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WHAT PRICE BANKRUPTCY: A PLEA FOR "FRIENDLY ADJUSTMENT"†

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During the past four months,[1] the public press has been filled with startling disclosures concerning the administration of bankruptcy in the Southern District of New York. On January 10, 1929, as a result of abuses brought to their attention, the six federal judges sitting in this district[2] ordered a sweeping investigation into bankruptcy conditions by the federal grand jury.[3] On January 11th, under the leadership of United States Attorney Charles H. Tuttle, the grand jury began its investigation,[4] and during the next eight weeks summoned witnesses and heard testimony concerning 5,000 different bankruptcy cases.[5] As a result of their findings and on their recommendation,[6] Mr. Tuttle on March 6th petitioned the Federal Judges for a general public investigation.[7] This was granted by the United States District Court, and Federal Judge Thomas D. Thacher was selected to preside.[8] In the meantime, the federal grand jury continued to probe matters brought before it and to investigate conditions that will be sifted even more thoroughly in the general public inquiry before Judge Thacher, which began on April 23rd.[9]

In the period covered by these developments, two prominent New York attorneys[10] pleaded guilty to embezzlement of funds while

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[1]Jan. 1–May 6, 1929.

[2]John C. Knox, Thomas D. Thacher, Henry W. Goddard, William Bondy, Francis A. Winslow and Frank J. Coleman.

The jusrisdiction of this district covers eleven counties, the only three having large commercial standing being New York, Bronx, and Westchester. New York Times, Dec. 30, 1927.

[3]New York Herald-Tribune, Jan. 11, 1929.

[4]*Ibid.*

[5]New York Sun, Mar. 7, 1929; New York World, Mar. 7, 1929.

[6]*Ibid.* [7]*Ibid.* [8]*Ibid.*

[9]New York Evening World, Apr. 23, 1929; New York Evening World, Apr. 25, 1929; New York Times, May 3, 1929. See *infra* note 19.

[10]Merrill E. Gates, Jr. and David H. Gladstone. New York Sun, Feb. 19, 1929.

serving as trustees and receivers in bankruptcy cases, and were sentenced to imprisonment;[11] one federal judge[12] resigned from office under the fire of grave charges of official misconduct; one federal auctioneer,[13] in office for twenty-five years, was removed and indicted for bankruptcy irregularities; one attorney[14] (under investigation for corrupt practices in bankruptcy administration and since indicted for embezzlement) resigned from practice in both federal and state courts and from participation as receiver or trustee in bankruptcy cases; and, as a final climax, Attorney David Steinhardt, the key witness in the government's probe into the bankruptcy ring and a fugitive from justice since last December, committed suicide[15] April 19th, on the eve of his surrender to the federal authorities. Steinhardt, the day before his death, sent a statement to United States Attorney Tuttle making extensive disclosures concerning New York bankruptcy evils. This document Mr. Tuttle proposes to use as the basis for his general inquiry.[16]

These are only the high lights in a series of events startling in their disclosure of inefficiency and corruption. A number of other persons have been indicted, scores have been questioned, and a public investigation precipitated which threatens to result in a general overhauling of the bankruptcy laws.[16a] Already two local reforms have been instituted by the Federal District Court. One was the selection on January 6th of the American Exchange-Irving Trust Co. (now the Irving Trust Company) to handle all receiverships in bankruptcy.[17] The other was the designation on February 7th of The Underwriters Salvage Company of New York as "an" official auctioneer[18] succeed-

[11]New York Sun, Feb. 26, 1929.

[12]Judge Frances A. Winslow. New York Evening Post, Apr. 1, 1929. See New York World, Mar. 2, 1929, giving Federal Grand Jury's report on Judge Winslow (quoted in part at *infra* note 35), and New York Evening Post, Mar. 2, 1929, which sets forth the formal impeachment charges by Representative F. H. LaGuardia of New York against Federal Judge Winslow on the floor of the House of Representatives. See also *infra* note 40.

[13]Charles T. Shongood, removed without explanation by order of six District Judges (New York Telegram, Jan. 28, 1929), and indicted by Federal Grand Jury. New York World, Feb. 5, 1929.

[14]Marcus Helfland. New York Sun, Apr. 1, 1929. See also New York Evening Post, Mar. 2, 1929, and New York Evening World, Apr. 2, 1929 (report of indictment).

[15]New York Times, Apr. 20, 1929. [16]New York Sun, Apr. 24, 1929.

[16a]See *supra* note 9 and *infra* note 62.

[17]The Trust Company will not act as receiver in equity cases, wherein there is litigation and the judges appoint a receiver. New York Times, Jan 17, 1929. See *infra* note 23.

[18]New York Sun, Feb. 8, 1929.

ing Charles Shongood, previously referred to as removed from office and indicted for misappropriation of bankrupt funds. Still further investigation and reform are contemplated, and to this end the bar associations of New York[19] and the National Association of Credit Men are lending their coöperation and assistance.

In view of these events, it is highly important to analyze in an impartial manner the actual results obtained in bankruptcy administration throughout the United States, and to try to arrive at the cause of some of its weaknesses. While the New York situation is primarily a striking example of fraudulent practice, it is also strong evidence of flaws in the system itself.[20] That system, as such, I propose to examine from the standpoint of both theory and practice, and to compare the results obtained under it with those obtained under "Friendly Adjustment"—the outstanding extra-legal means devised as an alternative to proceeding in bankruptcy.

THE CASE AGAINST BANKRUPTCY

The present bankruptcy law was enacted July 1, 1898 and, together with the amendments thereto and the General Orders in Bankruptcy adopted by the Supreme Court, constitutes the authority for all bankruptcy administration in the United States. It is a system of jurisprudence which grew out of special needs on the part of the business community, for which the "standard equipment"[21] of the

[19]Three bar associations (The Association of the Bar of the City of New York, The New York County Lawyers' Association and the Bronx County Bar Association) in response to an invitation to name counsel to assist Mr. Tuttle, have selected Colonel William J. Donovan. New York Evening World, Apr. 27, 1929. An item in the New York Evening Post, May 18, 1929, states that these three bar associations have taken over the public investigation begun under Mr. Tuttle and will pay for continuance of it.

The National Association of Credit Men and the New York Credit Men's Association manifested their coöperation in several ways. The Frauds Bureau of the N. A. C. M. assisted materially in gathering the evidence presented at the public inquiry before Judge Thacher. The N. A. C. M. also appointed a committee to study bankruptcy procedure. And the New York Credit Men's Association aided Mr. Tuttle's assistants in making a survey of 5,000 New York bankruptcy cases, this survey forming the basis of the general public inquiry. New York Sun, Mar. 7, 1929. New York American, Apr. 15, 1929.

[20]"The Bankruptcy statute, although a creation of the human mind, provides a well-nigh perfect system of jurisprudence by which the rights of creditors are zealously protected, and the honest bankrupt can avail himself of this kindly, humane, benevolent legislation and obtain a discharge from the payment of his debts, thereby obtaining a new lease of business life." Samuel C. Duberstein of the Brooklyn bar, quoted in ISAAC, FACTS ABOUT BANKRUPTCY (1928) 259.

[21]Sturges, *Commercial Arbitration* (1924) 34 YALE L. J. 480, 489.

law courts had proved inadequate. As generally conceded, it has two major purposes: (1) to furnish to a debtor, whose liabilities are greater than his assets, a method for turning over his property to creditors and beginning his economic life anew, free from debt; (2) to distribute the debtor's assets proportionately among his creditors.

How well the objects of the Act are fulfilled and whether the system does meet the requirements of the business community can best be demonstrated by a consideration of bankruptcy administration in terms of actual facts and figures.

The Statistics of Bankruptcy Proceedings for the fiscal year ending June 30, 1927, include the following summary of cases (voluntary and involuntary) for the entire United States:[22]

Number of cases concluded	48,269
Total liabilities	$885,557,335.03
Unsecured liabilities	672,498,083.28
Secured and preferred liabilities	213,059,251.75
Total realized from assets	96,558,929.90
Total paid secured and preferred creditors	28,484,578.92
Total paid general creditors	43,609,750.80
Total administration expenses (including attorney's fees)	21,342,066.64
Attorney's fees	7,306,335.43

Reduced to percentages, these figures are:

Percentage total administration expense to amount realized	22.10
Percentage attorney's fees to amount realized	7.57
Percentage paid general creditors as to unsecured liabilities	6.48
Percentage paid all classes of creditors as to liabilities	8.14

The involuntary cases for the entire United States during the same period show the following figures:

Cases concluded (including 480 petitions dismissed and 439 compositions confirmed)	5,974
Total liabilities	$356,972,102.30
Unsecured liabilities	303,260,505.13
Secured or preferred liabilities	53,711,597.17
Realized from assets	60,842,042.48
Total paid secured or preferred creditors	13,725,379.06
Total paid general creditors	30,781,344.02
Total administration expenses (including attorney's fees)	14,111,971.33
Attorney's fees	4,900,924.07
Percentage total administration expense as to amount realized	23.18
Percentage paid general creditors as to unsecured liabilities	10.11
Percentage paid all classes of creditors as to liabilities	12.49

[22]REP. ATTY. GEN. 1927, at 178.

One of the worst features in this survey is the extremely low percentage realized by general creditors on their unsecured liabilities (10.11% during 1926–27 for the involuntary cases alone and 6:48% for voluntary and involuntary cases combined). The sources of this are not difficult to find, and they constitute the principal counts against the bankruptcy system. They are:

(1) The problem of obtaining reasonable prices for the bankrupt's assets.

(2) The high cost of bankruptcy administration.

(3) The non-coöperation of creditors.

The Marketing Problem

The first of these, the marketing problem, arises from the fact that the settlement of an insolvent estate is normally an economic and not a legal function. In the troublesome case of fraudulent concealment of assets by the debtor, legal machinery is of course necessary. But in the average case of a business which goes to the wall, the debtor is more often inefficient than dishonest,[22a] and the claims of his various creditors are not active litigations. Under such conditions, the ordinary procedure of the liquidating agent is to reduce the debtor's assets to cash, to pay the expenses of liquidation, and then to distribute whatever remains to the creditors.

In carrying out these steps, the first source of difficulty is the frequent employment of a receiver or trustee who is skilled in the law rather than in merchandizing. The estate is thus deprived of whatever advantage accrues from commercial experience and efficiency in the sale of stocks, for not only is the receiver an unskilled merchandizing man himself, but it is also unprofitable for him to assemble about him for the purposes of a single case a staff trained in the disposal of bankrupt stocks. This, of course, is not true in the Southern District of New York since January 17th, for now the Irving Trust Company of New York City, with a staff of some sixty persons devoting their full time to bankruptcy administration, is acting as receiver in all bankruptcy cases.[23] There are occasional

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[22a] Bradstreet's summary of causes of failures in the United States for 1928 shows that only 544 failures out of 20,373 were due to fraud on the part of the debtor. Incompetence of the debtor was responsible for 6,396 failures and lack of capital for 7,290 others. "Specific conditions" (disaster, war, floods, etc.) took a toll of 3,613. Causes for the remainder include inexperience, unwise credits, neglect, and competition.

[23] In a report published in New York World, Mar. 2, 1929, the Irving Trust Company announced that it had been appointed receiver in sixty-four bankruptcy

exceptions in other cities also, as in Pittsburgh, where the more lucrative receiverships and trusteeships are sometimes filled by trust companies specially staffed to handle bankruptcies. These instances, however, are still much in the minority.

The second source of difficulty is that the assets are usually sold at public auction.[24] Theoretically, the trustee may choose to conduct a private rather than a public sale of the assets,[25] but, as a practical matter, he generally will have neither the organization nor the time to sell advantageously to private purchasers. Therefore, the public sale and its resulting low returns is virtually forced upon him. This not only means the added expenses involved in advertising and conducting a public sale, but also other losses. Too often the buyers who attend anticipate paying little for the bankrupt stock, for a public sale of this nature is a forced sale, and they are well aware of it. Then, too, collusion among the prospective bidders to keep down the selling price is not unheard of. In fact this practice became so serious in Detroit about ten years ago that Paul H. King, referee in bankruptcy for the district, suggested to the Detroit Association of Credit Men that a committee be appointed for the sole purpose of attending sales of bankrupt stocks and bidding against the "ring."[26] In another large city, too, at the present time, there is an instance of collusive bidding in the operations of a clique of buyers familiarly known as the "forty thieves." Credit men say that representatives

cases up to that date, in which the assets varied from $1,000 to between $150,000 and $200,000.

The bank officers made the following statement concerning the coöperation extended the Company by the bar: "The Receivership department has had the full coöperation of the Bar Association of the city, the New York County Lawyers Association, and many leading attorneys. Through this coöperation the Trust Company has been able to call upon these organizations for suggestions in various cases and draw upon their facilities for advice in merchandizing bankrupt stocks and in obtaining honest and satisfactory appraisals."

The New York Times, Jan. 17, 1929, said in describing the innovation of one trust company acting as receiver for the distict: "The plan of designating a trust company as receiver is said to have worked successfully in Chicago and Detroit. In isolated instances trust companies have been receivers here, but the plan of having one company handle bankruptcies for the whole judicial district is wholly new in New York."

[24]*Cf. infra* note 45.

[25]General Order XVIII provides: "1. All sales shall be by public aucton unless otherwise ordered by the court. 2. Upon application to the court, and for good cause shown, the trustee may be authorized to sell any specified portion of the bankrupt's estate at private sale; in which case he shall keep an accurate account of each article sold, and the price received therefor, and to whom sold; which account he shall file at once with the referee." 11 U. S. C. A. § 53.

[26](1919) BULL. NAT. ASSN. OF CREDIT MEN 365.

of this group visit every public sale of bankrupt stock in the district and attempt by concerted action to hold down the price.[27]

A further problem arises in connection with accounts receivable. As soon as the word is broadcast that shopkeeper X has been thrown into bankruptcy, his debtors make little or no effort to pay him. This condition is partly occasioned by the fact that unless the receiver attempts to run the business,[28] the bankrupt's shop will be closed. With the store doors locked, the debtors owing small accounts will scarcely go to the trouble of seeking out the receiver or trustee to pay their bills. As a result, the great bulk of small accounts is usually sold for a few dollars to some lawyer or collection agency.

The High Cost of Administration

The high cost of bankruptcy administration is brought out in the summary of statistics for 1926–1927, previously set out. In that year, the expenses involved in both voluntary and involuntary estates totalled $21,342,066.64, or 22.10 per cent of the total net amount realized from the sale of assets. The administration costs of the involuntary cases standing alone totalled $14,111,971.33, or 23.18 per cent of the net assets. These figures are especially interesting when compared with the dividend paid to creditors, which was 8.14 per cent of the claims for all classes of creditors and 6.48 per cent for general creditors. In the involuntary cases only, these percentages are both slightly higher, being 12.49 per cent for all classes of creditors and 10.11 per cent for general creditors.

Obviously the item of administration plays a great part in reducing this dividend to so low a figure. In such a highly complicated system as bankruptcy, every turn of the machinery is accompanied by some item of expense. For one thing a great many officials are necessary to perform the various functions outlined by the Act, and an elaborate fee system has been worked out to provide for their compensation. The Bankruptcy Act provides fees for referees,[29]

[27] In reporting the indictment of Charles T. Shongood (see *supra* note 13) the New York World, Feb. 5, 1929 said: "The indictment contains two counts in which the allegations parallel various complaints made by bankrupt creditors over a long period. These have been, in effect, that bankrupt assets have been sold for one price and then recorded much lower in the sales report."

[28] 11 U. S. C. A. § 11 (5).

"The business may be continued for a 'limited period'. These words are intended to indicate that the time should not be protracted, and that the receiver or trustee should use due diligence in bringing the active business affairs of the bankrupt to a speedy termination." Collier, Bankruptcy (13th ed. 1923) 83, citing *In re* Lisk, 167 Fed. 411 (W. D. N. Y. 1908). However, the instance is rare where the receiver attempts to run the business.

[29] 11 U. S. C. A. § 68 (a).

trustees,[30] receivers,[31] clerks,[32] and marshalls;[33] but these fees are only a part of those allowed in bankruptcy proceedings.

Compensation for the attorneys representing various parties totalled $7,306,335.04 in 1926–1927, or 7.57 per cent of the amount realized from the assets. The petitioning creditors are represented by counsel, as are also the bankrupt, the receiver, and the trustee. The services of these lawyers can not be dispensed with under the prevailing system. For as long as the settlement of insolvent estates is regarded as primarily a judicial proceeding, it follows that the various parties must be represented by counsel. Professional skill is also necessitated by the fact that the court must be petitioned for permission to make nearly every move involved in settling the estate. For example, the trustee cannot even file his account in the simple language of the business community, but instead must follow the technical form and procedure outlined by the Act, with resulting attorneys' costs.

In addition to the fees, there are other items of expense. Some of these are listed separately in the Attorney-General's report as "printing and advertising," "traveling expenses," and "office expenses," but most of them are grouped under an unexplained blanket item—"other expenses"—which in 1926–1927 totalled $9,237,655.14.

It may be advantageous to make this analysis of cost more specific by reference to a case closed during 1926 in the Western District of Pennsylvania. The record of expenditures in this bankruptcy is typical of the average cost of liquidation incurred in the smaller merchant bankruptcies prevalent in and around Pittsburgh.[34] The receiver, later elected trustee, was a man of integrity, who had at his command a staff skilled in the disposal of bankrupt stocks. Nevertheless, the expenses of administration swallowed up 42.8 per cent of the amount realized from sale of the assets.

The case went to the bankruptcy court when X, a hardware merchant, refused to make an assignment for the benefit of his creditors. After an involuntary petition was filed against him, he listed his liabilities as $7,593.52, and his assets as $3,797.31 for stock and fixtures (a fair valuation) and $1,027.84 for accounts receivable. The stock and fixtures brought $1,617.50 at public sale on June 1, 1926, and the trustee's account shows the following figures:

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[30] *Ibid.* § 76(a). [31] *Ibid.* § 76(d). [32] *Ibid.* § 80 (a). [33] *Ibid.* § 80 (b).

[34] It is common knowledge among both lawyers and credit men in this district that a bankruptcy involving assets of less than $1500 rarely pays general creditors a cent.

Receipts

Sale of Stock and Fixtures	$1,617.50
Collected on Accounts Receivable	165.60
Interest	3.89
	$1,786.99

Disbursements

Receiver's bond	$ 10.00
Deposit first meeting of Creditors	35.00
Insurance	47.41
Notaries' fees	6.50
Receiver's commission	82.72
Attorney for receiver	100.00
Receiver's expenses	61.19
Trustee's bond	5.00
Attorney for trustee	50.00
Trustee's commission	33.62
Trustee's expenses	17.75
Attorney for bankrupt	50.00
Attorney for petitioning creditors	50.00
Expenses of petitioning creditors	38.15
Referee's fees and expenses	39.95
Clerical aid	5.00
Taxes	27.70
Landlord's claim for rent	123.80
Partial dividend to creditors of 5%	352.44
Administration rent	70.00
Attorney for trustee	25.00
Trustee's commission	34.11
Administration expenses (heat and light)	5.18
Trustee's expenses	13.00
Referee's commission	31.56
Final dividend to creditors of 6.69%	471.91
	$1,786.99

Items of special interest in this case are:

Total Inventory	$4,825.15
Total Amount Realized	1,786.99
Realized from Stock and Fixtures	1,617.50
Realized from Accounts Receivable	165.60
Expenses of Administration	766.14

These figures shed additional light on some of the generalizations made concerning weaknesses in the bankruptcy system. The contrast between "total inventory" and "total amount realized" is specific evidence of two aspects of the marketing problem: (1) the impossibility of getting a reasonable price for assets at public sale; and (2) the difficulty of making collection on accounts receivable after the business has closed its doors. The item of $766.14 for

expenses speaks for itself. It amounted to 42.8 per cent of the total assets realized and left a dividend of only 11.69 per cent for creditors.

Before dismissing this subject of the high cost of administration, a word should be said concerning the element of fraud, for the elaborate technique of fees and expenses affords a fertile field for practices[35] such as those disclosed in the Southern District of New York. In fact, these practices are often blamed as the source of all the apparent inefficiency of bankruptcy administration. But serious as fraud may be, it is not the only element responsible for "high cost of bankruptcy." As has been shown, even where the administration is conducted with the highest possible degree of honesty and efficiency, as in the case of X, bankruptcy as now constituted proves to be a costly proceeding.

Non-Coöperation of Creditors

The third source of difficulty in the bankruptcy system is the non-coöperation of creditors in the adjudication—a condition so acute

[35]The Federal Grand Jury sitting in the Southern District of New York early in March, 1929, made the following critical report on the bankruptcy of Costis Takis, trading as the Goody Shops: "We also feel the affairs in the bankruptcy of Costis Takis should be presented to the Court for its summary consideration. Property under the receivership has not been accounted for, although the accounts of the receiver were judicially approved in the middle of 1927. The circumstances under which three separate attorneys were simultaneously employed and paid out of the comparatively small estate (out of which no dividend has yet been paid to the creditors) also demand, in our judgment, summary consideration." [The Referee in bankruptcy and Attorney Edwin F. Corcoran were exonerated.] New York World, Mar. 2, 1929.

"In the Takis case Helfland was one of the attorneys for the receiver. This is one of the situations known at the Federal Building in an old baseball expression—'Evers to Tinker to Chance'. In many of Judge Winslow's bankruptcy cases where Wilson was named receiver Helfland would be designated attorney and vice versa." *Ibid.*

The Referee's petition for the discharge in bankruptcy of Kardos & Burke, a brokerage firm, contains some interesting side-lights on the question of fees. This estate, with assets of $307,534, was in litigation for more than five years and 150 hearings were held. The first receiver in the case was paid $25,000 after his first request for $45,000 had been denied. One accounting firm received a total of $31,804. In fact, the demands of lawyers and accountants were so exorbitant that they finally had to be cut thirty per cent in order that creditors could participate at all in the estate. New York World, Apr. 10, 1929.

In connection with fraud in the Southern District of New York, some acknowledgment should be made of the excellent work done by the United States District Attorney's office. See, for example, the resolution passed by the New York Credit Men's Association on April 1, 1927, at the close of the term of United States Attorney Emory R. Buckner commending him for "his deep interest in suppressing commercial crime".

that the bankruptcy court has virtually become a debtors' court instead of a creditors' court. It is an important element at two points in the proceedings: (1) the filing of the petition and (2) the selection of a trustee.

In the first instance this failure to coöperate is occasioned by the action of some special group of creditors (or more often a lawyer or collection agency to whom several creditors' claims have been delegated) who take the lead in filing a petition that other creditors are not aware of[36] until notified by the referee to file their claims. This is made possible by a provision of the Act which permits a limited number of creditors to file an involuntary petition in bankruptcy.[37] It is a non-coöperation of which the non-coöperating creditors are ignorant, and it becomes a source of fraud in bankruptcy administration, because it lays the way open for the springing up of special types of the limited group who make a business of collecting creditors' claims and filing involuntary petitions. Thus a "ring" is created which stands ever ready to throw an estate into bankruptcy solely for purpose of graft.

The second point, lack of creditor coöperation in the election of a trustee, may occur either (a) where the creditor has turned over his

[36]"Congress has made no provision for giving notice to creditors of the institution of involuntary proceedings, other than that which results by the operation of law from the filing of the petition . . . ." COLLIER, *op. cit. supra* note 28, at 1194.

[37]11 U. S. C. A. § 95 (b). Four years ago the National Association of Credit Men sent out investigators to interview creditors in all involuntary bankruptcies closed in Chicago during a certain period. This survey shows that sixty-five per cent of the creditors involved never gave their consent to the filing of the petition against the debtor.

The following extract from the 1917 report of former Attorney-General Gregory is quoted in the New York Times, Dec. 30, 1927: "An unscrupulous attorney finds a house running on a narrow margin, learns the names of three creditors, induces them to file an involuntary petition, procures the appointment of a receiver of his own selection, obtains possession of the books of the business, learns the names therefrom of other creditors, mails them blank forms and procures proxies, elects his own trustee, procures the appointment of himself as attorney for the receiver and trustee successively, and so virtually manages the entire estate to its conclusion."

In speaking of the general public investigation authorized on Mar. 7th by the six federal judges, the New York World of that date said: "The inquiry also will go into the phases of bankruptcy petitions. In certain cases it has been found that a business man in trouble will have three creditors friendly to him file the petition. Then these creditors ask for a receiver favorable to them. The receiver in turn has an attorney appointed in sympathy with all hands. By this method, used more frequently than generally supposed, according to the authorities, a large majority of creditors often are 'frozen out'."

claim to somebody else or (b) where the creditor has retained his claim but simply does not bother to participate in the proceedings. The results of his turning over his claim to somebody else may be good or bad. If it is a delegation to an honest responsible agent acting as a representative for all the creditors, it is not an instance of non-coöperation. In fact, the pooling of creditors' interests in the hands of a common agent may be the very means of facilitating efficient concerted action by the creditors.[38] If, however, it is an assignment of the creditor's claim to a person or persons not a common agent for all the creditors, the way is again opened for extensive fraud. For a dishonest assignee may use the claim or claims in his possession for the purpose of putting one of his fellow ring members in the trusteeship.

The creditor's failure to avail himself of his right to participate in the election of a trustee is of frequent occurrence and leads to the charge, often made, that the creditor himself is primarily responsible for the low dividends he receives in bankruptcy. The reason for his negative attitude is two-fold. In the first place, he knows that coöperation will likely be unprofitable; and in the second place, he knows that coöperation may be useless.

As to the unprofitable aspect of the proceeding, it is scarcely to be expected that a business man will devote much time and energy to a project which brings him such small returns as a bankruptcy administration. Also there is a feeling prevailing among creditors that a bankruptcy liquidation is a lawyer's rather than a business man's game. The formality of the proceeding with its constant resort to petitions to the court does not appeal to the business man's sense of efficiency. The procedure is too costly and too drawn out to pay him for either his money or his time.

In addition to his realization of the unprofitable character of a bankruptcy litigation, the creditor too often is forced to feel that he would be coöperating in a useless venture. For if a bankruptcy "ring" of attorneys is in existence, it will usually succeed in controlling the election as it sees fit. Its device for accomplishing this purpose is to ask the court for one postponement after another of the first creditors' meeting until the other creditors wear out and lose out.[39] Then, too, there is nothing in the Bankruptcy Act which requires the court to

[38]See "The Bureau's Coöperation in Bankruptcy," *infra* p. 438.

[39]"All questions duly submitted at a meeting (of creditors) must depend upon . . . majority vote for their determination. . . . is it necessary that there be any definite quorum as in England; only creditors present or duly represented and entitled to vote may choose a trustee." COLLIER, *op. cit. supra* note 28, at 1108, citing *In re* Mackellar, 116 Fed. 5 (M. . . . 1902).

confirm the candidate whom the creditors wish to select as trustee. One of the complaints made by credit men in this connection is that district judges sometimes favor their own political henchmen over and against the wishes and advice of well-organized creditors' committees.[40]

Such, then, are the principal counts against bankruptcy as now administered in the United States. (1) It has an unsolved marketing problem which results in poor returns in the sale of bankrupt stocks. (2) It has an expense bill so high that a large proportion of what is realized from the assets is later eaten up in administration costs. (3) It has engendered in the creditors a spirit of non-coöperation resulting in a wide open door for fraud.

THE CASE FOR FRIENDLY ADJUSTMENT

Just as the intricate procedural technique of the old English common law courts eventually defeated the ends for which those courts were established, so the unwieldy and expensive procedure of the bankruptcy court has frustrated its declared purpose of serving the business community. And as the court of chancery, with its originally simple procedure, grew out of the need of party litigants for a speedy and efficient administration of justice, so the extra-judicial method of liquidating a debtor's estate, called "friendly adjustment,"[41] has grown out of the need of creditors for a speedy, efficient, and economical administration in the case of an embarrassed or insolvent debtor.

The chief characteristic of the friendly adjustment, in contrast to the estate in bankruptcy, is that it need adhere to no rigid outline of procedure such as that laid down by the Bankruptcy Act. The creditors in an adjustment do not work through the intervention of a court,

[40]Favoritism on the part of Judge Winslow in the appointment of political followers to receiverships, trusteeships, etc., was alleged in Representative La Guardia's impeachment charges. Mr. La Guardia charged among other things that Judge Winslow had made repeated appointments of a small group of men to receiverships, thus creating a "bankruptcy ring." See *supra* note 12.

[41]The phrase, "friendly adjustment," for purposes of this discussion, is limited strictly to describing the extra-legal settlements handled by a creditors' committee working through an adjustment bureau on the approved list of the National Association of Credit Men. For obvious reasons, a settlement outside of court furnishes an even wider field for inefficiency and misappropriation of funds than does an adjudication in bankruptcy, if worked out by either an unsupervised creditors' committee or by a private adjustment bureau operated for profit. See Michael, *Problems of a Common Law Assignee* (Dec. 1925) CREDIT CRAFT 32; *Incompetent Common Law Trustees* (Oct. 1927) N. Y. CREDIT MEN'S ASSN. BULL.

but through their own liquidating agent, namely, an "approved adjustment bureau"—a unit which is now an integral part of creditor organizations in some sixty-eight commercial centers of the United States. It is a type of settlement founded on the belief, widely existent in the commercial world, that the disposition of an insolvent debtor is a business and not a legal function. Under it, the relations of the parties are governed, not as a status prescribed by statute, but as a contract voluntarily entered into between the debtor and his creditor. In this point of view, and in the corresponding freedom from prescribed technique, there are advantages which will be brought out presently.

The Approved Adjustment Bureau

Before continuing further discussion of the technique used in friendly adjustments, a word should be said concerning the organization[42] which creditors have built up in order to administer insolvent estates outside the bankruptcy court.[43] The credit department

[42]As early as 1877 the friendly adjustment plan was put into practice by the Board of Trade of San Francisco, which still operates the adjustment bureau of the San Francisco Association of Credit Men. The National Association of Credit Men sponsored the adjustment idea early in its career, and by the end of 1904 brief reports appeared of adjustment bureau activities in LosAngeles, San Diego, Seattle, and Spokane. (Dec. 1, 1904) Bull. Ntl. Assn. of Credit Men 19. Middlewest and eventually eastern associations of credit men took up the plan. By June 1910, forty-five bureaus were in operation. Cases totalling liabilities of more than one million dollars annually were passing through the various bureaus reporting to the adjustment bureau committee of the credit men at that time. *Report of the Adjustment Bureau Committee, New Orleans Convention, N.A.C.M.* (June 15, 1910) Bull. Ntl. Assn. of Credit Men, 508, 511. Unfortunately, only a few of these earlier bureaus kept adequate records of their activities. At present there are approved adjustment bureaus located in the following places: Los Angeles, Oakland (Calif.), San Diego (Calif.), San Francisco, Denver, Washinton, Tampa, Jacksonville, Miami, Atlanta, Augusta, Boise (Idaho), Chicago, Evansville (Ind.), Indianapolis, South Bend (Ind.), Davenport (Iowa), Des Moines, Sioux City (Iowa), Wichita (Kan.), Lexington (Ky.), Louisville, New Orleans, Baltimore, Boston, Springfield (Mass.), Detroit, Grand Rapids (Mich.) Duluth, St. Paul, Kansas City, Billings (Mont.), Great Falls (Mont.), Omaha, Newark (N. J.), Buffalo, New York City, Charlotte (N. C.), Cincinnati, Cleveland, Columbus, Toledo, Youngstown (Ohio), Oklahoma City, Portland (Ore.), Allentown (Pa.), Philadelphia, Pittsburgh, Providence, Chattenooga, Knoxville, Memphis, Dallas, El Paso (Tex.), Houston (Tex.), San Antonio (Tex.), Salt Lake City, Lynchburg (Va.), Norfolk, Richmond, Seattle, Spokane, Tacoma (Wash.), Clarksburg (W. Va.), Huntington (W. Va.), Milwaukee, Green Bay (Wis.), Oshkosh (Wis.).

[43]I am indebted to Mr. E. Paul Phillips, director, Adjustment Bureaus, National Association of Credit Men, for the information contained in this paragraph. The inclusion in this study of much hitherto unpublished material was made possible by the kindly coöperation of Mr. Phillips.

representatives of business houses scattered all over the United States are linked in a powerful nation-wide body known as the National Association of Credit Men, which was organized at Toledo, Ohio, in 1896. It is this group which has fostered the creation and maintenance by member associations of what is called "an approved adjustment bureau."[44] Such a bureau is a non-profit-making, incorporated unit in charge of a manager and manned by heavily bonded, salaried employees who are specialists in the field of liquidating insolvent estates and rehabilitating embarrassed debtors. The number of employees varies with the size of the bureau, but runs as high as sixty-three in New York City and forty in Los Angeles. Great expanses of territory are covered in the operations of some of the bureaus, especially those in the middle and far west. For example, the Northwestern Jobbers Credit Bureau, with offices in St. Paul, handles cases not only in the entire territory included within the Ninth Federal Reserve District, but also in northern Michigan, northern Iowa, and northern Nebraska. Close touch is kept by the various bureau staffs with buyers of stocks of all kinds,[45] special stress being laid on the disposition of the assets of insolvents at fair rather than at forced prices. The St. Paul bureau, for instance, has on its lists the names of six hundred buyers of hardware stocks located within a narrow radius. Elaborate systems, too, have been worked out for the collection of accounts receivable, the New York

[44]"In order to secure the approval of the National Association of Credit Men, adjustment bureaus are required to comply with strict regulations covering organization, management, personnel, machinery, policies, protection of clients' interests, care in correspondence, finances, records, and supervision by local boards of directors and by the National Association of Credit Men." IN DEFENSE OF THE NATION'S RECEIVABLES (1927) 9, published by the National Association of Credit Men.

[45]"There are many diversifications of the private sale method. Time is usually the essence of most liquidations because if the sale is delayed too long, rent, insurance, custodian charges and other expenses will eat up the estate waiting to be sold. It is therefore essential to build up an organization with a large mailing list of buyers so that bids can be solicited and the sale consummated in as quick a space of time as possible. With the growth of such an organization the time necessary to be taken in getting a satisfactory bid is shortened so that the sale can be consummated just as quickly as an auction sale. Bulk sales notices are sent out on every kind of sale, so there is at least a five-day period for solicitation of bids, and with a good organization this is ample time. Most stocks can be sold intact in the store where taken over. Sometimes an emergency arises necessitating the removal of a stock. For this reason all large liquidators have a warehouse, but a very small percentage of stocks handled ever reaches the warehouse." L. J. Michael, formerly assistant manager of the adjustment bureau, Chicago Association of Credit Men, writing in (Nov. 1925) CREDIT CRAFT 18.

Credit Men's Adjustment Bureau reporting that it now is averaging a fifty per cent return on such accounts. And upon the entire sixty-eight bureaus now functioning, the National Association of Credit Men keeps a close check, in order that extremely high qualifications for remaining upon the approved list may be maintained.

Such then is the type of organization which handles friendly adjustments. While no two cases are adjusted in precisely similar fashion, the methods of settlement fall roughly into two classes: (a) those called *extensions* in which the business of the debtor is not wound up, but is kept running through the coöperation of debtor and creditors; (b) those in which the business is liquidated under an *assignment* or deed of trust taken by the agent of the creditors, who is ordinarily the manager of a creditors' adjustment bureau.

The Extension Case

Throughout this discussion special emphasis will be laid upon the assignment rather than the extension type of case, as the assignment procedure more nearly approximates an adjudication in bankruptcy. However, at least something should be said concerning this extension method of saving the debtor in advance, rather than of watching his business crash and then attempting to pick up the pieces.

The general technique used in an extension is illustrated by the case of the K Cotton Dyeing Company, a corporation operating a plant in territory adjacent to New York City. The case was handled by the New York Credit Men's Adjustment Bureau,[46] and at the present time is still in the active file of that bureau.

The K company, during the later months of 1926, found itself unable to meet its maturing obligations—a condition due primarily to two causes, dissension among the stockholders and the run down condition of the plant. A conference of the principal creditors was held at the offices of the New York adjustment bureau on December 23, 1926. A financial statement of the company presented at the meeting showed that the plant and equipment were subject to three mortgages totalling $45,000. In addition, other obligations of the concern had mounted to $43,000, and it was obvious to the creditor group that if the company were liquidated, the mortgage debt would swallow up almost the entire sale price of its assets.

Untrammelled by any rules save those of business judgment the larger creditors, through the coöperation of the adjustment bureau, began working out the debtor's economic salva-

[46]A record of this case was placed at my disposal by Mr. Thomas O. Sheckell of the New York bureau.

tion. A corporate control extension agreement was arranged between the corporation and the creditors, providing that all the capital stock of the company was to be deposited in escrow with a member of the bureau as trustee. Several of the larger creditors were to be placed on the board of directors, and the finances controlled by the election of members of the adjustment bureau as treasurer and assistant treasurer. This agreement was executed on January 4, 1927 and ratified at a general meeting of creditors held at the bureau on January 10, 1927.

The advantages that ensued were apparent during the course of the next two years. In the first six months of 1927 it was possible to carry the mortgage charges and also to declare a ten per cent dividend to general creditors. By July 1, 1928 the debtor was beginning to pay current accounts on a thirty day basis. During the fall of 1928 a second ten per cent dividend was paid general creditors. At the present time the mortgages have been reduced $8,000, the factory is in excellent condition, and no reason exists why the general creditors should not eventually be paid in full.

Extension cases carefully supervised generally show exceptional returns to creditors. During 1927, for instance, the Board of Trade of San Francisco (the Adjustment Bureau of the San Francisco Association of Credit Men) closed 63 extension cases, in which net recoveries of $235,087.49 on liabilities of $367,600.86 permitted payment of 64 per cent to creditors.[47] And during 1928 the same bureau closed 61 extension cases with net recoveries of $353,372.03 on liabilities of $490,646.32 or 72 per cent to creditors.[48] Figures from other cities show up equally well.[49]

The Assignment Case

While the extension case is an extremely effective arrangement where conditions warrant its use, the type of friendly adjustment more nearly resembling a bankruptcy adjudication and therefore fairer to consider for purposes of comparison is the assignment case. The adjustment in this type of case is a liquidation of the debtor's assets through an assignment to a bureau manager as trustee for the creditors. Its procedure is set in motion by notification to the adjustment bureau through one or more creditors of X that X is delinquent in meeting his accounts. The bureau, thus notified, starts

[47](1927) Fiftieth Annual Report, Board of Trade of San Francisco.

[48](1928) Fifty-First Annual Report, Board of Trade of San Francisco.

[49]See (1927) Annual Report, Los Angeles Wholesalers' Board of Trade; (1928) Annual Report, Los Angeles Wholesalers' Board of Trade.

action by asking X to come in and talk the matter over. It is here that a credit man of long experience, such as is the manager of virtually every "approved" adjustment bureau, can be of monumental service to an insolvent or financially embarrassed debtor. If the debtor appears to be an honest individual who is willing to lay his cards on the table and if his economic condition is not entirely hopeless, the manager rarely will advise bankruptcy, for despite some evidence to the contrary most insolvent debtors are not persons who have attempted to cheat their creditors, and the stigma attached to going through bankruptcy is abhorrent to them. Consequently, what happens is that the manager and the debtor, with their feet literally under the same table, work out together the best means for X to employ in making an adjustment with his creditors.

The next step is for the bureau to call a creditors' meeting for the purpose of approving or disapproving a settlement outside of court. Notification of the meeting is sent not to a few but to all of the creditors, secured and unsecured alike; adjustment bureau practice strictly insists that each creditor have an opportunity to be heard. If the creditors approve a settlement outside of court, the debtor will then be asked to make an assignment of his property to the bureau manager as a trustee for the benefit of the creditors. The form of this assignment, which is variously described as a trust deed, or a trust mortgage, or even a bill of sale, varies in the different jurisdictions, but it always empowers the trustee to sell the property, pay the expenses of administration, and distribute the residue to the creditors. Once such a document has been signed, the marketing organization of the adjustment bureau is free to begin functioning, and the estate is then liquidated in orderly fashion, the creditors being advised of each step in the process.

One of the outstanding assignment cases of the last few years is that of the Y Automobile Manufacturing Company, which was handled by the adjustment bureau of the Detroit Association of Credit Men.[50] There were four hundred and twenty-nine creditors involved, with claims originally filed totalling $685,491.85. At the first meeting of creditors, held in the office of the Detroit adjustment bureau, the financial condition of the debtor was considered by the creditors present and by representatives of the debtor. A friendly adjustment was planned, and a creditor's committee composed of

[50]Mr. L. E. Deeley, manager of the adjustment bureau, Detroit Association of Credit Men, furnished a detailed report of this case, including copies of letters sent creditors.

business men of high standing was elected.[51] The committee requested all creditors[52] to execute powers of attorney authorizing the committee either to liquidate or to reorganize the company, and the creditors complied. After a thorough investigation, the committee decided that immediate liquidation was necessary. The company, however, was still operating, and it was essential that operation should not be entirely discontinued if the goodwill of the business, believed to be valuable, was to be conserved. Accordingly, the company executed a mortgage to the manager of the adjustment bureau as trustee for creditors and the mortgage, in accordance with its provisions, was foreclosed at once. In the meantime the committee had been working to reduce the amount of unliquidated claims and because the plan of sale facilitated the making of similar automobiles by the new owners, certain large commitment creditors withdrew or greatly reduced their claims against the Y Company. The property sold for an excellent price. The proceeds of the sale enabled the bureau to pay creditors 32% on the amount of claims allowed, $399,400.67. The total costs of administration were only 10.6%. Thus settlement was made with every creditor without resort to a court of law, the first dividend was paid within seven months, and this large estate was closed in seventeen months.

The Y Manufacturing Company case is exceptional in the number of creditors involved and in the amount of money and property passing through the hands of the liquidating agent. It is not exceptional either as to the high percentage paid creditors on their claims or as to the low cost of administration. This is demonstrated in the first of two appended tables, which shows how the liquidating assignment is meeting the pragmatic test in eighteen different commercial centers of the United States. The figures given are for assignment cases closed during the years 1926 and 1927, and they have been analyzed in an attempt to place before the reader the first statistical summary so far published of results attained in extrajudicial liquidation of insolvent estates. These figures should be analyzed and compared with those set forth in the second table, containing a similar statistical survey of the bankruptcy cases

[51]This committee consisted of E. R. Ailes of Detroit Products Company, W. R. Cogger of American Bosch Magneto Company, C. W. Dickerson of Timken-Detroit Axle Company, G. H. Lundberg of E. S. Evans Company, and Henry E. Mead of American Motor Body Corporation.

[52]The dealer creditors alone totalled 163 and were scattered all over the United States, Canada, Mexico, Belgium, Bahama Islands, Columbia, England, Greece, Hawaii, Haiti, Holland, Italy, Ireland, Latvia, Philippine Islands, Poland, Porto Rico, Spain, Sweden and Venezuela.

ASSIGNMENT CASES HANDLED BY BUREAUS

	Fiscal Period	No. Cases Closed	Total Liabilities	Unsecured Liabilities	Realized from Assets	Total Paid General Creditors	Total Cost Administration	Percentage Cost Administration as to Amount Realized	Percentage Dividend General Creditors as to Liabilities	Percentage Dividend General Creditors to Amount Realized
San Francisco	Mar. 31, 1926 to Mar. 31, 1927	154	$1,047,170.21	$ ——	$ ——	$332,508.57	$ ——	16.00	31.70	——
Los Angeles	Oct. 1, 1926 to Sept. 30, 1927	363	1,863,784.56	——	661,105.50	473,964.88	120,163.41	20.23	26.32	79.77
Seattle	Mar. 31, 1926 to Mar. 31, 1927	90	——	——	——	——	——	12.00	40.00	88.00
Salt Lake City	Jan. 1, 1926 to Jan. 1, 1927	95	535,349.00	——	202,229.00	144,640.00	30,595.00	15.00	34.00	71.30
Denver	1927	17	84,257.78	79,573.28	25,510.13	12,185.50	3,835.47	15.03	15.31	47.76
Omaha	Jan. 1, 1927 to Dec. 31, 1927	22	116,378.71	——	43,443.98	23,846.63	8,095.54	18.60	20.50	64.00
Okla. City	Jan. 1, 1926 to Jan. 1, 1927	31	238,196.00	——	94,697.00	62,424.00	11,615.00	12.00	28.00	70.00
Kansas City	Jan. 1, 1926 to Jan. 1, 1927	81	373,856.37	263,511.86	75,249.25	50,399.95	4,202.79	5.00	19.00	67.00

St. Paul	June 30, 1926 to June 30, 1927	134	1,106,991.20	———	642,800.66	377,102.77	110,696.46	31.01	28.11	58.66
Chicago	Jan. 1, 1926 to Jan. 1, 1927	68	235,201.00	———	62,237.00	38,202.00	12,971.00	20.00	16.60	80.00
Detroit	Jan. 1, 1927 to Dec. 31, 1927	40	241,311.74	———	103,859.53	65,255.13	19,252.55	18.54	27.04	62.83
South Bend	Oct. 1, 1926 to Oct. 1, 1927	4	13,074.54	11,900.00	3,090.00	2,779.00	311.00	10.00	31.50	89.00
Cleveland	May 1, 1926 to Apr. 30, 1927	48	291,559.20	———	119,404.86	73,021.95	18,418.02	15.19	25.04	61.36
Pittsburgh	Jan. 1, 1926 to Jan. 1, 1927	31	———	120,495.66	59,278.48	36,237.14	7,144.72	12.05	30.07	61.09
Newark	Jan. 1, 1926 to Jan. 1, 1927	4	13,074.54	11,900.00	9,818.19	4,863.14	780.51	7.80	40.80	93.00
New York	Jan. 1, 1926 to Jan. 1, 1927	30	1,750,701.00	———	769,307.00	647,552.00	60,098.00	8.00	31.50	89.00
New Orleans	Jan. 1, 1926 to Jan. 1, 1927	27	180,667.00	———	56,734.00	52,253.00	3,369.00	5.90	28.00	92.00
Tampa	Jan. 1, 1926 to Jan. 1, 1927	45	470,813.53	———	———	94,081.56	———	7.00	20.63	———
		Total	Total	Total	Total	Total	Total	Av. 18 Bur.	Av. 18 Bur.	Av. 16 Bur.
		1284	$8,562,386.38	$487,380.80	$2,928,764.58	$2,491,317.22	$411,548.47	13.85	27.45	73.42

BANKRUPTCY CASES

	No. Cases Closed	Total Liabilities	Unsecured Liabilities	Realized from Assets	Total Paid General Creditors	Total Cost Administration	Percentage Cost Adm. to Amount Realized	Percentage Div. General Creditors to Unsecured Liabilities	Pecentage Dividend Gen. Cred. to Amt. Realized
N. D. California	1183	$13,284,454	$11,550,397	$ 877,199	$ 458,834	$ 262,856	29.97	3.97	52.31
S. D. California	1461	32,481,684	24,993,479	2,227,880	1,153,748	599,050	26.89	4.62	51.78
W. D. Washington	744	8,771,199	6,549,147	1,057,495	442,582	245,185	23.19	6.76	41.85
Utah	325	1,319,090	1,123,237	18,897	3,543	11,480	60.75	.32	18.75
Colorado	400	5,285,799	3,682,573	308,897	99,175	60,596	19.62	2.69	32.11
Nebraska	689	11,158,337	9,108,342	1,746,420	1,127,825	333,237	19.08	12.38	64.58
E. D. Oklahoma	358	19,308,596	10,184,385	370,876	181,253	79,210	21.36	1.78	48.87
W. D. Oklahoma	318	7,244,498	5,735,827	972,536	169,346	139,666	14.36	2.95	17.41
Kansas	1015	11,007,978	8,674,414	1,503,457	493,353	244,235	16.25	5.69	32.82
Minnesota	1840	17,587,524	12,304,721	847,260	436,188	281,457	33.22	3.54	51.48
N. D. Illinois	1710	26,679,124	23,668,602	2,906,389	1,442,470	946,602	32.57	6.09	49.63
E. D. Michigan	570	19,582,400	14,638,663	4,343,610	796,084	512,216	11.79	5.44	18.33
Indiana	413	6,371,108	4,822,701	814,933	515,580	149,294	18.32	10.69	63.27
N. D. Ohio	1748	23,326,698	19,246,761	3,162,536	986,019	678,696	21.46	5.12	31.18
W. D. Pennsylvania	588	13,170,983	9,949,472	2,746,971	1,352,906	485,908	17.69	13.60	49.25
New Jersey	846	15,691,437	11,937,903	2,786,904	805,998	735,621	26.40	6.75	28.92
S. D. New York	2350	204,509,436	169,689,463	18,539,737	11,822,396	4,559,201	24.59	6.97	63.77
E. D. New York	933	20,544,551	18,420,509	1,765,825	1,165,408	440,076	24.92	6.33	66.00
E. D. Louisiana	171	2,709,970	2,124,223	238,053	87,076	71,541	30.05	4.10	36.58
S. D. Florida	265	11,443,864	6,059,325	799,344	380,396	101,292	12.67	6.28	47.58
	Total	Total	Total	Total	Total	Total	Av. 20 Dist.	Av. 20 Dist.	Av. 20 Dist.
	17,927	$471,478,730	$374,464,144	$48,035,219	$23,920,180	$10,937,419	24.26	5.80	43.32

concluded during 1926–1927 in the same judicial districts in which the respective adjustment bureaus are located.

Some explanation is necessary in order to clarify the assignment statistics set forth in the first table. In the first place, the period of time covered in the case of each bureau is twelve months taken from the years 1926 or 1927 or both, the exact opening and closing dates concurring with those of the fiscal year of the particular bureau. This is the same general period covered by the bankruptcy statistics set out in the second table. It represents the last period for which complete adjustment bureau statistics are available, the figures for 1928 being as yet too fragmentary towarran tthe deducing of accurate conclusions.[53] The item, "Percentage Cost Administration," is calculated from the ratio of administration expenses to the total amount "Realized from Assets."[54] And the item, "Percentage Dividend General Creditors as to Liabilities," is arrived at from the ratio of the total amount which the general creditors received as to liabilities.[55]

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[53]The 1928 figures from five bureaus—San Francisco, Los Angeles, Seattle, Cleveland, and Pittsburgh—parallel closely those presented here for 1926–1927.

[54]The St. Paul bureau, although one of the most efficiently managed, shows a figure of 31.5 for "Percentage Cost Administration." This high figure is explained by the fact that the bureau includes under the head of "Total Cost Administration" the items, (1) personal property taxes paid on the debtor's assets and (2) debtor's exemption. In North Dakota and South Dakota, states covered by the bureau operations, the debtor's personal property taxes sometimes are not collected by the taxing officials for periods ranging from two to seven years prior to the debtor's failure and so must be paid out of the estate. Again North Dakota has a debtor's personal exemption allowance of $1,000 in cash or merchandise in addition to absolute exemption on his homestead, household goods, and wearing apparel. In South Dakota the head of a family has a personal exemption allowance of $750, plus the absolute exemption on his homestead, household goods, and wearing apparel.

The Los Angeles bureau deducts the amount paid preferred and secured creditors and the amount returned to solvent debtors from the total "Realized from Assets." It then computes its "Percentage Cost of Administration" as the ratio between the amount remaining in the estate and expenses of administration.

The Pittsburgh bureau has a low percentage figure (12.05) for "Percentage Cost Administration." However, the general creditors do not reap the full advantage of this efficient management. Landlords in Pennsylvania are given a preferred claim not only for rent actually accrued at the date of the failure, but also for rent during the still unexpired term of the lease. From Jan. 1, 1926 to Jan. 1, 1927, this bureau settled four cases in which the landlord's claim took all the assets.

[55]Some of these percentages are computed on the basis of total unsecured liabilities, and others on the basis of total liabilities, secured and unsecured. Bureau practice varies in the method of arriving at this item, and I am submitting these percentages in the exact form in which they were given me by bureau managers.

The following comparative percentages taken from the two tables tell a rather startling story:

	Percentage Dividend General Creditors To Liabilities	Percentage Cost Administration To Amount Realized	Percentage Dividend General Creditors To Amt. Realized
Assignment.....	27.45	13.85	73.42
Bankruptcy.....	5.80	24.26	43.32

Possible Objections

The two principal extra-judicial methods used by an approved adjustment bureau, namely, an operating extension and an assignment in trust, have been considered. I shall now examine some of the possible objections which critics may launch against the adjustment plan of settlement.

First of all, it may be argued that it will be difficult to obtain the continuously harmonious action of creditors throughout the course of a settlement, and that lack of harmony may result in embarrassing legal snarls for the adjustment bureau, for the assignment of a debtor's business to the bureau manager is an act of bankruptcy, and any three disgruntled creditors with unsecured claims totalling $500 or more may, within four months, "upset the apple cart" by filing a petition for involuntary bankruptcy.

The answer to this argument is that this catastrophe, admittedly possible, rarely happens. Creditors are peaceable business men and they are inclined to rely on court action only as a last resort. Also, the difficulty of preserving harmony among the creditors is not so great as might appear offhand, for when creditors are acquainted with friendly adjustments, they are usually willing to coöperate with the bureau, simply because it is to their financial advantage to do so.[56] Non-coöperation on their part leaves the bureau with no choice except to turn the case over to the bankruptcy court for adjudication, and this, as illustrated in the accompanying tables, is a result which will bring no pecuniary profit to the objecting creditors. In fact, the large number of cases concluded each year by the various adjustment bureaus, a number constantly growing as the knowledge of friendly

[56]At one stage of the Y Manufacturing Company liquidation, three creditors who did not understand the nature of the settlement filed a petition in bankruptcy. However, when the purposes of the friendly liquidation were explained to them, they not only withdrew their petition but also commended the Detroit adjustment bureau for its excellent work in the case.

adjustment becomes more widespread, is in itself conclusive proof that the bugaboo of non-coöperation by creditors is more apparent than real.[57]

An analysis of these cases, from the point of view of determining this element of creditor coöperation, brings out some interesting facts. It is noticeable at once that such coöperation is not necessarily dependent upon the number of creditors involved nor upon their location. For example, the files of the Western Pennsylvania Association of Credit Men at Pittsburgh (which serves one of the most thickly populated industrial districts in the world) are filled with cases involving, for the most part, the failures of small tradesmen, the majority of whose creditors are located within a relatively narrow radius.[58] On the other hand, the files of the New York Credit Men's Association contain the adjustment records of some of the largest industrial and mercantile failures occurring within the territory covered, and the creditors are widely scattered.

Specific cases illustrative of this coöperating power of creditors, regardless of number and location, are the Y Manufacturing Company Case, already discussed, and the J. Chain Store Corporation Case,[59] which follows.

The J. Corporation, operating a chain of grocery stores in South Florida, became involved financially during 1927. The corporation owed more than $75,000 to 225 creditors located in thirty states. The chain had $13,000 worth of merchandise on hand and approximately $45,000 worth of fixtures, the latter being of such a character that if taken from the store they would have become practically worthless. Those creditors located in Tampa authorized an assignment of the business to the adjustment bureau of the Tampa Association of Credit Men. Creditors situated at a distance were notified by telephone and telegraph of the resident creditors' action and so rapidly did they respond that the assignment was either authorized or ratified by 224 firms and individuals within seventy-two hours.

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[57]There are occasional instances of business houses whose policy is never to accept less than one hundred per cent on the dollar on accounts receivable, except in bankruptcy.

[58]Through the kindness of Mr. L. I. MacQueen, executive manager of this association, and Mr. H. M. Oliver, manager of the adjustment bureau, I was permitted to spend several weeks in the bureau office and could observe at first hand the actual functioning of the friendly adjustment plan of settlement.

[59]A report of this case was sent by Mr. S. B. Owen, Adjustment Bureau Manager, Tampa Association of Credit Men.

See also the case of the Parham-Lindsay Grocery Company (involving 482 widely scattered creditors), reported in (1923) 25 CREDIT MONTHLY 12.

The business was kept going and a buyer was secured who took over the entire chain. The case paid a 35% dividend to creditors at a cost of only 5% of the amount recouped.

A second objection that may be made to the friendly adjustment plan is that, while in bankruptcy the debtor receives a full discharge from his debts, in a contract of assignment for the benefit of creditors such is not necessarily the case. This objection is hardly worth considering, as it is entirely possible for the creditors by contract[60] to release the debtor from the payment of all further claims. Whether or not the debtor shall enjoy the privilege of a full discharge depends a great deal upon the character of his specific case and upon the good faith he shows in dealing with those whom he owes. The matter is entirely within the discretion of the adjustment bureau, and if the facts seem to warrant release, the bureau will simply recommend this to the creditors and supervise the making of contracts between debtor and creditors that will effect the discharge.

The Bureau's Coöperation in Bankruptcy

One function of the approved adjustment bureau remains to be considered. This concerns bureau activity, not outside, but inside the court of bankruptcy. As has been shown, credit men, whenever possible, favor the settlement of debtors' estates by extra-judicial means. However, it sometimes happens that an estate is already in bankruptcy when the bureau is called in, or a preliminary investigation of the facts may indicate that the debtor has concealed assets, or again, this investigation may reveal that conflicting groups of creditors, through the use of attachments or other available remedies, have involved the estate in a complicated legal tangle. In these latter two situations and in all other cases where either the debtor or the majority of the creditors refuse to play the game, the adjustment bureau will recommend an adjudication in bankruptcy.

Notwithstanding the fact that the estate may thus be thrown into bankruptcy, there is no reason why the bureau manager cannot still be of enormous service to creditors. He may serve them (1) by

[60]One form of trust mortgage used by the Wichita Association of Credit Men, Wichita, Kan., contains the following clause: "It is hereby understood and agreed, that each and all of the creditors of the party of the first part who shall accept hereunder do thereby and hereby release and acknowledge as full paid and satisfied any and all claims and demands proved hereunder."

"The trust agreement should contain a provision releasing the debtor from his obligations only after the trustee, acting in coöperation with the creditors' committee, has found that the case is not tainted with fraud." (July 1927) N. Y. Credit Men's Assn. Bull. 240.

representing a group of creditors or (2) by acting as receiver or trustee.

As to the first of these functions, suffice it to say that although the receiver and the trustee are supposed to give the creditors a high type of fiduciary service, as a practical matter it often behooves the creditors to look out for their own interests. For this reason, a bureau manager, serving the creditors in a representative capacity, is often instrumental in curbing the abusive practices so common in bankruptcy administration.

As to the second of these functions, that of serving either as receiver or trustee, the organization and equipment of the bureau make it possible for these offices to be filled with a high degree of efficiency by the bureau manager. As a result, referees in some districts are constantly appointing bureau managers to receiverships —for example, in Wichita, Kansas, where Mr. M. E. Garrison, executive manager of the local association of credit men, is placed in charge of virtually all mercantile bankruptcies. In some other cities (as Tampa and Chicago) the adjustment bureau officials receive no trustee or receivership appointments.

In districts where the bankruptcy court does sometimes appoint the head of an adjustment bureau as a receiver, there exists the basis for an interesting comparison with the results achieved by the same bureaus in their assignment trusteeships. Such an analysis is as fair as any which can be made of the two systems of liquidation, for the same marketing organization functions in both instances—in the one case, untrammelled by the requirements of a statute, and in the other, restricted by the stipulated procedure of the Act. The same organization, in the first instance, uses the few simple documents necessary to legalize an assignment; in the other, it files through an attorney (with the consequent expense) the endless papers prescribed for use in a bankruptcy adjudication. In order to bring out these points of contrast more forcibly, I have considered a group of cases in which bureau managers acted as receivers or trustees and have compiled the results in the appended table.

While the table of cases does not include those from Pittsburgh (the total figures for this district not yet being computed), it happens that two cases[61] closed by that bureau are best suited to the purposes of an accurate and more detailed analysis. The facts are such that they bring out in sharp relief the specific results attained under the

[61]These cases were selected from the files of the Western Pennsylvania Association of Credit Men in Pittsburgh by Mr. Paul A. Kerin, who is now in charge of a branch office of that Association located at Altoona, Pa.

BANKRUPTCIES CONTROLLED BY BUREAUS

	Fiscal Period	No. Cases Closed	Total Liabilities	Unsecured Liabilities	Realized From Assets	Total Paid General Creditors	Total Cost Administration	Percentage Cost Administration to Amount Realized	Percentage Div. General Creditors to Liabilities	Percentage Div. General Cred. to Amt. Realized
Kansas City	Jan. 1, 1926 to Jan. 1, 1927	46	$ 178,316		$41,244	$ 17,324	$ 4,968	12.00	9.00	42.00
Cleveland	May 1, 1926 to Apr. 30, 1927	105	2,072,612		233,690	81,893	80,240	34.11	3.95	35.09
Detroit	Jan. 1, 1927 to Dec. 31, 1927	18	319,448		126,075	53,375	43,010	34.11	16.70	42.33
Omaha	Jan. 1, 1927 to Dec. 31, 1927	40	984,948		141,535	81,019	30,404	21.30	8.20	57.30
		Total	Total		Total	Total	Total	Av. 4 Bur.	Av. 4 Bur.	Av. 4 Bur.
		209	$3,555,324		$542,544	$233,611	$158,622	25.38	9.46	44.18

two systems. Both involved drug stores in Wilkinsburg, Pennsylvania, a borough adjoining Pittsburgh, both had assets that inventoried about the same (within $200 of each other), and both estates were closed during the fall of 1927.

The first, an assignment case, involved the A pharmacy. It was taken over by the bureau on September 13th, 1927, and as the debtor was too involved to justify an operating extension, the bureau decided to sell the store. An adjuster from the staff succeeded in getting three prospective buyers interested in the business, and it was put up at private sale. The competitors ran up their bids from $2,000 to $2,750, and at the latter figure a sale was made on September 24th, just eleven days after the case opened. The bureau fee for handling the adjustment was $275.86, or ten per cent of the sale price, and all other expenses connected with the liquidation totalled $3.00. There was a balance for creditors of $2,370.86, or 65.8 per cent of their claims. The record of receipts and disbursements tells even more forcibly the story of this excellent recovery for creditors:

Receipts

From sale of business	$2,750.00
Cash from sales to customers	8.60
From book accounts	.73
	$2,759.33

Disbursements

Rent	$ 101.22
For consignment of goods	8.39
Expenses of sale	3.00
Bureau commission	275.86
Dividends of 65.8 per cent to thirty-one general creditors on claims of $3,603.14 finally allowed	2,370.86
	$2,759.33

In his final letter to creditors, Mr. H. M. Oliver, the bureau manager, wrote:

> "Our opinion is that if this business had been sold in bankruptcy it would not have brought more than a thousand dollars and if administered in bankruptcy this would probably have left a dividend of ten to fifteen per cent."

As in the previous case, the liquidation involving the B pharmacy began as an assignment, the case opening March 19, 1927. The case was, however, turned over to the bankruptcy court for adjudication, because the debtor was unwilling to coöperate in a manner satisfactory to the bureau. The bureau manager was appointed receiver and later

elected trustee. It was found necessary to close the store a few days prior to the filing of the petition and to keep it closed through the long period of liquidation, ending November 8, 1927. The rent accruing until the business was finally sold at public auction for $1,105.00 totalled $200. The debtor took his entire exemption of $300, and these items, together with administration expenses and a couple of preferred claims, ate up all the estate except $195.08, which was paid to general creditors. As the unsecured liability claims allowed totalled $4,810.72, these creditors received only 4.05 per cent. The complete receipts and disbursements in the case follow:

Receipts

From sale of business	$1,105.00
From sale of perishable property	62.50
Cash on hand	127.89
Interest	1.52
	$1,296.91

Disbursements

Expenses first meeting of creditors	$ 30.00
Appraisers' fee	30.00
Notary fees	5.50
Receivers' bond	10.00
Receivers' expenses	39.56
Attorney for receiver	125.00
Receiver's commission	61.32
Trustee's bond	5.00
Trustee's expenses	10.00
Trustee's commission	24.17
Attorney for trustee	25.00
Referee's expenses	27.00
Referee's commission	10.44
Attorney for bankrupt	50.00
Bankrupt's exemption	300.00
Insurance	49.34
Rent during administration	200.00
Rent prior to bankruptcy (preferred)	50.00
Wages due prior to bankruptcy (preferred)	49.50
First dividend of one per cent on forty-three claims of $4,810.72	48.11
Second and final dividend of 3.05 per cent on forty-three claims of $4,810.72	146.97
	$1,296.91

In attempting a comparison of these two liquidations, several items are noteworthy. In the first place, although the assets were of about the same value, the amount realized from assets was $2,759.33

in the one case and only $1,296.91 in the other. In the second place, although the estates were administered in the same district at about the same time, the expenses in the first amounted to only $388.47, but in the bankruptcy case ran up to $1,101.83. As a result of these figures, the creditors in the assignment case realized a dividend of 65.8% on their claims, and in the bankruptcy case only 4.08%.

In fairness, however, it must be said that the contrast between these respective percentages is slightly qualified by several factors. The unsecured claims finally allowed in the bankruptcy case exceeded those in the assignment case by $1,207.58, and the bankruptcy case also had additional preferred claims of $99.50. But the remarkable thing about it is that if we make allowance for the difference in claims by deducting $99.50 from $2,370.86 (net amount payable to general creditors in the assignment case) and by adding $1,207.58 (additional unsecured claims) to the general liabilities figure of the adjustment case, we still have a net amount, payable to the general creditors in the assignment case, which allows them a dividend of 47% on their claims.

It is therefore fair to conclude that, with the concurring factors of equal assets, equal liabilities, same type of business, and same locality in two cases liquidated in the fall of 1927 by the same marketing organization, the two different types of administration result in dividends of 47% and 4.08% respectively!

CONCLUSION

At the beginning of this article, reference was made to a situation existing in New York City which indicates that there is something seriously wrong with our system of bankruptcy administration. It has been my purpose to discover, if possible, why this condition exists. The development, therefore, has consisted of a critical analysis of bankruptcy, from the standpoint of both theory and practice, which has involved (1) a consideration of what the objects of bankruptcy legislation are and (2) an application of the pragmatic test to determine whether these objects are met in actual bankruptcy administration.

The chief purpose of bankruptcy legislation is to furnish a method for liquidating the estate of an insolvent debtor and distributing the assets to his creditors. Therefore, the results of bankruptcy administration are best demonstrated by the figures furnished in the Attorney General's Report of Bankruptcy Proceedings. These reveal as an outstanding thing a very low percentage of distribution to creditors in proportion to their liabilities. It is the factors operating

to produce this result that constitute the chief counts against the bankruptcy system. As already shown, they are the marketing problem, the fee problem, and the non-coöperation of creditors in the adjudication.

On further analysis these three problems reduce themselves to one major defect in theory and two outstanding faults in practice. The theoretical flaw is simply that bankruptcy regards the whole matter of insolvency as a legal and not primarily an economic problem. The practical faults are (1) high cost of administration, and (2) loopholes for fraud. Under each of the latter two lies the common cause for both—an unwieldy and cumbersome technique.

Apparently, then, the objects of bankruptcy legislation are not met in our present bankruptcy administration—at least not in such a manner as to serve the needs of the business community. This is demonstrated not only in the non-coöperation of creditors in bankruptcy proceedings, but also and more forcibly in the fact that the commercial world has worked out a system of its own for dealing with the insolvent debtor—namely, friendly adjustment. When we apply the same analysis to friendly adjustment that was applied to bankruptcy, we find (1) that its objects are practically the same as those of bankruptcy and (2) that, contrary to bankruptcy, it is meeting the pragmatic test by functioning well. The statistics furnished by a representative group of approved adjustment bureaus show that, on the average, creditors receive five times the amount of dividends they do in bankruptcy and at about half the cost. Theoretically, friendly adjustment, in contrast to bankruptcy, rests on the true concept that insolvency is about nine-tenths an economic problem and one-tenth a legal one. Practically, friendly adjustment eliminates the high cost of bankruptcy, because a simplified technique stipulates for only one fee, that received by the bureau, and the same simplified technique reduces to a minimum the possibility of fraud.

In other words bankruptcy, because it is a costly, technical, cumbersome system, founded on a false theory, is failing to carry out its major purpose. Friendly adjustment, an extra-judicial means, because it is a simple, inexpensive procedure founded on a true theory, is at present serving a large part of the business world as a bankruptcy court.

What, then, is the remedy for the present unfortunate condition of bankruptcy administration? The first step, as in the progress of any reform, is in arousing public sentiment to a realization of existing conditions. In this respect, substantial progress has apparently been made by the instigation in New York City of a general public

inquiry into bankruptcy evils. The courageous stand taken by the public press in the whole question has been largely responsible for the extension of public interest beyond the confines of New York City. Already there have been two Congressional committees appointed to investigate special phases of the New York situation,[62] and on April 23rd a resolution was introduced into Congress, directing that the United States Attorney-General be asked to aid the New York investigation. Whatever the immediate result may be, all these things bid fair to make the demand for reform nation-wide.

One of the most favorable aspects in the investigation now under way in New York City is that the federal prosecutor has the coöperation of the bar associations and the National Association of Credit Men. This combination of the legal and economic elements is, in my estimation, an essential factor in any proposed change in our bankruptcy law, for, as already pointed out in this discussion, if legislation is really to serve the business community, the practical business man's point of view must be taken more largely into account than it has been in the past. In fact, the coöperation of both lawyers and business men is absolutely necessary for working out the various aspects of the market problem and the fee problem that are present sources of difficulty.

It is my purpose to set out in a future article some detailed suggestions for a statute, general in nature, designed to assist the business world in dealing with insolvency. Suffice it to say here that such an enactment (1) should take into account both the legal and economic aspects of the insolvency problem; (2) should provide a simpler, less technical procedure; and (3) should not attempt to place all insolvency in one fixed category.[63]

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[62]New York Sun, Feb. 25 and 27, 1929. *Ibid.* Apr. 24, 1929. See *supra* note 12.

[63]The Bankruptcy Act declares that "an" insolvent is one whose aggregate property (minus any property concealed or removed with intent to defraud creditors) is insufficient in amount to pay his debts. 11 U. S. C. A. § 1 (15). For settling the estate of such "an" insolvent a fixed procedure has been outlined. On the other hand, credit men recognize various classes of insolvency and govern their procedure accordingly.

"Insolvent estates may be divided into eight classes; namely,

(a) debtors find themselves in embarrassed conditions due to poor management, drop in market, etc., and business requires either liquidation or re-organization, no fraud or preference of any kind being involved;

(b) similar to (a) with the exception that some preferences have been granted;

(c) some preferences have been granted, and theoretical concealment of small amount developed by accountants, but no false statement;

(d) there is some fraud but not sufficient proof to convict either for concealment or for false financial statement, and probability of developing same in bankruptcy is nil;

(e) debtor has issued financial statement substantially false, no concealment of assets but some preference granted;

(f) debtor has issued financial statement substantially false, but admittedly no concealment or preferences;

(g) debtor has issued substantially false financial statement or concealed large amount of assets, and legal proof thereof can be obtained only by investigation in bankruptcy proceedings;

(h) bankrupt has concealed assets." (July, 1927) N. Y. CREDIT MEN'S ASSN. BULL. 241.