedules filed by the bankrupt. While it is difficult to prescribe what form the inquiry should take, it should usually include a review of various records, including the bankrupt's prior income tax returns, local, real and personal property records and reports from credit bureaus. It should also include interviews with the bankrupt and spouse, the bankrupt's attorney, accountant, major creditors, customers and suppliers, and, if the bankrupt is a corporation, its major officers and directors. It appears that in the overwhelming majority of small cases, and many large cases as well, such a comprehensive inquiry is the exception rather than the rule.[96] Moreover, since the foregoing type of inquiry is obviously expensive, a requirement of full inquiry conflicts with the doctrine that estate expenses should be minimized. Trustees are also discouraged from undertaking such an investigation by the knowledge that, in most cases, it not only will be unproductive but the referee will not allow the costs of a complete investigation as an administration expense.

On one hand, the rules could have required the trustee to investigate only in larger cases; in all other cases, the referee would examine the debtor at the first meeting of creditors. An-

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spite such absolute language, the court does have some discretion, although it is not clear how much. *See* 4 COLLIER ¶ 67.16, at 185.

95. *See* Bankruptcy Act § 47a, 11 U.S.C. § 75(a) (1970).

96. Blunt statements criticizing trustee performance are, as might be expected, rare. However, widespread demands for reform of the proxy solicitation rules suggest some dissatisfaction with the results of the selection. Hints of the problem appear in STANLEY & GIRTH 79, 84, 126; Clark, *supra* note 51, at 1205; Herzog, *Bankruptcy Tomorrow*, 45 AM. BANKR. L.J. 57, 68 (1971); Schrag & Ratner, *supra* note 54, at 1175 & n.168, 1182 & n.214. It should be noted that the term "trustee" should be taken to include the trustee's attorney who frequently does the lion's share of the work because of the low statutory fees for trustees. *See* Clark, *supra* note 51, at 1197; J. MACLACHLAN, *supra* note 40, at 121.

other approach would be to require "preliminary" investigation only in cases where the bankrupt's statement of affairs or the questioning at the first meeting revealed a problem. Still another approach would be to require a complete inquiry in all cases *and* to acknowledge and accept the increase in administration costs. If so, it might be desirable to have a prescribed checklist of required investigatory acts to enable "objective" verification of the trustee's effort.

Although the Advisory Committee must be presumed to know of deficiencies in trustees' performance of their investigative duties, the rules neither hint at nor attempt a solution of the problem. The draftsmen have placed investigatory burdens on the trustees which are uncalled for in the vast majority of cases and have provided a penalty via surcharge for his default, with the knowledge that the trustee cannot and will not carry out his investigatory obligations.[97]

6. *21a Examinations*

One provision of the rules seems destined to make it even more difficult for the trustee to carry out his investigatory function. Proposed Rule 205 permits an examination of any person upon the application of any party in interest—this will usually be by the trustee. The rule further provides that the referee shall preside at the examination, thus continuing the prior practice under section 21a of the Act. This is unfortunate since referees have more than enough to do without presiding over examinations that may involve detailed examination of records, review of transactions which the referee lacks background to understand, and questioning of the most routine and trivial nature. The author has seen more than one referee bored—and trying to do other work "under the table"—during lengthy 21a examinations. The referee may schedule a short time for a long examination and make his displeasure over further examination clear to the trustee. It is not apparent why the examinations could not be held before a court reporter, with court approval. In the case of a complicated bankruptcy, a further advantage of utilizing court reporters is the opportunity to conduct an investigation at the location of the pertinent records, thus avoiding frequent postponement of an inquiry due to absent documents.

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97. *See* 2 COLLIER ¶ 47.08[1].

7. Trustee Serving as Counsel

Proposed Rule 219(c)(2) constitutes a considerable advance in the administration of the typical nonbusiness estate by providing that the trustee can serve as his own legal counsel and receive compensation above the statutorily prescribed trustee's fees. The rule that neither the trustee nor his firm should serve as counsel[98] should be limited to larger cases where financial considerations permit the employment of this "two heads are better than one" approach. In most smaller estates the benefits of separate representation are far outweighed by utilizing a trustee who presumably is already somewhat familiar with the estate.

8. Preventing Dismemberment of Bankrupt Estate

One of the great dangers in bankruptcy administration is that the bankrupt estate may be subject to attack in other forums in the period between adjudication and qualification of the trustee. While the results of the "attack" may often be undone once the trustee qualifies,[99] the procedures are often expensive and time consuming. Proposed Rule 601 is an exceptionally useful provision which provides that the filing of a petition itself operates as a stay of the commencement or continuation of proceedings to enforce (1) liens against property in the custody of the bankruptcy court, or (2) judicial liens obtained within four months of bankruptcy. The rule is grounded on the well established principle that the court which first acquires custody over property administers it. The new rule, however, operates automatically. Although not specified, the bankruptcy court's custody must be superior to other courts for this provision to be operative.[100]

The automatic stay of proceedings is based on section 67a of the Act, which gives the bankruptcy court summary jurisdiction to avoid such liens. Rule 601, however, contains two advances over existing law. First, it resolves uncertainty concerning

98. *See In re* Ira Haupt & Co., 361 F.2d 164, 168 (2d Cir. 1966) (in large bankruptcy, trustee should not have appointed his own firm as counsel).

99. *See* Isaacs v. Hobbs Tie & Timber Co., 282 U.S. 734 (1931); Bankruptcy Act § 70d, 11 U.S.C. § 110(d) (1970).

100. *See, e.g.,* Straton v. New, 283 U.S. 318, 326 (1931) (bankruptcy court may not enjoin sale of property being administered in state court proceeding to enforce lien which is valid in bankruptcy); 1 COLLIER ¶¶ 2.62[1], 2.63.

whether the bankruptcy court's jurisdiction under 67a is paramount or concurrent. If only concurrent jurisdiction existed, the bankruptcy court would be ousted of jurisdiction where property was already in the possession or custody of another court.[101] The result of this provision will be to move all 67a summary proceedings into the bankruptcy court.[102] Second, it operates automatically and avoids placing the trustee in the position of having to retrieve property which is in the hands of a purchaser at a sheriff's sale conducted after bankruptcy to satisfy a lien voidable under section 67a.[103]

D. Is Bankruptcy a Game? If Not, Why is there a Referee?

1. *Background*

The title accorded the individual who supervises most bankruptcy activities—Referee in Bankruptcy—is symptomatic of the problems which surround his role in bankruptcy proceedings. At present the referee has duties which may be called clerical, administrative, executive, and judicial. His clerical duties include the responsibility for countersigning checks and keeping a record of claims. His administrative duties, which have already been noted, include the supervision of the activities of the trustee, such as liquidation of the estate, sale of property, and compromise of claims. His adjudicatory functions range from determining dischargeability to hearing proceedings under the lien avoidance and anti-preference sections of the Act.

One of the identified problems of the present bankruptcy system has been the imposition of clerical duties upon the referee. Aside from being a waste of the time of a very busy public servant, clerical duties were thought to demean the referee's office. Critics have also objected to the unification of administrative and judicial functions in one officer, especially since the separation of rulemaking and adjudication in administrative agencies occurred more than twenty-five years ago.[104] For ex-

101. *See* Landers, *The Shipowner Becomes a Bankrupt*, 39 U. Chi. L. Rev. 490, 495-96 (1972).

102. As a matter of comity, it may be desirable for the trustee to apply to the court in which the lien enforcement proceeding is pending for a stay, or at least, to give notice that the matter is now being heard by the bankruptcy court.

103. *See* 4 Collier ¶ 67.15[4]; *cf.* Clarke v. Larremore, 188 U.S. 486 (1903).

104. Administrative Procedure Act, 60 Stat. 237 (1946), *as amended*, 5 U.S.C. §§ 551-59, 701-06, 1305, 3105, 3344, 6362, 7562 (1970); *see* Rep. Att'y Gen. Comm. Ad. Proc. 55-56 (1941).

ample, George Treister, a member of the Rules Advisory Committee, pointed out that the same referee who heard contested matters also participated informally in administrative matters and often gleaned considerable information about the estate and the bankrupt in the process. Further, the referee often had a close working relationship with the trustee whom he probably appointed in the first place.[105] While the danger of prejudice to the adverse party was most acute when the referee tried a case whose compromise he had previously denied, or a preference or fraudulent conveyance action he had encouraged the trustee to bring, litigants have expressed understandable doubt over his complete objectivity in other matters as well.[106]

In addition to the foregoing, the referee's office has, to put it bluntly, an image problem. Part of the problem is historical. Until 1946 the referee's salary was a fraction of the assets of the estate, and some felt that this resulted in a noticeable pro-trustee bias.[107] And even now the referee's salary and the expenses of the bankruptcy administration are not paid from the public treasury, but from funds collected from the bankrupt's themselves.[108] The "inferiority complex" was reinforced by the distinction of referees from federal judges generally. Even today, they receive less compensation, occupy smaller courtrooms, and do not wear robes. The referee's decisions were not "appealed" to a higher court; the creditor "petitioned for review" of the referee's decision.[109] Unlike the usual situation in civil litigation, where the litigants were responsible for the record on appeal, the referee himself had to prepare a summary of the evidence and findings for the review process.[110] Once the case reached the district judge, the referee's authority was undercut by General Order 47 allowing the judge to open the record to permit the taking of further testimony or the receipt of additional evidence. When the referee's findings were reviewed in the district court, some judges did not apply the same "clearly

105. Treister, *supra* note 91, at 85-88; *see* J. MACLACHLAN, *supra* note 40, at 196, 226; Cowans, *An Agenda For Bankruptcy Reformers,* 42 REF. J. 3, 47 & n.62 (1969).

106. *See* Gendel, *Summary Jurisdiction in Bankruptcy Related to Possible Referee Disqualification,* 51 CALIF. L. REV. 755, 757-58 (1963); Treister, *supra* note 91, at 86-87.

107. Treister, *supra* note 91, at 85.

108. Bankruptcy Act § 40, 11 U.S.C. § 68 (1970). This "self-supporting" philosophy recently received a shot in the arm from the Supreme Court's decision that the $50 filing fee was constitutional. United States v. Kras, 93 S. Ct. 631 (1973).

109. Bankruptcy Act § 39c, 11 U.S.C. § 67(c) (1970).

110. Bankruptcy Act § 39a(8), 11 U.S.C. § 67(a)(8) (1970).

erroneous" standard which governed the review of judicial findings but a lesser standard which gave the district judge greater authority over factual determinations.[111] In addition, it is still an open question whether the referee can conduct jury trials. When the notion that he could was first broached, more than one district judge recoiled in horror.[112] Then there was the crowning blow: the referee could not even punish contempts in his own courtroom, but had to certify the facts to the district judge in a procedure which was so cumbersome as not to be worth the effort.[113]

2. The New Provisions

The response of the draftsmen to the myriad of complaints surrounding the referee's office was varied. The clerical functions will be delegable to subordinate officers.[114] On the other hand, despite the presence of Mr. Treister on the Committee, nothing whatever was done to separate the administrative from the adjudicatory responsibilities of the referee. The referee has been spared the task of preparing anything for the petition for review, and upon review the trial judge will not be permitted to take additional evidence and will be required to accept the findings of the referee unless clearly erroneous.[115]

3. Bestowing the Contempt Power

Perhaps the best evidence of the continuing uncertainty over the proper role of the referee, as well as over the scope of rulemaking authority itself, was the sharp controversy generated by the proposal to grant the referee the power to punish for contempt.[116] Courts are said to have an inherent power to punish

111. *See In re* Duvall, 103 F.2d 653 (7th Cir. 1939). In addition, courts purporting to apply the "clearly erroneous" standard have in some instances made factual redeterminations which seriously undercut that doctrine. *See* American Nat'l Bank & Trust Co. v. Bone, 333 F.2d 984 (8th Cir. 1964) (referee should have given predominate weight to expert testimony of value of farm rather than relying on actual sale price).

112. In March, 1960, the Judicial Conference adopted a resolution that referees "should not preside upon jury trials of involuntary petitions in bankruptcy." *See* Landers, *The Dischargeability Bill,* 40 KAN. B.J. 13, 65 & n.22 (1971).

113. Bankruptcy Act § 41, 11 U.S.C. § 69 (1970); *see* 2 COLLIER ¶¶ 41.08-.10.

114. Rules 506, 507, 605(c).

115. Rules 801, 806, 810.

116. *See* Kennedy, *The Proposed Bankruptcy Rules and Official Forms,* 46 AM. BANKR. L.J. 53, 58, 70 (1972).

for contempt which is not alterable by statute. The Supreme Court has thought the power so important that it has denied defendants their usual constitutional right to a trial by jury and trial before an impartial tribunal.[117] Although the inherent power to punish for contempt had been judicially extended to bankruptcy courts,[118] section 41b of the Act denied the referee such power and instead required him to certify the facts to the district court, which then had the discretion to punish for contempt. No case has yet questioned the ability of section 41b to restrict the referee's contempt power. Although there is substantial authority that a court's inherent power to punish for contempt is not subject to statutory modification,[119] section 41b will be assumed to be valid for the purpose of this discussion.

Critics attacked 41b on two fronts. First, it was argued that the 41b contempt procedure was so cumbersome that referees were reluctant to invoke it for minor offenses. The referee's inability to punish summarily diminished his control over his own courtroom.[120] Second, it was asserted that section 41b reinforced the notion that the referee was not really a judge but some type of clerk, special master, or arbitrator. Indeed, it could be pointed out that even some administrative agencies possess the contempt power.[121] Two issues thus confronted the Advisory

117. *See, e.g.*, Frank v. United States, 395 U.S. 147 (1969); Sacher v. United States, 343 U.S. 1, 9 (1952); *Ex Parte* Terry, 128 U.S. 289, 303 (1888) (dictum); Goldfarb, *The Constitution and Contempt of Court*, 61 MICH. L. REV. 283 (1962); Note, *Procedures for Trying Contempts in the Federal Courts*, 73 HARV. L. REV. 353 (1959).

118. *See* Boyd v. Glucklich, 116 F. 131, 135 (8th Cir. 1902); *cf. Ex parte* Robinson, 86 U.S. (19 Wall.) 505, 510 (1873) ("The power to punish for contempt is inherent in all courts . . . .").

119. There is substantial authority that a court's inherent power to punish for contempt is not subject to statutory modification. *See Advisory Committee's Note to Rule 920*, at 289 (citing authorities). Although section 1(9) of the Bankruptcy Act defines the referee as a "court," this seems directed toward allocating functions between referee and district court, and not pertinent to the contempt power.

120. *See, e.g.*, *In re* Osborne, 344 F.2d 611 (9th Cir. 1965) (attorney refused to proceed with cross-examination and insisted on taking noon recess). *See* Nelles, *The Summary Power to Punish for Contempt*, 31 COLUM. L. REV. 956, 964-65 (1931); *Advisory Committee's Note to Rule 920*, at 290-91. In Sacher v. United States, 343 U.S. 1, 11-12 (1952), the Supreme Court rejected a construction of the contempt power of a district judge which would compel him to bring the matter as a complaining witness before another judge as inadequate to deal with "hectoring, abusive and defiant conduct." It is not clear why such a referral procedure has been so long-sanctioned in bankruptcy.

121. While federal administrative agencies do not have the power to punish for contempt, a number of states have conferred that power on state agencies. *See* 1 K. DAVIS, ADMINISTRATIVE LAW TREATISE § 3.11

Committee: could the power to punish for contempt be conferred by rule and, if so, to what extent should it be conferred?

The history of the contempt power as a judicial function—possibly not even susceptible of legislative change—apparently overcame any uncertainty respecting the first issue. The Committee resolved the latter question by the "fudge" method. Although the referee was given the power to punish for contempt, his power was limited to imposing a fine of not more than $250.[122] The minimal fines would presumably suffice to enable the referee to preserve decorum in his courtroom while preserving the power of the district judge in the more serious cases. Although such a limitation might be sensible if one is uneasy about conferring the power to punish for contempt in the first place, it makes no sense in light of the other pronouncements of the draftsmen about increasing the prestige and dignity of the bankruptcy court.[123] The obvious compromise attests to the failure of the draftsmen to resolve current uncertainty concerning the office of the referee and suggests a fundamental dispute as to whether the referee should be a judge. While the Committee was quick and eager to bestow the title,[124] they were obviously hesitant to confer the power which normally accompanies it.

4. *Some Old Problems Remain*

Despite the drafters' awareness of a need to separate the administrative and adjudicatory functions of the referee (if only by the presence of Mr. Treister on the Committee) the Rules make no attempt to correct the problem. Although some of the proposed solutions concerning the assignment of referees in multi-referee districts seem unquestionably within the rulemaking power, it may be that the draftsmen thought them inadequate. Since the Committee thought far reaching reform to be impossible because of its narrow construction of the scope of its rulemaking power, the rules' solution was to abstain.

Other examples of piecemeal reform are the continuing doctrines that the referee's decisions are reviewable by the district

(1958). *See also* Federal Maritime Comm'n. v. New York Terminal Conference, 373 F.2d 424, 426 n.2 (2d Cir. 1967).

122. Rule 920.

123. *See, e.g.,* ADVISORY COMMITTEE ON BANKRUPTCY RULES, PRELIMINARY DRAFT OF PROPOSED BANKRUPTCY RULES AND OFFICIAL FORMS UNDER CHAPTERS I TO VII OF THE BANKRUPTCY ACT xxxviii (1971); Herzog, *supra* note 96, at 67; Kennedy, *supra* note 116, at 58.

124. Rule 901(7).

court and the widespread allowance of interlocutory appeals in bankruptcy matters.[125] A good argument could be made that the referee, as a "bankruptcy judge," should be regarded as the trial court level and that his decisions be directly reviewable by the court of appeals. This would build on the administrative law model of having agency determinations reviewed by an appellate court.[126] In any event, apart from doubts about the quality of justice dispensed by the referee, no compelling reason can be advanced for bankruptcy litigants to be given an extra rung of appeals unavailable to federal litigants generally. Similarly, no reason is apparent for continuing the availability of interlocutory appeals. If the draftsmen thought themselves powerless to accomplish reform of this procedure, then one must question the worth of rulemaking. If one doubts the competence of referees, then that problem should be attacked directly rather than by the retention of provisions in the Act to protect litigants from anticipated miscarriages of justice at the hands of the referee.

A further problem concerns the relationship between the Rules Committee and the Bankruptcy Commission. The Rules Committee operated within a given institutional framework: voluntary and involuntary petitions, administration by the trustee, and supervision by the referee. The Brookings Report has suggested a different institutional framework based on the administrative model. Whether or not one agrees with the latter suggestion, the promulgation of the rules may cause understandable reluctance on the part of the Bankruptcy Commission to consider the kind of radical overhaul of the system which would make the efforts of the members of the Advisory Committee superfluous. Here then we have the tail of limited rulemaking authority wagging the dog of overall bankruptcy reform; the result is that relics of the past have again become fixtures for the future.

E. Administrative Costs

Administration expenses take more than 25% of all funds administered in bankruptcy, and total almost $30,000,000 per year. Trustees and attorneys for trustees garner more than 55% of all administration expenses, and a total of about 15% of all funds administered in bankruptcy. Since the Referee's Salary

125. Bankruptcy Act §§ 24, 39c, 11 U.S.C. §§ 47, 67(c) (1970).
126. *See, e.g.*, 15 U.S.C. § 45(c) (1970) (FTC review); 15 U.S.C. § 78y (1970) (SEC review).

and Expense Fund, which is presumably not subject to change by rule, takes an additional 10% of administration expenses, it is obvious that any major effort to cut costs must start with trustee, referee, and attorney fees.

The conventional wisdom holds that administration expenses, which have long consumed about 25% of the assets in those cases where there are assets, are too high.[127] What is unclear is the basis for this assertion. While there are obviously no correct or proven formulae to calculate "proper" administration costs, it should be noted that the lawyers working on a contingent fee usually receive between 1/4 and 1/3 of the recovery and may receive as much as 1/2 on smaller claims. Collection agencies generally charge 50% for services which in some ways resemble bankruptcy administration. And, although the figures on compensation in class and representative actions are sparse, lawyers have regularly been awarded between 10% and 40% of the recoveries.[128] Considering these possible analogies, the 25% figure for administering bankrupt estates does not seem disproportionately high.[129]

A second explanation of cost complaints is that trustees and their attorneys are being asked to do too many things. The assumption is that, if they were asked to do less, they could be compensated at a lower figure. A diligent trustee and his attorney (if one is appointed) might be expected to confer with the bankrupt and at least one or two major creditors, inspect the bankrupt's real and personal property as well as records of bank accounts and stockholdings, investigate possible hidden assets and avoidable transactions, object to improperly claimed exemptions, object to the bankrupt's discharge where appropriate, attend all creditors' meetings, and file the various required docu-

127. *See* 3A COLLIER ¶ 62.02[1]; Address by Chief Justice Earl Warren, Annual Dinner of National Association of Referees in Bankruptcy, Oct. 23, 1962, in 37 REF. J. 3, 4-5 (1963); *Hearings Before a Subcommittee of the House Committee on the Judiciary on S.J. Res. 88*, 91st Cong., 1st Sess. 44 (1969).

128. *See* Hornstein, *The Counsel Fee in Stockholder's Derivative Suits*, 39 COLUM. L. REV. 784, 814 (1939). *See also* 2 G. HORNSTEIN, CORPORATION LAW AND PRACTICE § 732, at 253 (1959) (overall average of 20%).

129. Referee Cyr has noted that administration expenses were reduced about 5% between 1961 and 1968. This is especially significant since average realization per case declined by 28% and the proportion of administration expenses to total assets tends to rise as the realization declines, and because the period was one of persistent inflation. Cyr, *Single Claim Jurisdiction for the United States Court of Consumer Affairs*, 46 AM. BANKR. L.J. 199, 215 n.58 (1972).

ments. In addition, the sending of notices to a number of persons for creditors' meetings or informing creditors of a proposed settlement invariably results in a number of callers seeking further information and possibly assistance. If the trustee refuses to help a small creditor file a proof of claim, to photocopy the bankrupt's schedules for a creditor, or to answer the routine questions about the estate upon request, he is regarded as boorish and uncooperative; if he helps and then seeks some measure of compensation for his efforts, he is regarded as greedy. In light of the duties of the trustee and his attorney, compensation hardly appears overly generous. A third possible explanation of complaints about over-compensation is that it is widely felt that trustees and their attorneys are not adequately carrying out their responsibilities. The quick answer might be that too much is demanded of the trustee and his attorney in light of the resources of most bankrupt estates; the estate pays minimal compensation for minimal services.

In any event, one would expect new procedural rules to do something about widespread complaints of excessive administration expenses. There is no evidence to suggest that the Advisory Committee even took note of these critiques, let alone attempted to do something about them. Possible approaches available to the Committee include lessening the trustee's responsibilities, changing the selection method, placing a maximum percentage limit on compensation, providing for the designation of a court officer as trustee in specified categories of cases, or, at a minimum, giving evidence of having considered and rejected the criticisms as unjustified. If the new rules win acceptance this apparent void will probably yield continued criticism.[130]

F. DISTRIBUTION TO CREDITORS

Under section 57n of the Act, creditors have six months after the first date set for the initial meeting of creditors to file

130. Rule 219 does regulate compensation of trustees and attorneys. While the Advisory Committee was apparently hesitant about getting into this area as one which was arguably beyond the scope of their rule-making power, the question was ultimately resolved in favor of a rule which simply codified the existing case law. *See Advisory Committee's Note to Rule 219*, at 100. On the other hand, the draftsmen considered possible changes such as abolishing present limits in section 48 of the Act on the amount of compensation for trustees as being for Congress. ADVISORY COMMITTEE ON BANKRUPTCY RULES, *supra* note 123, at xxxv.

proofs of claims. The rules draftsmen have made this relic of bygone days—when letters travelled by stagecoach—a permanent part of the future.[131]

It is not clear whether the six month period was left intact because the draftsmen agreed with it or whether they doubted their power to effect a change. On a policy level, it is difficult to take seriously the contentions that creditors really need six months to file claims, and that the draftsmen were not hesitant to shorten time limits where appropriate. For example, the rules contemplate that the alleged holder of the bankrupt's property or recipient of a preference may be compelled to go to trial within 25 days of filing the trustee's complaint.[132] Objections to discharge or to the dischargeability of individual debts must be made after only thirty days' notice.[133] There is no justification for providing a longer period in the much less complex matter of filing claims. The draftsmen have defined their scope too narrowly if they doubted their power to change this six month provision.[134]

The draftsmen have made the approved proof of claim somewhat more cumbersome and incomprehensible,[135] even though there is evidence that it is already incomprehensible to some "unsophisticated" creditors.[136] Moreover, under the rules the creditor will never receive a copy of the official form. Again, unsophisticated creditors might be at a loss to know where to obtain the form. One possible solution is to require the referee to make a determination from the petition and schedules that the case is one where there are substantial numbers of creditors who would benefit from receiving a copy of the official form. In such a case a copy of the official form would be sent to them.

Moreover, the rules do not pay any heed to recent innovative proposals to simplify the claims process for small claimants. Since small claims are rarely contested, the creditor's claim could be allowed simply upon his returning a self-addressed postcard signifying his agreement to the amount listed on the

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131. Rule 302(e).

132. *Advisory Committee's Note to Rule 704*, at 201.

133. Rules 404(a), (b); 409(a)(2).

134. The six month provision has been high on the agenda for procedural reform. *See* Herzog, *supra* note 96, at 70-71; STANLEY & GIRTH 207.

135. Official Form No. 15. There is a special form for wage earners that is somewhat easier to complete. Official Form No. 16.

136. *See* Schrag & Ratner, *Caveat Emptor—Empty Coffer: The Bankruptcy Law Has Nothing to Offer*, 72 COLUM. L. REV. 1147, 1171 (1972).

bankrupt's schedules. In cases where there is a large group of similarly situated creditors with small claims, the Rules could authorize a "class claim" filed by a member of the class, a representative such as a labor union, or by a governmental agency.[137]

The procedure for allowing claims is somewhat altered. It will no longer be necessary for the court to formally allow each claim. Instead, a duly filed claim is considered prima facie valid and will be allowed unless an objection is made.[138] Ordinarily the objection will be made by the trustee, who is charged with the duty of investigating claims. An objection to a claim is not treated as an adversary proceeding; the objector simply sends the objection and notice of a hearing to the claimant, and the court will hear the pertinent evidence and decide whether the claim is valid.[139]

Proposed Rule 308 requires the court to pay dividends as promptly as possible. Nevertheless, the Comment recognizes that various contingencies such as requests for administration expenses, determinations of contested proceedings, and liquidations of assets, "freqently dictates caution to avoid premature and excessive distributions that may have to be recovered." Ordinarily it is doubtful whether preliminary dividends should be paid. If there are more than a few claimants, such dividends involve considerable bookkeeping and clerical expense which is difficult to justify more than once in the bankruptcy process. Since the final dividend can never be precisely known until the estate is wound up, a better course would be to speed up the process so that the estate could be closed expeditiously. If the bankrupt's funds are invested in an interest bearing account, creditors will not be prejudiced by delaying the final distribution.

G. THE BANKRUPT AND THE ADMINISTRATION OF HIS ESTATE

The bankrupt seeks three interrelated ends from the bankruptcy process. The first is discharge of his debts. Second, and in tandem with the first, he seeks relief from the pressure of his creditors and protection against any attempt by them to fru-

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137. *See id.* at 1176-82, 1190-91. Rule 723 indicates that Rule 23 of the Federal Rules of Civil Procedure—authorizing class actions—applies in "adversary proceedings." However, the filling of a claim is not an "adversary proceeding" under Rule 701. Hence, there is no authority for the class proof of claim.

138. Rule 306(b).

139. Rule 306(c).

strate his discharge. Third, he seeks to gain any exemptions to which he is entitled under state law as incorporated in section 6 of the Bankruptcy Act.

1. Discharge

There are two basic exceptions to the general right of a debtor to have his debts discharged in bankruptcy. Section 14 sets forth a number of grounds upon which a discharge may be denied in toto. Section 17 sets forth eight categories of claims which are not dischargeable; in any such case, the bankrupt can only obtain a discharge which exempts the nondischargeable debts. There are a few further exceptions. Under section 63 of the Act, certain claims are not provable—meaning that they survive bankruptcy. The most important are tort claims which are not the subject of actions pending at the time of the petition. Where an otherwise provable contractual claim involves damages difficult or impossible to calculate, it may be converted into an unprovable claim under section 63c.

Congressional amendments of 1970, and to a lesser extent those of 1960, provided the bankrupt with the necessary protection of his rights to discharge. The rules carry forward the existing practice.[140] The court must fix a date between 30 and 90 days after the first date set for the initial meeting of creditors for filing objections to the bankrupt's discharge, or the dischargeability of particular debts pursuant to section 17 of the Act. Thirty days notice must be given of the deadline for filing such objections.[141] However, if notice of no assets is given, the court may determine dischargeability at the first meeting of creditors and upon ten days notice.[142] Here the draftsmen seemed to have made an untenable distinction between no asset and low asset cases. There is no reason why the referee should not have discretion to determine dischargeability at the first meeting of creditors in any case. Such a short time limit would reinforce the policy of the Bankruptcy Act to discourage objections to dischargeability.[143]

140. *See, e.g.*, Countryman, *The New Dischargeability Law*, 45 AM. BANKR. L.J. 1 (1971); Landers, *supra* note 112.

141. Rules 404(a), (b), 409(a)(2).

142. *Id.*

143. A recent study showed that objections to the dischargeability of individual debts were made in approximately 12% of the cases. Shuchman, *Impact Analysis of the 1970 Bankruptcy Discharge Amendments*, 51 N.C. L. REV. 233, 247-54 (1972). This was a substantial reduction from the number filed before the amendment. *Id.* at 243-45, 248.

2. Protection of the Discharge

The bankrupt has a need for protection both during and after the bankruptcy proceedings. The main danger is that greedy creditors may attempt to evade the bankruptcy proceedings by action in another court which they hope the bankrupt will ignore for a sufficiently long time to enable them to reacquire or retain some of the rights which they otherwise appear to lose in the bankruptcy proceeding. Prior to 1970, this issue frequently arose with reference to debts which were allegedly not discharged by section 17 of the Act. Not only did the discharge itself fail to specify which debts were discharged but, absent special circumstances, the bankruptcy court was not even permitted to determine dischargeability questions. Instead, a creditor who believed that a debt was not dischargeable was able to sue in state court where the former bankrupt was expected to raise his discharge as a defense. Widespread abuses by creditors led to Congressional reform which required that the most common objections to dischargeability—liabilities based on a false financial statement, frauds, conversions, and willful torts—be determined exclusively in the bankruptcy court.[144] The bankrupt's discharge will be supplemented by a broad-based injunction: within 45 days of discharge creditors will be sent a notice of discharge informing them that any judgments on discharged debts are void; that all debts which are discharged by statute or which have been determined to be dischargeable are discharged; and enjoining creditors from instituting or continuing action to collect the debts.[145]

Prior to the rules, however, the bankrupt had no absolute protection prior to obtaining his discharge. Although section 11a authorized the court to grant a stay if it was applied for, the procedure was not automatic. Now, Rule 401(a) specifically provides that the bankrupt's adjudication operates as an automatic stay of all pending or future actions if the action or judgment is founded on "an unsecured provable debt", except one which is not dischargeable under sections 17a(1), (3), (5), (6), or (7).[146] To obtain relief from the stay, a creditor must file a for-

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Objections to the bankrupt's discharge have been sustained in fewer than 1% of the cases. STANLEY & GIRTH 90-91.

144. *See* authorities at notes 140 and 143 *supra*.

145. Bankruptcy Act § 14f, 11 U.S.C. § 32(f) (1970).

146. The claims not excepted are for certain tax claims, unscheduled debts, wages and commissions, obligations to employees on security deposits, and alimony and support.

mal complaint commencing an adversary proceeding. The stay remains in force until the case is dismissed or the bankrupt is denied a discharge; if the bankrupt is granted a discharge the stay is replaced by the broad based injunction noted earlier. Thus, under the rules and the Act, the bankrupt will obtain continuous protection against the possibility that his discharge will be sandbagged in other courts from the time of adjudication.

To be sure, there is no specific authority for the predischarge injunction. However, section 11a which authorized the court to grant such a stay of suits on dischargeable debts and the policy of the 1970 amendments to protect the discharge provide considerable support. Moreover, it appears that requests for such injunctions are granted as a matter of routine when requested, and similar injunctions are regularly included in orders authorizing Chapter X and XI proceedings.[147] Thus, it appears to save considerable time and effort to issue the broad injunction first, and place the initiative upon creditors to secure modifications.

3. Exemptions

Section 6 provides that the bankrupt shall have all exemptions provided by state law and may claim those exemptions in his schedule of assets. Rule 403 requires the trustee to examine the claimed exemptions and to specify to the court those exemptions which are properly and improperly claimed within 15 days of his qualification. The trustee's report has prima facie validity, and objections to the report by the bankrupt or a creditor will be heard by the referee. The objector carries the burden of proof. There is, however, no provision for notifying creditors of the claimed exemptions. In this respect, Rule 403 places the burden of performing the necessary investigatory act on the trustee. That being the case, it is not clear why creditors retain any right to object. Again, it reflects a nagging distrust of trustee performance. Moreover, it should be noted that in contrast with the rules governing sales of assets, assumption of contracts and abandonment of property, the referee's approval of the exemption list is not required. It is not clear why the draftsmen made this distinction.

4. Representing the Bankrupt

The filing or contemplation of a bankruptcy petition indicates that the usual restraints on incurring excessive obligations

147. *See* STANLEY & GIRTH 84 (requests for injunctions against

have failed. As a group, potential bankrupts face an array of decisions of a legal nature. The potential bankrupt must choose from among a straight bankruptcy petition, a Chapter XIII petition, a state law composition proceeding, a private arrangement with his creditors, or doing nothing. Obviously an informed decision is impossible if the potential bankrupt does not understand the legal ramifications of each course of action. If he decides to file a straight bankruptcy petition, the debtor will ordinarily need help in filing schedules, listing creditors and the amounts owed, dealing with secured creditors, securing his discharge, and claiming exemptions. During the bankruptcy proceeding, he may need legal advice in regard to an investigation or contested matter. After obtaining his discharge, the bankrupt may still have carry-over problems with contumacious creditors who have commenced legal proceedings in spite of the discharge or who are trying to induce the bankrupt to assume his former debts.

Section 64a of the Bankruptcy Act provides for the representation of the bankrupt in the bankruptcy proceeding, with the bankrupt's attorney to be paid from the estate. Such an approach creates obvious difficulties in the vast majority of cases where there is no estate, or where the bankrupt's attorney must share a tiny estate with an array of trustees, attorneys, appraisers, referees, and other hat holders. For instance, in the 15% of bankruptcy cases in which there were insufficient assets to cover administration expenses (nominal asset cases), the bankrupt's attorney received an average of slightly over $10. While these attorneys probably received something more from the bankrupt or his friends or relatives, the totals were hardly princely. In addition, the court may inquire as to any pre-bankruptcy payments or promise of compensation in order to insure that the bankrupt's attorney is not overpaid: such pre-bankruptcy payments are not permitted if the bankrupt is paying the filing fee in installments.[148]

The bankrupt's lawyer is thus paid very little. As might be expected, he also does very little, as evidenced by the Brookings Report finding of grave deficiencies in the bankrupt's representation. The spectre of the bankrupt's attorney running madly around the courthouse to find his client (the bankrupt) before the first meeting of creditors would be funny if it was

creditor interference granted in almost all cases); Landers, *supra* note 112, at 66 n.23; Schrag & Ratner, *supra* note 136, at 1185.

148. Rules 107(b)(3), 220.

not so tragic.[149] Unfamiliarity with the case seems to be the rule rather than the exception. Moreover, even if the bankrupt does have an attorney who is sufficiently compensated from the estate, he is nonetheless disadvantaged by the rule that the attorney may not be compensated out of estate funds for personal benefits to the bankrupt, such as securing exemptions or insuring the bankrupt's discharge.[150] Finally, the bankrupt's attorney is not expected to represent him in any post-bankruptcy legal matters, even if they grow out of the bankruptcy. There is likewise no provision for debt-counseling even though the bankrupt is particularly vulnerable to the soft-sell of eager creditors after the bankruptcy. The bankruptcy system, although designed to give the bankrupt a fresh start, may have led him to a swamp from which he cannot be pulled for another six years.[151]

About the only justification for this state of affairs is that the bankrupt is no worse off in connection with bankruptcy matters than he is generally in dealing with his creditors. Put another way, the problem is hardly unique to post-bankruptcy disputes with creditors, but rather is inherent in litigation between the small or middle income consumer and large well-financed opponents. Be that as it may, the draftsmen of the rules blithely ignore the problem while the apologists for the present system continue to defend it on the assumption that there is no inherent flaw.[152] However, it seems that the Brookings suggestions for administrative control are based in large part on the obvious deficiencies in the bankrupt's representation. While the Brookings proposal may be objectionable, it is difficult to sustain the attack on it by arguments that administrative control would deny the bankrupt effective representation by counsel of his own choosing and would substitute an administrator. The fact is that such representation may be substantially more than the bankrupt gets under the present system.

III. CONCLUSION

Subsequent to the preparation of this Article, an event occurred which is bound to make those in the rulemaking area

149. See STANLEY & GIRTH 80; Cowans, *supra* note 105, at 52.

150. *See* V. COUNTRYMAN, CASES AND MATERIALS ON DEBTOR AND CREDITOR 337-38 (1964).

151. Bankruptcy Act § 14c(5), 11 U.S.C. 32(a)(5) (1970); *see* Cowans, *supra* note 100, at 4-5.

152. *See* Levit, *Bankruptcy Administration and the Brookings Report—A Critical Analysis,* 77 COM. L.J. 179, 181 (1972).

shudder. The Federal Rules of Evidence, eight years in the drafting, finally finished, duly promulgated by the Supreme Court, and sent to Congress, received an icy reception in the legislative halls. Just two days after submission, the Senate passed legislation which would delay the effective date of the rules.[153] Little more than a month later, the House went further and enacted by the lopsided majority of 399 to 1 a bill to delay the effective data of the rules indefinitely and until Congress specifically said otherwise.[154] A chorus of House members expressed vehement opposition to rules which altered and restricted traditional husband-wife and doctor-patient privileges, expanded governmental immunity for state secrets and official information, affected state-law presumptions, expanded the powers of trial judges, and altered the ubiquitous hearsay rule. Some Representatives were particularly upset with the failure to accord a newspaper reporter's privilege, while others were simply puzzled that the rules dealt with such a privilege when Congress was considering legislation dealing with precisely the same subject. Other House members complained that the rules had not been submitted to the ABA for comment, and concern was expressed with last minute changes made at the instigation of the Justice Department. Finally, some members of Congress expressed resentment against what they regarded as an intrusion into the legislative domain. Indeed, the legislation was termed a "bill to promote the separation of powers."

There are valuable lessons to be learned and applied to bankruptcy rulemaking. On one hand, it might be argued that the attitude of rulemaking restraint articulated by the bankruptcy draftsmen—although, as noted in the text, not always followed—was a shrewd choice. However, an analysis of the House comments reveals something even more fundamental about the debate's; many Congressmen disagreed "on the merits" with the new evidence proposals and frequently regarded them as a step backward rather than forward. The new bankruptcy rules may face a similar reaction. Moreover, the expressed concern with the evidentiary rule governing privilege being adopted while Congress was considering the reporter's

153. Although the Rules were approved by Court Order on November 20, 1972, for reasons which are unclear, they were not sent to Congress until February 5, 1973. 119 CONG. REC. H 1721 (daily ed. Mar. 14, 1973) (remarks of Rep. Rodino). The Senate action appears at 119 CONG. REC. S 2241-42 (daily ed. Feb. 7, 1973).

154. The House action, and the accompanying debate, appears at 119 CONG. REC. H 1721-31 (daily ed. Mar. 14, 1973).

privilege may raise legitimate questions about the respective roles of the rules promulgated by the Advisory Committee and anticipated proposals by the Bankruptcy Commission. Again, one may be concerned with the lack of apparent public attention paid to bankruptcy rulemaking. Both the Federal Rules of Civil Procedure and the now moribund Federal Rules of Evidence were preceded by decades of discussion and debate among scholars and practitioners about the wisdom and scope of such rules, and particular attention was frequently focused on particular provisions which might be included. Bankruptcy rulemaking was preceded by a much more general discussion, limited almost entirely to bankruptcy "buffs," expressing the general need for reform. Even more surprisingly, there has been a paucity of attention paid to the Advisory Committee's draft of the Bankruptcy Rules, and almost all of the scholarly writing has been by members of the Advisory Committee. Indeed, the American Bar Association apparently regarded the eventual adoption of the rules as assured. In the past year, long before the final draft had even been submitted by the Advisory Committee to the Supreme Court, the ABA held four institutes in various cities to familiarize the bar with the still-to-be-accepted rules.

The attorney who deals with few bankruptcy matters and has not heard of the new rules may feel right at home when he next appears in the bankruptcy court. If, perchance, the bankruptcy judge enters his courtroom wearing his robe and castigates the attorney for calling him a "referee," the attorney will be certain that the era of the new rules has begun. We in the audience will unfortunately have to watch and listen carefully, for this is one of the precious few clues we will have.