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AMBIGUITIES IN THE CHANDLER ACT *

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The statement that legislation can be “scientifically” created seems a platitude. But it is a platitude too frequently disregarded. One may object to the use of the word “scientific” in this connection, but it will suffice for the want of a better. The fact remains, however, that great masses of laws are poorly conceived and atrociously drafted, resulting in confusion and unnecessary litigation.

In the broad field of commercial law “scientific” legislation is especially possible and especially important. For here there can be calm, dispassionate judgment, removed from the fervor and pull of politics. Such deliberation seems essential in matters which affect the pocketbook of the man in the street. In commercial law, when evils are prevalent, it is possible to ascertain the facts surrounding the evils as a basis for reform. It is possible to secure the aid of experts familiar with relevant case law and awake to judicial attitudes. Such truths, almost too obvious for mention, are nonetheless too frequently ignored. Now, with such preliminary information at hand, all points of view and all interests would be represented by the collaboration of lawyers, professors, economists and businessmen. Such a group would formulate objectives and statements of purpose, which should be generally available after enactment, as a guide to administration and interpretation. After enactment, a law and its administration should be carefully and constantly scrutinized with a view to amendment when the need should arise.

Legislation so conceived may well be labelled “scientific”. It should produce improvement where improvement is needed. Soundly conceived and skillfully drafted, it should inevitably reduce the quantum of litigation. And such a task is not too difficult.

There is cause for enthusiasm in the discovery that the Chandler Act is one of the most “scientifically” created pieces of legislation ever

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2. See examples cited in Mulder, note 1 supra at 29.
3. Cardozo, note 1 supra; Mulder, note 1 supra at 33 et seq.
penned by the hand of man. The need for drastic revision of the Bankruptcy Act of 1898 had long been apparent. Economic conditions had brought awareness that the Act was now creaking with antiquity. It needed more than a new coat of paint. A modern, streamlined version was essential. Further, the fact material was at hand—an official report, based upon a painstaking, unbiased study of the Act of 1898, which painted a sordid picture of inefficiency, dishonesty, and inadequacy of administration. An unselfish group of men, all experts, from various fields of activity, representing all points of view, joined hands in the arduous task of reformation. Among them were scholars well-versed in the great body of case law which had developed under the Act of 1898. They held numerous public hearings as their work progressed in conjunction with the appropriate Congressional Committees. They set up a list of ten major objectives to be attained under the new Act. Those objectives, now publicly available, constitute an ever-present help to one in retaining perspective when confronted with specific problems. In addition, the more specific intent of the framers with reference to particular sections of the Act are in published form.

In one instance there may have been the purpose to incorporate or overrule a pertinent decision of the United States Supreme Court; in
another section there may have been an intent to obliterate a previously prevalent evil. Obviously these statements of purpose will not provide a panacea for all problems, but the fact remains that now as never before there is available information concerning legislative intent to serve as a guide in ascertaining what was meant by the words employed. Thus ambiguities may be lessened, clarity obtained, and litigation diminished, if such background material is constantly consulted.

The Chandler Act has only recently passed its second birthday. Encouraging evidence of the continuation of the "scientific" attitude is apparent. The National Association of Credit Men, one of the sponsors of the Act, is already conducting a survey of its administration. The Association has circulated among its membership questionnaires designed to discover the extent to which the Act is succeeding or failing in the attainment of its ten major objectives. A special committee on Bankruptcy Administration, appointed by the Attorney General of the United States, is conducting, through the various law schools of the country, a study of the cases arising under the Chandler Act, with a similar purpose in view. These surveys are undoubtedly premature. The material available at this early date is insufficient to produce comprehensive analysis. The sweeping reforms of the Act have not yet been sufficiently absorbed by the Bench and Bar. But the effort is laudable. The cases constitute valuable source material; when a substantial number have been carried through to completion they will form the basis for amendments, correcting mistakes and removing ambiguities. At least, however, the "scientific" attitude is being conscientiously continued.

Current comment on the Chandler Act is favorable. Little disposition to make radical changes is apparent. There seems to be a
general feeling that better results are already being achieved, that it is
better not to tamper until the full import of the reforms have been
absorbed and given a fair trial. But no matter how scientifically
conceived, legislation must be constantly altered to meet the exigencies
of new situations, exigencies which could not have been anticipated by
its makers. Man's limitations are ever made manifest when his handi-
work is submitted to the practical test. And new situations arise with
such rapid frequency in times of economic unbalance that defects in
the Act have already cropped up. Mistakes in draftsmanship have
become apparent; some difficulties were not anticipated; omissions have
come to light; and phraseology is at times needlessly ambiguous. It is
not amiss to place these revelations on the table where they can be
microscopically examined and evaluated.

Attention will be directed in this paper to various instances of
faulty draftsmanship which have now come to light, to be rectified by
the courts as pertinent problems arise, or to be placed eventually in the
hands of Congress for amendment. The symposium on Bankruptcy
at the recent American Bar Association Convention dealt with the more
popular and better-known aspects of the Act. Consideration will
here be devoted mainly to an examination of the less-talked of problems
which, though important, may otherwise remain unnoticed.

Until very recently bankruptcy meant liquidation of a debtor's
assets and distribution of the proceeds among the creditors. The Act
of 1898 concerned itself almost completely with that aspect of bank-
ruptcy, devoting thereto approximately seventy-two sections. The
liquidation machinery is retained in the Chandler Act, but weak spots
which had long gone unnoticed have been repaired; serious efforts
have been made to curb dishonest bankruptcies; clarity of expression

16. Few amendments dealing with matters of substance have been proposed thus
far.

17. The addresses included the following: Robert T. Swaine, Railroad Reorganiza-
tions and Legislative Proposals Affecting Them; Randolph E. Paul, Tax Problems in
Reorganizations; W. Randolph Montgomery, Chapter XI of the Bankruptcy Act:
Should It Be Drastically Revised?

18. Until 1933, only § 12 dealt with rehabilitation, by means of a bankruptcy com-
position.

19. §§ 70 (a) (7) dealing with various types of future interests held by the bank-
rupt in realty, and 70 (a) (8) dealing with property passing to the bankrupt by devise,
bequest, or inheritance within a period of six months after bankruptcy, are now present
to promote a greater realization of assets, assets which were formerly outside of the
sphere of the bankruptcy courts. See HANNA AND MCLAUGHLIN, op. cit. supra note 9
at 78; WEINSTEIN, op. cit. supra note 7 at 158, 159.

§ 60 of the Act has more definitely stated the time limit of transfers and has, there-
fore, done away with secret transfers to a large extent. This feature is discussed at
greater length, infra at p. 22.

Another section which underwent a great change for the better is § 67, also dis-

20. Wolfe, Detection of Fraud Under the New Bankruptcy Law (1938) 13 TEMP.
L. Q. 1. See infra p. 34.
and uniformity of terminology have been attempted; and procedural provisions have been altered in the interests of speed and efficiency. The remainder of the Act represents something new in bankruptcy legislation. It proceeds not upon a concept of liquidation but rather upon a theory of rehabilitation of unfortunate debtors. The economic depression created the need for rehabilitation, and, commencing in 1933, the need found expression in piecemeal amendments to the Bankruptcy Act. Rehabilitation becomes an established feature in the Chandler Act, in the forms of Arrangements, Real Property Arrangements, Wage Earners' Adjustments, Agricultural Adjustments, Railroad Reorganizations, Corporate Reorganizations and Municipal Debt Plans.

Recent events tend to vindicate the foresight of the fathers of the Chandler Act. The rehabilitation provisions have assumed pre-eminence in bankruptcy administration. Perhaps this manifests a permanent trend toward the use of rehabilitation where possible, with resort to liquidation or straight bankruptcy only when rehabilitation becomes impracticable. Or it may be merely the result of present-day economic conditions, or the popularity that usually attends something novel and new. At any rate, non-asset cases now seem to predominate in straight bankruptcy. However, probably one hundred million individuals, as well as thousands of partnerships and corporations, remain eligible for straight bankruptcy, which cannot as yet be considered a dead letter in the law. It should also be remembered that important sections contained in the liquidation portions of the Act, probably because they have always been there, are applicable as well to proceedings for rehabilitation. Hence, they remain of significance.

The liquidation provisions of the Act are based upon approximately forty years of experience, accompanied by a vast accumulated

21. By way of illustration note the identity of phraseology in §§ 3 (b), 60 (a), and 67 (d) (5), dealing with the time at which a transfer becomes perfected.
23. The Act of 1933, added Chapter VIII, containing §§ 73, 74, 75, 76 and 77 to the bankruptcy laws. In 1934, §§ 79 and 80, dealing with municipal debt readjustments were added. [These two sections were invalidated as unconstitutional in Ashton v. Cameron Co., 298 U.S. 513 (1936).] The last amendments, by the Act of 1934, added § 77 (a) and § 77 (b) to the Act.
24. Chapter XI, Chapter XII, Chapter XIII, § 75 (s), § 77, Chapter X, Chapter IX, respectively.
25. As a practical matter, rehabilitation should have great permanent utility. In straight bankruptcy, a debtor having liabilities in excess of assets is usually beyond hope; but in rehabilitation proceedings he may be potentially solvent, but merely unable to meet his debts as they mature.
26. See note 15 supra.
27. See §§ 102, 302, 402, 602.
body of case law.\textsuperscript{28} The rehabilitation portions are frankly experimental in nature. Consequently, no surprise is occasioned by the fact that greater difficulties and more frequent ambiguities are being encountered in the rehabilitation features.

I. ARRANGEMENTS UNDER CHAPTER XI

It was the hope of the draftsmen that Chapter XI would repopularize the bankruptcy composition. That hope has been realized with dramatic suddenness. In fact, there has been a veritable stampede of petitions under this chapter. Because of the unanticipated character of many of these petitions, vulnerable weak spots have immediately come to the forefront, giving rise to numerous judicial difficulties.

The bankruptcy composition in itself is nothing new. Provision therefor had existed since 1898 in Section 12. Thereunder a bankrupt could attempt rehabilitation by securing the consent of his creditors to pay them off on a \textit{pro rata} or instalment basis. In a common-law composition, only assenting creditors were bound; non-assenters received no share in the proceeds, but retained their claims against the debtor \textit{in toto}.\textsuperscript{29} To a debtor, the desirable feature of a composition under Section 12 was that non-assenting creditors were also bound, provided a majority of the total number approved, and the court found the plan to be in the best interests of creditors.\textsuperscript{30} The subsequent discharge released the bankrupt from all of the unsecured provable claims against him.\textsuperscript{31}

In theory, Section 12 offered a quick, simple and economic means of rehabilitation to an unfortunate debtor and the promise of greater dividends to creditors than would be forthcoming in straight bankruptcy. In practice, however, such was not the case. Since the debtor was already a bankrupt, he was too frequently beyond financial rehabilitatio.\textsuperscript{32} The machinery proved cumbersome and expensive, and Section 12, throughout its existence, remained substantially a dead letter. In 1933 Section 74, which sought to eliminate the difficulties of Section 12, was adopted in order to repopularize the bankruptcy com-

\textsuperscript{28} The American Bankruptcy Reports, commencing at the time of adoption of the Act of 1898, now comprise more than ninety volumes.


\textsuperscript{32} § 12 read: “A bankrupt may offer terms of composition . . .”. See Weinstein, \textit{op. cit. supra} note 7 at 260; Mulder and Solomon, note 29 \textit{supra} at 787; Weinstein, note 30 \textit{supra} at 14.
position. But Section 74 in turn gave rise to so many difficulties that failure again followed.\textsuperscript{33}

Chapter XI now replaces Sections 12 and 74 and is supposed to have simplified and speeded up the composition machinery. It provides in brief that a debtor, whether an individual or a corporation, may work out a simple arrangement with his unsecured creditors, by which he can remain in business and retain the goodwill of his going concern.\textsuperscript{34} He secures the consent of his creditors to scale down his debts or to extend the time of their payment. Insofar as corporations were concerned, Chapter XI seemed, from its inception, to be doomed to failure, for usually financial difficulties of a corporation result from inability to meet payments on secured debts. This at once excludes the enterprise from Chapter XI, which is concerned only with unsecured debts.\textsuperscript{35} Obviously the Chapter is suited for use only by individuals and small corporations having no secured indebtedness, or for business enterprises which are not desirous of modifying their secured indebtedness. It is therefore undoubtedly to the surprise of the draftsmen that courts have been literally flooded with petitions by large corporations seeking to adjust their difficulties under Chapter XI rather than Chapter X. The reason for this has now become apparent.

Chapter X, which replaces Section 77B, contains intricate and detailed provisions for corporate reorganizations.\textsuperscript{36} Proceedings thereunder are prone to be drawn out and expensive. Usually the appointment of a disinterested trustee is mandatory.\textsuperscript{37} The trustee originates

\textsuperscript{33} WEINSTEIN, op. cit. supra note 7 at 260; Mulder and Solomon, note 29 supra at 788; Weinstein, note 30 supra at 16.

\textsuperscript{34} WEINSTEIN, op. cit. supra note 7 at 260-261; Mulder and Solomon, note 29 supra at 788-789.

\textsuperscript{35} § 307 (1). "An arrangement within the meaning of this chapter shall include provisions modifying or altering the rights of unsecured creditors generally or some class of them, upon any terms or for any consideration." (Italics supplied.) MOORE'S \textit{BANKRUPTCY MANUAL} (1939) 648; WEINSTEIN, op. cit. supra note 7 at 264; Weinstein, note 30 supra at 16-17.


\textsuperscript{37} "Upon the approval of a petition, the judge shall, if the indebtedness of a debtor, liquidated as to amount and not contingent as to liability, is $250,000 or over, appoint one or more trustees. Any trustee appointed under this chapter shall be disinterested and shall have the qualifications prescribed in Section 45 of this Act, except that the trustee need not reside or have his office within the district. If such indebtedness is less than $250,000, the judge may appoint one or more such trustees or he may continue the debtor in possession. In any case where a trustee is appointed the judge may, for the purposes specified in Section 189 of this Act, appoint as an additional trustee a person who is a director, officer, or employee of the debtor." § 156. See Israels, \textit{Some Problems of Policy and Procedure in the Conduct of Reorganization Proceedings} (1940) 89 U. OF PA. L. REV. 63.
and controls the reorganization plan. Usually the Securities and Exchange Commission will participate generally in the proceedings and will pass upon the fairness or unfairness of a plan. In theory, at least, the creditors have no say with respect to the plan until the tail end of the proceedings. Acceptances obtained by them prior thereto are invalid. The powerful creditors' committees, the control of reorganizations by management and creditors' groups are, more than in mere theory, a thing of the past. It is this reversal of process, this court control, and this power of the Securities and Exchange Commission which persuades corporations to avoid Chapter X. Instead they seek a haven under Chapter XI. For Chapter XI makes no mention of participation by the Securities and Exchange Commission. Acceptances to the plan obtained even prior to commencement of the proceedings may be valid. The appointment of a trustee is not mandatory, and the machinery, at least on the surface, is speedy and inexpensive.

38. "Where a trustee has been appointed the judge shall fix a time within which the trustee shall prepare and file a plan, or a report of his reasons why a plan cannot be effected, and shall fix a subsequent time for a hearing on such plan or report and for the consideration of any objections which may be made or of such amendments or plans as may be proposed by the debtor or by any creditor or stockholder." § 169. WEINSTEIN, op. cit. supra note 7 at 217; Heuston, supra note 36 at 1215.

39. "The Securities and Exchange Commission shall, if requested by the judge, and may, upon its own motion if approved by the judge, file a notice of its appearance in a proceeding under this chapter. Upon the filing of such a notice, the Commission shall be deemed to be a party in interest, with the right to be heard on all matters arising in such proceeding, and shall be deemed to have intervened in respect of all matters in such proceeding with the same force and effect as if a petition for that purpose had been allowed by the judge; but the Commission may not appeal or file any petition for appeal in any such proceeding." § 208. See also § 172. WEINSTEIN, op. cit. supra note 7 at 230.

40. "After the hearing, as provided in Section 169 or Section 170 of this Act, and, if a plan has been submitted to the Securities and Exchange Commission, as provided in Section 172 of this Act, then after filing of the report or notice that it will not be filed, or after the expiration of the time for its filing, whichever first occurs, the judge shall enter an order approving the plan or plans which in his opinion comply with the provisions of Section 216 of this Act, and which are fair and equitable, and feasible, and shall fix a time within which the creditors and stockholders affected thereby may accept the same." § 174. See Israels, note 37 supra.

41. "No person shall, without the consent of the court, solicit any acceptance, conditional or unconditional, of any plan, or any authority, conditional or unconditional, to accept any plan, whether by proxy, deposit, power of attorney or otherwise, until after the entry of an order approving the plan or plans which in his opinion comply with the provisions of Section 216 of this Act, and which are fair and equitable, and feasible, and shall fix a time within which the creditors and stockholders affected thereby may accept the same." § 174. See Israels, note 37 supra.

42. Levi, Corporate Reorganizations and a Ministry of Justice (1938) 23 MINN. L. REV. 3, 12.

43. "At such meeting, or at any adjournment thereof, the judge or referee . . . (4) shall receive and determine the written acceptances of creditors on the proposed arrangement, which acceptances may be obtained by the debtor before or after the filing of a petition under this chapter." § 336.

44. "The court may, upon the application of any party in interest, appoint, if necessary, a receiver of the property of the debtor, or, if a trustee in bankruptcy has previously been appointed, shall continue such trustee in possession." (Italics added) § 332. See also § 342.
Undoubtedly, Chapter XI is early on the "must" list for amendment. Its manifold ambiguities are undoubtedly caused by the fact that the framers were groping in an experimental field. They have been accentuated by the unanticipated influx of petitions by large corporations. Recently, however, the Supreme Court, in the United States Realty Corporation case, has been called upon to settle a few of the problems. In that case a corporation with some seven thousand shares of stock in the hands of the public, and an indebtedness in excess of five million dollars, sought to effectuate an arrangement under Chapter XI. The Securities and Exchange Commission attempted intervention, asking that the debtor's petition be dismissed upon the ground that the proceedings should have been filed under Chapter X. The ambiguities of the chapter are made more apparent by the fact that the Circuit Court of Appeals, with a dissenting opinion, reversed the District Court, and by the fact that the Supreme Court split by a six to three vote. The majority opinion is by Mr. Justice Stone and the dissent by Mr. Justice Roberts. Together they present an illuminating discussion of the vague line of demarcation between Chapters X and XI.

With large corporations, having securities outstanding in the hands of the public, seeking to utilize Chapter XI, it is not surprising that the Securities and Exchange Commission should seek to intervene. The majority of the court, relying upon the broad equitable powers of the bankruptcy court and upon the new Federal Rules of Procedure, held that the Commission might properly intervene in the public interest. The dissent, objecting strenuously to resort to such general equitable principles, found no provision of the Federal Rules that

45. Montgomery, Chapter XI of the Bankruptcy Act (Address before American Bar Association, September 9, 1940).
49. "The 'claim or defense' of the Commission founded upon this interest has a question of law in common with the main proceeding in the course of which any party or creditor could challenge the propriety of the Court's proceeding under Chapter XI. The claim or defense is thus within the requirement of Rule 24 and intervention was properly allowed. The Commission was, therefore, a party aggrieved by the court's order refusing to dismiss and was entitled to appeal under §§ 24 and 25 of the Bankruptcy Act. . . ." Ibid.
justified intervention, and concluded that intervention should be denied because not mentioned in Chapter XI, while express provision therefor is found in Chapter X.

The majority opinion apparently means that corporations with securities outstanding in the hands of the public are not eligible to proceed under Chapter XI. Under Chapter X, with the Commission present as a party, the public interest might be more adequately protected. And the content of Chapter XI in effect limits its application to small corporations, upon the theory that a feasible plan cannot be properly promulgated thereunder. The dissent, adhering strictly to the letter of the Chapter, finds that the legislative intent must have been that any corporation, whether large or small, is entitled to seek relief thereunder. It finds no basis for the conclusion of the majority that the legislative intent was based upon whether or not a corporation has securities outstanding in the hands of the public.

In this difference of opinion, the dissent has probably come closer to the legislative intent. Surely if the draftsmen had so intended, they would have set up as a line of demarcation the existence or non-existence of outstanding securities. The test set up by the majority of the court is vague in itself, since it mentions no amount of outstanding securities as a prerequisite. But the majority opinion, though subject to the charge of judicial legislation, is plausible, and may well be heeded by legislators. The machinery of Chapter XI is ill designed for adjusting the difficulties of corporations with com-

51. Mr. Justice Roberts, dissenting, stated that Rule 24 of the Rules of Civil Procedure does not permit intervention here. The Commission may not intervene as of right under this rule because no statute confers upon it an unconstitutional right to do so; it is not entitled to permissive intervention because no statute gives it that right. Cases allowing creditors to raise questions of venue or jurisdiction, and equity receivership cases where an official intervenes in order to claim the right to take over and administer the property in the possession of the court, are inapplicable here. Id. at 1059.

52. "Since the sections under Chapter XI already considered admit of an 'arrangement' only with respect to unsecured creditors without alteration of the relations of any other class of security holders, and since it contemplates, as required by § 366, that the arrangement shall be fair and equitable within the meaning of the Boyd case, it is evident that Chapter XI gives no appropriate scope for an arrangement of an unsecured indebtedness held by some nine hundred individual creditors of a corporation having seven thousand stockholders. The hope of securing an arrangement which is fair and equitable and in the best interests of the rights of the stockholders such as may be had under Chapter X, but is precluded by Chapter XI, is at best but negligible and, if accomplished at all, must be without the aids to the protection of creditors and the public interest which are provided by Chapter X, and which would seem to be indispensable to a just determination whether the plan is fair and equitable." Id. at 1052.

53. "That chapters X and XI were not written in ignorance of the distinction between corporations having publicly owned securities and those which have not, is shown by the fact that a special committee's report called attention to this difference and suggested that corporations not having such securities outstanding be permitted to go under the arrangements chapter, whereas the first named should be required to file under what is now Chapter X. With this suggestion before it Congress adopted a different criterion." Id. at 1058.

54. Montgomery, note 45 supra.

55. Ibid.
plicated financial structures. It does not appear that reorganizations were intended thereunder. No provision is made for the issuance of new securities or stock, nor are the rights of stockholders adequately protected. From this it seems a reasonable conclusion that the Chapter was created merely for small enterprises to continue their identity and adjust their unsecured debts by agreement with creditors—a composition and no more. Yet an amendment seems necessary to make more explicit the limits of the chapter, to determine whether or not reorganization is possible thereunder, to clarify the status of the Securities and Exchange Commission, to settle the issue of whether new securities may be issued, and to protect the interests of stockholders. These defects by no means prophesy the failure of the chapter; they suggest merely the necessity of amendment based upon experience.

II. ACTS OF BANKRUPTCY

In the liquidation portions of the Act many of the changes were for the purposes of clarifying meaning and creating uniformity of terminology. Occasionally, however, the zeal for uniformity is at the unconscious expense of clarity. Under the Act of 1898, an act of bankruptcy, to constitute the basis for an involuntary petition, must have been committed within four months prior to the filing of the petition. If the act of bankruptcy alleged consisted of a fraudulent conveyance, a preference, or a general assignment, Section 3(b) expressly provided that the period within which a petition could be filed should not expire until four months after such transaction had been recorded, if recording was required or permitted under applicable state law.

Now what has been done under the Chandler Act? Section 3(b), defining the four-month period, now states that such period shall not

56. Ibid.
58. "A petition may be filed against a person who is insolvent and who has committed an act of bankruptcy within four months after the commission of such act. Such time shall not expire until four months after (1) the date of the recording or registering of the transfer or assignment when the act consists in having made a transfer of any of his property with intent to hinder, delay, or defraud his creditors or for the purpose of giving a preference as hereinbefore provided, or a general assignment for the benefit of his creditors, if by law such recording or registering is required or permitted, . . . ." Ibid.
59. On measurement of the four-month period see 1 COLLIER, BANKRUPTCY (14th ed. 1940) § 3.702.
60. Id. at §§ 3.703, 3.705.
expire until four months after the transfer has become so far perfected as to be good against any creditor or bona fide purchaser from the debtor.\(^6\) This subdivision again applies to fraudulent conveyances, preferences, and general assignments.\(^6\) Obviously, a general assignment or a preference in the form of a mortgage is perfected on recording, because usually under local law recording renders the transfer immune from attack by creditors or bona fide purchasers. In short, the intent of the draftsmen was to insure that the four-month period dates from the time of recording.\(^6\) But does the phraseology carry out this intent in the case of a fraudulent conveyance? It does not. Suppose again that a man transfers property on January 1 to his wife, without consideration. Suppose that the wife records the transfer on January 2. If that transaction constitutes a fraudulent conveyance recording does not render it immune from attack. Under State law creditors may have it set aside at any time until the statute of limitations has run, and in the case of a sealed instrument that means in some jurisdictions as much as ten or twenty years.\(^6\) Since the transaction cannot be perfected by recording, the plain wording of Section 3(b) would mean that it constitutes an act of bankruptcy for ten or twenty years. But if the transfer were a preference instead of a fraudulent conveyance, the same words would mean only four months. The phraseology was altered in the interest of uniformity to make it conform to similar terminology found in Sections 60 and 67.\(^6\)

Incidentally, something might be said as a matter of policy in favor of treating a fraudulent conveyance as an act of bankruptcy until the state statute of limitations has run. A fraudulent conveyance is the worst of all the acts of bankruptcy. It injures all the creditors, and is usually intended as a secret means of benefiting only the bankrupt at their expense. But whether the draftsmen of the Act intended this result is another question.\(^6\) It is apparent that a mistake has been made for it was intended that the four-month period run from

\(^{61}\) "Such time (for the filing of the petition) with respect to the first, second, or fourth act of bankruptcy shall not expire until four months after the date when the transfer or assignment became so far perfected that no bona-fide purchaser from the debtor and no creditor could thereafter have acquired any rights in the property so transferred or assigned superior to the rights of the transferee or assignee therein." 52 STAT. 845 (1938), 11 U. S. C. A. 21A (Supp. 1939).

\(^{62}\) In § 3 (b) these are referred to, respectively, as "the first, second, or fourth act of bankruptcy". Ibid.

\(^{63}\) I COLLIER, BANKRUPTCY (14th ed. 1940) § 3.701; WEINSTEIN, op. cit. supra note 7 at 21.

\(^{64}\) Georgia, for example, has a twenty-year statute of limitations on sealed instruments. GA. CODE (1933) § 3-703. As to limitation of creditor's suits see I GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES (Rev. ed. 1940) § 88.

\(^{65}\) § 60 (a) (as to preferential transfers), and § 67 (d) (5) (as to fraudulent conveyances).

\(^{66}\) I COLLIER, BANKRUPTCY (14th ed. 1940) § 3.702.
the date of recording, and the matter should be taken up for amendment.\textsuperscript{67}

It is worth mentioning that the same error occurs in Section 67(d) which sets up the circumstances under which a fraudulent conveyance may be set aside by the trustee.\textsuperscript{68} The time period here, in most instances, is twelve months, but the section states that the twelve-month period shall commence to run from the time that the transfer is so far perfected as to be good against bona fide purchasers or creditors of the bankrupt.\textsuperscript{69} Obviously the draftsmen meant that the twelve-month period should run from the time of recording, but just as in Section 3(b), they have failed to express clearly that intent.

\section*{III. Preferences}

Few problems gave greater difficulty to the courts under the Act of 1898 than that of voidable preferences. Briefly, Section 60 provided that a transfer by an insolvent debtor to a creditor, within four months of bankruptcy, constituted a voidable preference, if the effect would be to give that creditor a greater percentage of his debt than other creditors of the same class, and if that creditor had reasonable cause to believe that he was receiving a preference.\textsuperscript{70} Now, the four-month period began to run from the date of recording, if recording was \textit{required} or \textit{permitted} under state law.\textsuperscript{71} Difficulties arose as to the interpretation of this last clause, which the Supreme Court finally resolved in three decisions. These cases involved respectively a real property mortgage, a chattel mortgage, and a conditional sale.\textsuperscript{72} In each instance the transaction took place more than four months prior to bankruptcy and present value was given. But the recording took

\textsuperscript{67} Correspondence by the writer with one of the draftsmen brings the admission that an error was made, and that the matter will be brought up for amendment at an appropriate time.

\textsuperscript{68} See infra p. 26.

\textsuperscript{69} § 67 (d) (3). "... a transfer shall be deemed to have been made at the time when it became so far perfected that no bona-fide purchaser from the debtor and no creditor could thereafter have acquired any rights in the property so transferred superior to the rights of the transferee therein, ..."

\textsuperscript{70} In a proceeding under § 67 (d) (15) the trustee operates under federal law as to transactions outside the twelve-month period, which are voidable under the state law. See § 70 (e).

\textsuperscript{71} Act of 1898, §§ 60 (a) and (b), 30 Stat. 562 (1898), 11 U. S. C. A. (1927) 96.

\textsuperscript{72} Martin v. Commercial Nat. Bank of Macon, Ga., 245 U. S. 513 (1918) (chattel mortgage); Carey v. Donohue, 240 U. S. 430 (1916) (real property mortgage); Bailey v. Baker Ice Machine Co., 239 U. S. 268 (1915) (conditional sale). Although at the time these cases were decided § 60 referred only to whether recording was "required", it was subsequently held that the addition to § 60 (a) in 1926 of "or permitted" did not alter the results in these three cases. First Nat. Bank of Lincoln v. Live Stock Nat. Bank, 31 F. (2d) 416 (C. C. A. 8th, 1929); see Note (1934) 44 \textit{Yale} L. J. 109.
place just prior to bankruptcy with reasonable cause to believe in the debtor's insolvency. Yet the Supreme Court in each instance held that the transaction dated from the time of actual transfer instead of from the time of recording. Hence each of the transactions was upheld. In each instance the Court was undoubtedly influenced by the fact that present value had been given at the time of transfer, despite the fact that Congress intended the transfer to date from the time of recording. In other words, Congress was attempting to clamp down on secret liens, but the Court refused so to interpret the section.73

The express intent of the draftsmen of the new Section 60 was to change the holding of those three Supreme Court decisions.74 It states that the four-month period shall begin to run from the time the transaction shall be so far perfected that it cannot be upset by creditors or bona fide purchasers from the debtor.75 In most instances this means the date of recording. Here it is clear that the intent is to clamp down on secret liens. The effect is as follows: a debtor gives a mortgage for present value more than four months prior to bankruptcy. The mortgagee sits by for some time and does not record. Then he learns that the debtor is insolvent. So he records and shortly thereafter the debtor goes bankrupt. The transaction was perfected, by recording, within four months of bankruptcy and hence constitutes a voidable preference. The transfer is deemed to have taken place when recorded, and at that time it constitutes a past debt and therefore a preference.76 Thus the new act expands the definition of preference to include secret liens. It does so, in keeping with the policy of the Act to secure larger

73. Prior to the passage of the Chandler Act, Professor McLaughlin wrote concerning these cases that, "The intention to defeat transfers such as that in the Martin case seems clear. The recording act protects lienholders. The trustee is a lienholder. The validity of the transfer is to be tested as of the date of the recording, not of the transfer. Secret liens first made public during insolvency and with notice thereof are to be vulnerable for a period of four months. Unfortunately, a technical flaw appears. The recording act does not protect lienholders who become such the day after the recording, and although it may be urged that the Bankruptcy Act discloses a clear intention to let the trustee reach back for four months under the circumstances, it does not say so in so many words. Accordingly, the Court held that recording was not required to defeat the claim of a subsequent lienholder such as the trustee. Even on the most literal basis it would seem admissible to urge that, since a day's further delay in recording would have permitted the trustee to prevail, recording certainly was most emphatically required as to him." McLaughlin, Aspects of the Chandler Bill to Amend the Bankruptcy Act (1937) 4 U. of CHr. L. Rav. 369, 392. See Note (1934) 44 YALE L. J. 199.

74. See HANNA AND MCLAUGHLIN, op. cit. supra note 9 at 58; McLaughlin, note 73 supra at 393.

75. § 60 (a). "For the purposes of subdivisions (a) and (b) of this section, a transfer shall be deemed to have been made at the time when it became so far perfected that no bona-fide purchaser from the debtor and no creditor could thereafter have acquired any rights in the property so transferred superior to the rights of the transferee therein. . . ."

76. § 60 (a). If the transfer is deemed to have taken place at the time of recording, it constitutes security for a past debt, since the consideration passed prior to the time of recording.
dividends to general creditors, at the expense of the secured creditor who was negligent in failing to record.

The subdivision seems clear. Yet in two instances the purpose may have failed of accomplishment, and in both instances the matter will be in the hands of the courts to fulfill or to defeat the purpose of the Act. In one of the three Supreme Court Cases mentioned above, Bailey v. Baker Ice Machine Co.,77 a refrigerating machine was sold for $5,000 under a conditional sales contract. The buyer paid more than $3,000 of the purchase price. Though the sale was made more than four months prior to bankruptcy, the recording took place within four months thereof. The Supreme Court held that the transaction was not a voidable preference. Except for one thing, it would seem that the new Act would change this rule. However, the Supreme Court stated that there never had been a transfer by the debtor because he never owned the machine, title having been reserved in the seller.78 This language is most unfortunate. The purchaser was in possession and operation of the machine—to all intents and purposes he had the indicia of ownership. Moreover, he had paid more than one-half of the purchase price. His creditors could have sold the machine on execution, prior to the recording of the contract. In other words, the conditional sales contract was and is the same as a purchase-money mortgage, and should be treated as such.79 In either instance the creditor holds merely a secret lien. The expanded definition of transfer in Section 1 (30) is broad enough to include a conditional sales contract,80 and it is greatly to be desired that when this type of transaction comes before the courts it will be seen in its true light, as a secret lien, and that the Bailey case will be held to be no longer the law. Such a holding will create uniformity as to secret liens, and will carry into effect the expressed purpose of the draftsmen.

77. 239 U. S. 268 (1915).
78. Id. at 274. "... § 60 (b) refers to an act on the part of a bankrupt whereby he surrenders or encumbers his property or some part of it for the benefit of a particular creditor, and thereby diminishes the estate which the Bankruptcy Act seeks to apply for the benefit of all the creditors. ... Applying this test to the contract in question, we think it did not operate as a preferential transfer by Grant Brothers, the bankrupts. The property to which it related was not theirs but the Baker Company's. The ownership was not transferred, but only the possession, and it was transferred to the bankrupts, not from them." Cf. In re Lake's Laundry, Inc., 79 F. (2d) 325 (C. C. A. 2d, 1935).
80. "Transfer" shall include the sale and every other and different mode, direct or indirect, of disposing of or of parting with property or with an interest therein or with the possession thereof or of fixing a lien upon the property or upon an interest therein, absolutely or conditionally, voluntarily or involuntarily, by or without judicial proceedings, as a conveyance, sale, assignment, payment, pledge, mortgage, lien, incumbrance, gift, security or otherwise; ... .
In still another matter, there is already an open effort among writers to defeat the probable intent of the framers of Section 60. The situation involves a very common type of security which by nature is not recorded, namely the assignment of accounts receivable. Let us assume that X assigns accounts receivable to A as security for a loan. He may subsequently attempt an assignment of the same accounts to B. Now, under state law two rules of priority obtain as between A and B. Under the first, A prevails whether he gave notice to the various debtors or not. The reasoning is that the assignment to A carried full ownership of the accounts, and hence X had nothing further to assign to B. Stress is here placed on the concept of title or ownership. The other rule, which prevails in Pennsylvania, looks at the rights of both parties. It is merely that the first to give notice of the assignment prevails. Its policy is thus to prevent secret liens.

It is, of course, common knowledge that frequently as a matter of practice X assigns accounts receivable to A, and never does attempt any further assignment of the same accounts to any other person. But A, who may be a lending bank, does not give notice of the assignment to the various debtors. The reason for this is that A wants to protect X. It might injure X’s business if it were discovered that it was necessary for him to assign his accounts. The business policy is to encourage secret liens; the policy of the law, in requiring notice, is to discourage them, for the protection of third parties.

Now, suppose X assigns to A accounts receivable as security and A does not give notice to the debtors. More than four months later X goes bankrupt. In the meantime X could have cut off A’s rights by an assignment of the same accounts to B. In other words, under the Pennsylvania rule, B could cut off A’s secret lien because it was never perfected by notice. Therefore, under the wording of Section 60 the

81. Salem Trust Co. v. Manufacturers’ Finance Co., 264 U. S. 182 (1924), 72 U. of Pa. L. Rev. 446, 3 Wis. L. Rev. 55; Notes (1924) 24 Col. L. Rev. 501, (1924) 11 Va. L. Rev. 62, (1924) 33 Yale L. J. 762. “By the first assignment, the rights of the assignor pass to the assignee. The creditor has a right to dispose of his own property as he chooses and to require the debt to be paid as he directs without the assent of the debtor. . . . Notice of the assignment to the debtor adds nothing to the right or title transferred: A subsequent assignee takes nothing by his assignment, because the assignor has nothing to give.” Salem Trust case, at 197.

trustee should be permitted to do likewise. The transaction has never been perfected and can therefore be cut off by a bona fide purchaser. Section 60 applies. Will the courts follow this line of reasoning? It is desirable, but doubtful. Three writers, at least, have already argued strenuously that A should be protected upon the ground that the transfer is good without notice, and notice does not add anything to A's title. Such reasoning misses fire. The same argument could be applied to the recording of a mortgage, but it is not likely that these same writers would argue for such a result. Their entire argument is based upon the doubtful claim that it might not be good business to give notice of the assignments. But it would seem that the policy of the state law and of the bankruptcy law against secret liens is otherwise and is stronger. The trustee should prevail, A's claim should be treated as a voidable preference, and the secret lien should be cut off.

This brief summary is perhaps unfair to both sides in its incompleteness, but the situation, so commonly occurring, is bound to come before the lower courts and the Supreme Court, sooner or later. Already an amendment to the Section has been proposed, which will produce an undesirable result and have the effect of upholding such assignments without notice. The amendment proposes to treat the matter as one of federal, instead of state law. The Supreme Court, in a non-bankruptcy case some years ago, adopted the rule that the first assignee prevails even in the absence of notice. The amendment will probably not receive the attention of Congress in the present session, but when it does ultimate defeat is to be desired.

IV. FRAUDULENT CONVEYANCES

Another instance of unfortunate draftsmanship occurs in Section 67 (d) (3). The main part of Section 67 (d) incorporates the Uni-

84. Hanna and McLaughlin, op. cit. supra note 7 at 58; McLaughlin, note 73 supra at 393.
86. See, e. g., note 85 supra.
87. Senate Bill 3554, 76th Cong., 3d Sess. The bill proposes to amend § 60 (a) to provide that “... in the case of accounts receivable, choses in action, and other intangibles, a transfer shall be deemed to have been perfected within the meaning of this Act when it has been fully consummated between the debtor and his transferee.” Apparently such consummation would be complete without the necessity of notice by the assignee to the various debtors.
A recently developed practice, if given judicial sanction, might well solve the problem without the necessity of amendment. Under that practice, all accounts receivable are plainly stamped as having been assigned to A. Such would give notice to subsequent assignees without the necessity of notice to the various debtors.
form Fraudulent Conveyances Act. It provides in general that fraudulent conveyances made by the debtor within one year prior to the filing of a petition in bankruptcy may be set aside by the trustee. In two respects this subdivision departs significantly from the corresponding provisions of the Act of 1898. First, whereas the Act of 1898 incorporated the antiquated provisions of the Statute of Elizabeth, the new Act modernizes the machinery by the substitution of the more composite Uniform Fraudulent Conveyances Act. Secondly, under Section 67 of the Act of 1898 a fraudulent conveyance could be set aside only if it had occurred within four months of bankruptcy. The Chandler Act, on the other hand, in keeping with its general policy to secure higher dividends for the creditors and to clamp down upon the dishonest bankrupt, extends that period to one year prior to bankruptcy. In the words of one of the draftsmen of the Act, "Experience has demonstrated that a dishonest debtor will begin his fraudulent activities long prior to four months before his bankruptcy and that many of his fraudulent transfers occur within the earlier period."

Section 67 (d) (3) of the new Act, however, represents a specialized type of fraudulent conveyance to which the four-month period continues to apply. Draftsmen of the Act have explicitly stated that the purpose of this Section was to incorporate the rule of Dean v. Davis. Actually, it has not only failed so to do, but is so phrased as to lead to harsh and undesirable consequences.

The facts of Dean v. Davis are simple. A debtor, insolvent, owed money to a bank. Being pressed by the bank for payment, he explained his situation to his brother-in-law. The brother-in-law then loaned...
money to the debtor to pay off the bank, taking a mortgage on the debtor's property as security. The debtor became a bankrupt shortly thereafter. There is no evidence in the case that the bank acted in bad faith, and no evidence that the bank had reasonable cause to believe that it was receiving a preference. In short, there is no finding or showing that the payment to the bank could have been set aside as a voidable preference under Section 60, and very probably for this reason the trustee did not proceed again the bank. Instead he sought to set aside the mortgage given to the brother-in-law. He could not treat the mortgage as a voidable preference since adequate present value was given.\(^9\)

But Mr. Justice Brandeis held that even though present value was given the mortgage constituted a voidable fraudulent conveyance, because the brother-in-law acted in bad faith. The case turns squarely on the brother-in-law's bad faith; \(^9\) Mr. Justice Brandeis indicated that the result might have been otherwise had the brother-in-law acted in good' faith.\(^9\) In short, the case stands for the following proposition alone: where an insolvent debtor borrows money, giving security, and the lender has knowledge that the money is to be used to pay off debts, the transfer of security constitutes a fraudulent conveyance regardless of whether the payment to creditors constituted a voidable preference.

Now, let us see what the draftsmen have done in attempting to incorporate this rule into Section 67 (d) \(^9\) That subdivision

\(^9\) Dean v. Davis, 242 U. S. 438, 443 (1917). "The mortgage was not voidable as a preference under § 60b. Preference implies paying or securing a pre-existing debt of the person preferred. The mortgage was given to secure Dean for a substantially contemporary advance. The bank, not Dean, was preferred. The use of Dean's money to accomplish this purpose could not convert the transaction into a preferring of Dean, although he knew of the debtor's insolvency. Mere circuity of arrangement will not save a transfer which effects a preference from being invalid as such. National Bank of Newport v. National Herkimer County Bank, 225 U. S. 178, 184. But a transfer to a third person is invalid under this section as a preference, only where that person was acting on behalf of his creditor, as in In re Beerman, 112 Fed. 663, and Walters v. Zimmerman, 208 Fed. 852; 220 Fed. 805. Here Dean acted on the debtor's behalf in providing the money and taking up the notes."

\(^9\) Id. at 444. "Making a mortgage to secure an advance with which the insolvent debtor intends to pay a pre-existing debt does not necessarily imply an intent to hinder, delay or defraud creditors. The mortgage may be made in the expectation that thereby the debtor will extricate himself from a particular difficulty and be enabled to promote the interest of all other creditors by continuing his business. The lender who makes an advance for that purpose with full knowledge of the facts may be acting in perfect 'good faith'. But where the advance is made to enable the debtor to make a preferential payment with bankruptcy in contemplation, the transaction presents an element upon which fraud may be predicated. The fact that the money advanced is actually used to pay a debt does not necessarily establish good faith. It is a question of fact in each case what the intent was with which the loan was sought and made."

\(^9\) The lower courts were justified in concluding . . . that Dean [lender], who, knowing the facts, cooperated in the bankrupt's fraudulent purpose, lacked the saving good faith."

\(^9\) Glenn, op. cit. supra note 64 at 528; Hanna and McLaughlin, op. cit. supra note 9 at 74. These writers assume that the subsection does incorporate the rule of Dean v. Davis.
states that every preference made or obligation incurred by a debtor within four months of bankruptcy is fraudulent, if made or incurred with intent to use the consideration to give a preference to a third person voidable under Section 60. Clearly in one respect and possibly two this is a departure from the rule of Dean v. Davis. It is to be remembered that there is no showing in that case that the payment to the bank constituted a voidable preference. The issue was not even raised. Yet, under Section 67 (d) (3) before the loan can be set aside the money must have been used to create a voidable preference. Maybe the change is not a bad idea. But it does represent a restriction upon the rule of Dean v. Davis which appears to have been unintentional.

The second departure is far more serious. The subdivision states that every such obligation is fraudulent, "if made or incurred with intent to use the consideration" to give a preference to a third person voidable under Section 60. To whose intent does this refer? Usually intent under a fraudulent conveyance refers to the intent of the transferor, the debtor. But Dean v. Davis said nothing about the debtor's intent—it turned on the intent of the brother-in-law, who was the transferee. So if the intent referred to in the new Section 67 (d) (3) is the debtor's intent, the departure from Dean v. Davis is drastic. The intent of the transferee will no longer be significant. And the result may be unfortunate. By way of illustration, a debtor comes to a bank, or to anyone, seeking a loan. He is insolvent but offers the lender perfectly adequate security. He has the secret intent to use the proceeds of the loan to pay off a favored creditor, but he tells the lender nothing about this. The lender in perfect good faith, makes the loan. The debtor is then thrown into bankruptcy. Under Dean v. Davis the lender would be protected, but under the plain wording of Section 67 (d) (3) he loses his security—manifestly, a most undesirable result. Given the case to decide, what should a court do? It would have the choice of following Dean v. Davis, pointing out that the draftsmen intended to incorporate it, though the words of the subsection do not lend themselves readily to such a construction. Or, it could follow the words of the Act and reach an undesirable result.

99. § 67 (d) (3). "Every transfer made and every obligation incurred by a debtor within four months prior to the filing of a petition in bankruptcy of an original petition under chapters X, XI, XII or XIII of this Act by or against him is fraudulent, as to then existing and future creditors, if made or incurred with intent to use the consideration, obtained for the transfer or obligation, to effect a preference to a third person voidable under Section 60 of this Act."

100. See the language of Mr. Justice Brandeis in note 96 supra.
V. Priorities and Liens

Under the act of 1898, Section 64 (b) provided that wage claims up to $600, earned within three months prior to commencement of the proceedings, should be fifth in order of priority of payment. Under the revised Section 64, wage claims are second in order of priority, being subordinate only to administrative costs and expenses. It should be noticed that as a matter of bankruptcy history, unsecured claims given priority have always been subordinate to valid liens. Never before in straight bankruptcy law have valid liens been interfered with. Straight bankruptcy has always concerned itself merely with the distribution of general assets to general unsecured creditors; and general assets would exist only after valid lien claimants had been fully compensated out of their security. In short, historically, the order of payment has always been thus: lien claimants first, priority claimants as designated by Section 64 second, and unsecured creditors out of what balance remained thereafter. Whatever may be done in corporate reorganization, in straight bankruptcy secured claims have never been scaled down or otherwise affected.

It comes with distinct surprise, then, to notice that in one instance this formerly fundamental precept has been altered. Section 67 (b) recognizes the validity of statutory liens under either state or federal law, even though such liens may not have been perfected at the time of bankruptcy, so long as the time for perfecting them under local law has not expired. This subdivision is but an incorporation of what

101. "Wages due to workmen, clerks, traveling or city salesmen, or servants, which have been earned within three months before the date of the commencement of the proceeding, not to exceed $600 to each claimant." Act of 1898, § 64b (5), as amended in 1906 and 1926. 30 Stat. 544 (1898), 11 U. S. C. A. § 101 (1934).

102. § 64 (a) (2). "... wages, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt."

103. Of course, the trustee might participate in the foreclosure of mortgages on the bankrupt's property, but only for the purpose of securing a possible surplus for the benefit of unsecured creditors.

104. One of the purposes of corporate reorganizations is, of course, to enable the debtor to scale down secured indebtedness. See § 197. The attempt to affect secured debts in compositions under § 74 was short-lived. See supra p. 16.

105. "The provisions of Section 60 of this Act to the contrary notwithstanding, statutory liens in favor of employees, contractors, mechanics, landlords, or other classes of persons, and statutory liens for taxes and debts owing to the United States or any State or subdivision thereof, created or recognized by the laws of the United States or of any State, may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition in bankruptcy or of the original petition under chapters X, XI, XII or XIII of this Act, by or against him. Where by such laws such liens are required to be perfected and arise but are not perfected before bankruptcy, they may nevertheless be valid, if perfected within the time permitted by and in accordance with the requirements of such laws, except that if such laws require the liens to be perfected by the seizure of property, they shall instead be perfected by filing notice thereof with the court."

For a brief statement of the intent and effect of this section see WEINSTEIN, op. cit. supra note 7 at 144.
had already been established by case law under the Act of 1898.\textsuperscript{106} Most frequently occurring among these liens would be those of wage-earners, materialmen, mechanics, and landlords. This would seem to be an extension of the theory above mentioned, of protecting valid secured claims, and a limitation upon other portions of the Act, invalidating liens and preferences created within four months of bankruptcy.\textsuperscript{107} The new Section 67 (c) reveals, however, that this protection to secured claims is only partial. That subdivision provides that the statutory liens just mentioned, when they exist on personal property, shall be postponed in priority to the payment of debts specified in Section 64 (a) (1) and (2) and, except as against other liens, the liens for wages and rent shall be limited to the same extent as provided for wages and rent in Section 64 (a).\textsuperscript{108} This change is not only startling but is double-barreled. In the first place it means that these liens created by state law because of a strong public policy in favor of their existence, and recognized as valid by the bankruptcy law, are none-the-less postponed in priority of payment to two types of completely unsecured claims, namely, administrative costs and wage claims.\textsuperscript{109} Such a provision is revolutionary in the history of straight bankruptcy, and is therefore more than a little startling. Yet the reasons for it are apparent. Since only personal property is involved, and that personal property will be administered by the bankruptcy court, it was deemed advisable that the costs of administration should be paid first. And unsecured wage claims are likewise given priority because of a public policy (given sanction by a paramount federal law) that wage-earners are more in need of protection than are the lien claimants, for in substantially all cases, bankruptcy means that the wage-

\textsuperscript{106} Henderson v. Mayer, 225 U. S. 631 (1912); New York-Brooklyn Fuel Corporation v. Fuller, 11 F. (2d) 802 (C. C. A. 2d, 1926); \textit{In re West Side Paper Co.}, 162 Fed. 110 (C. C. A. 3d, 1908). The same result had been previously obtained under the Act of 1867. Austin v. O'Rielly 2 Fed. Cas. No. 665 (C. C. S. D. Miss. 1875).

\textsuperscript{107} §§ 60 and 67a. See Legis. (1939) 87 U. of PA. L. REV. 317.

\textsuperscript{108} "Where not enforced by sale before the filing of a petition in bankruptcy or of an original petition under Chapters X, XI, XII or XIII of this Act, though valid under subdivision b of this section, statutory liens, including liens for taxes or debts owing to the United States or to any State or subdivision thereof, on personal property not accompanied by possession of such property, and liens whether statutory or not, of distress for rent shall be postponed in payment to the debts specified in clauses (1) and (2) of subdivision a of Section 64 of this Act, and, except as against other liens, such liens for wages or for rent shall be restricted in the amount of their payment to the same extent as provided for wages and rent, respectively, in subdivision a of Section 64 of this Act." § 67 (c).

It will be recalled that § 64 (a) (1) deals with administrative costs and § 64 (a) (2) with wage claims. This latter section limits the wage claims to $600 and restricts the claims to those arising within the period of three months before the date of the commencement of proceedings.

Under the Act of 1898, the priorities given to administrative costs and to wage earners did not apply to liens. Richmond v. Bird, 249 U. S. 174 (1919); \textit{In re Brannon}, 62 F. (2d) 659 (C. C. A. 5th, 1933).

\textsuperscript{109} Legis. (1939) 87 U. of PA. L. REV. 317, 322; WEINSTEIN, \textit{op. cit. supra} note 7 at 144.
earner's employment has ceased. One may wonder why such priority was not extended over all lien claimants, whether their security consist of personal or real property, and whether the liens be created by statute or by contract. Before long the matter will be litigated. Thus far, though raised in the Third Circuit, the issue has been avoided because the cases were governed by the Act of 1898 rather than by the Chandler Act.

It has been observed that the change created by Section 67 (c) was double barreled. The second shot still remains. The Act further provides that such statutory liens when based upon wage or rent claims, except as against other liens, shall be limited to the same extent as provided in Section 64 (a). As previously pointed out, under Section 64 (a) (2) wages up to $600 earned within three months of bankruptcy are given priority of payment. The second barrel of Section 67 (c) means that except where other liens are present, wage-earners' liens created by statute, if earned within three months of bankruptcy, are limited to $600. It seems to follow that if other liens should perchance exist, no such limitation would apply. If so, it seems strange that a wage earner's protection should depend upon the accidental circumstance that a third party might also have a lien upon the same property. The same limitation is placed upon landlords' liens, for their priority is restricted by 64 (a) (5) to rent accruing within three months prior to bankruptcy.

The revolutionary double-barreled provision of Section 67 (c), then, means this: that certain statutory liens are not only postponed in favor of other unsecured claims, but are also for the first time reduced in amount. If one has a wage-earners' statutory lien for $1500, part of which represents wages earned within three months and part for a prior period, it will be seen that Section 67 (c) can now give rise to mathematical complexities. In this respect, the draftsmen of

110. The same policies in favor of priorities would seem to be applicable. The explanation for the limitation seems hardly adequate. "... the historical development, and the inherent differences in the incidents attaching to real and personal property, made it advisable to restrict the remedy provided by this paragraph to liens on personal property." Weinstein, op. cit. supra note 7 at 145.

111. In re Mount Holly Paper Co., 110 F. (2d) 220 (C. C. A. 3d, 1940) (two cases discussed there); see Ginsberg v. Lindel, 107 F. (2d) 721 (C. C. A. 8th, 1939).

112. Note (1939) 87 U. of Pa. L. Rev. 317, 322. One of the draftsmen of the Chandler Act defends his position by pointing out that the intent of the framers was to help the general unsecured creditors and that absent other lienors, the wage-earner or landlord should be limited in amount of recovery. However, he asserts, where other lienholders exist, a limitation upon the amount of the wage-earner's or landlord's lien will inure to the benefit of the other lienholders and not to the general creditors, a result not intended by the Act. Weinstein, op. cit. supra note 7 at 144.

113. "Provided, however, that such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy." § 64 (a) (5).
the Act have complicated, and not simplified, administration; and
whether the result is an improvement is seriously open to question.

VI. Achievement of Objectives

As previously mentioned, there are ten major objectives of the
Chandler Act. Of present concern are the following:

1. To increase efficiency in administration.
2. To improve the procedural sections of the Act.
3. To minimize evasions by bankrupts.
4. To perfect the sections relative to preferences, liens and fraud-
lent conveyances, and the title of the trustee.
5. To make more effective the discharge provisions of the Act.¹¹⁴

In other words, the Chandler Act aims to secure larger divi-
dends to creditors and to eliminate so far as possible the dishonest
bankrupt. It is a deplorable fact that under the Act of 1898 the aver-
age dividend in bankruptcy proceedings was extremely low. For
example, during 1926-27 general creditors realized only 10.11% on
their unsecured liabilities in involuntary cases and 6.48% for volun-
tary and involuntary cases combined.¹¹⁵ Let us examine briefly what
has been attempted in order to improve his situation.

Procedure has been streamlined. More rapid action means more
economical action. The powers of a referee have been expanded so
that he becomes virtually a judge, thus reducing the constant shuttling
of small matters back and forth between the referee and judge.¹¹⁶
The summary jurisdiction of the bankruptcy court has been increased
in vital spots.¹¹⁷ Government claims, as well as those of private cred-
itors, must now be presented within six months after the date set for
the first meeting of creditors.¹¹⁸ It was a demonstrated fact that
under the Act of 1898 great delay and confusion were caused because
government claims were not within the six-month rule.¹¹⁹ These and
other procedural reforms should be definite time savers.

Incidentally, former Attorney General Murphy appointed a Com-
mittee on Bankruptcy Administration in April, 1939. One of the func-

curred in by Sen. Rep. No. 1916, 75th Cong., 3d Sess. (1938) 3. 4. 1 Collier, Bank-
ruptcy (14th ed. 1940) 22.
¹¹⁶ § 38. Moore's Bankruptcy Manual (1939) 117; Weinstein, op. cit. supra
note 7 at 79.
¹¹⁷ §§ 2 (21), 60 (b), 67 (a) (4), 70 (a) (8). Weinstein, op. cit. supra note 7
at 16, 143, 158.
¹¹⁸ § 57 (n). Hanna and McLaughlin, op. cit. supra note 9 at 54; Moore's
Bankruptcy Manual (1939) 148; Weinstein, op. cit. supra note 7 at 110.
¹¹⁹ Weinstein, op. cit. supra note 7 at 110.
tions of this Committee is to study the fee system. From it has evolved a bill designed to place referees on a permanent salary basis upon the theory that the fee system now employed is inefficient and expensive.120 It seems also that the Committee is in favor of eliminating creditor control and of proposing the appointment of permanent administrative officers, such as licensed, registered and official receivers, trustees, examiners and liquidators.121 Thus far these proposals have not been carried into effect. Although their purpose is to increase efficiency and economy in bankruptcy administration, their desirability has already given rise to divergence of opinion.122

Most important are the new and improved devices for detecting and checking the dishonest bankrupt. The new Section 7 requires the bankrupt to file a statement of his affairs within five days prior to the first meeting of the creditors.123 According to the Official Forms, this statement is designed to furnish the trustee, the creditors and the court with detailed information concerning the debtor's transactions by which concealment and fraud may be more easily discovered.124 The value of this new device is still a matter of speculation. It is, at any rate, a step in the right direction, and if properly carried out should have substantial utility.125 The bankrupt is now held to closer accountability concerning the purchase and disposal of assets.126 Provisions for examination of the bankrupt have likewise been materially strengthened.127

Detection of concealment of fraud means recovery of additional assets for creditors as well as the denial of a discharge. Some of the things that have been done to clarify and give teeth to the provisions of the Act relative to fraudulent conveyances and preferences have already been mentioned.128 In addition, the trustee's title to assets of the bankrupt has been expanded. It is common practice for a man to secure extended credit on the strength of a prospective inheritance.

120. Senate Bill 2550 (1939).
121. Address of Jacob I. Weinstein to American Bar Association Convention (September 11, 1940), loc. cit. supra note 14.
122. "While I recognize that the Chandler Act, which has been in operation for only about two years, may not have cured all the defects and abuses of bankruptcy administration, nevertheless, it is still my conviction that in respect to the proposal of Attorney General Murphy, the fee system for referees, under the present set-up of the office, is the most feasible and workable method of compensating referees and that official administration of bankruptcy estates is not desirable or necessary." Ibid.
123. § 7 (a) (8). See Moore's Bankruptcy Manual (1939); Weinstein, op. cit. supra note 7 at 32.
124. Comprehensive requirements for information from the bankrupt are set forth in Official Form No. 2.
125. I Collier, Bankruptcy (14th ed. 1940) 995; Wolfe, Detection of Fraud under the New Bankruptcy Law (1938) 13 Temp. L. Q. 1, 6.
127. I Collier, Bankruptcy. (14th ed. 1940) 21.01 et seq.; id. at 3 et seq.
128. See supra pp. 22, 26.
Under the Act of 1898 the trustee succeeded to the debtor’s title to assets as of the date of bankruptcy.\footnote{129} Anything acquired thereafter by the bankrupt was free and clear of the claims of creditors in the bankruptcy court.\footnote{130} Consequently such debtors developed the racket of using bankruptcy to defeat their creditors, receiving their inheritances subsequently, to the exclusion of their creditors. That racket has been at least partially squelched by the new Section 70\footnote{131} wherein it is provided that property acquired by inheritance, bequest or devise within six months after bankruptcy shall none-the-less pass to the trustee.\footnote{132}

Discharge features of the Act have also been noticeably tightened. Adjudication now operates as an application for a discharge as to bankrupts other than corporations.\footnote{133} Under the Act of 1898 bankrupts frequently delayed making application or secured continuances in the hope of lulling to sleep creditors who might otherwise file objections to the granting of a discharge.\footnote{134} The trustee may now of his own volition file objections to a discharge,\footnote{135} whereas under the Act of 1898, he could act only with the consent of the creditors.\footnote{136}

\footnote{129} “The trustee of the estate of a bankrupt, upon his appointment and qualification, and his successor or successors, if he shall have one or more, upon his or their appointment and qualification shall in turn be vested by operation of law with the title of the bankrupt, as of the date he was adjudged a bankrupt, except in so far as it is to property which is exempt. . . .” § 70a. Bankruptcy Act of 1898, 30 Stat. 544 (1898), 11 U. S. C. A. § 710 (1934).

\footnote{130} In re Baker, 13 F. (2d) 707 (C. C. A. 6th, 1926), (1927) 27 Col. L. Rev. 87, 36 Yale L. J. 272.

\footnote{131} “These provisions seek to remedy situations which, under the old Act, had given rise to frequent and serious abuses and inequities.” Weinstein, op. cit. supra note 7 at 157.

\footnote{132} Section 70 (a) (7) provides that the trustee shall be vested by operation of law with title to all “contingent remainders, executory devises and limitations, rights of entry for condition broken, rights or possibilities of reverter, and like interests in real property, which were non-assignable prior to bankruptcy and which, within six months thereafter, became assignable interests or estates or give rise to powers in the bankrupt to acquire assignable interests or estates; and . . . (8) all property which vests in the bankrupt within six months after bankruptcy by bequest, devise, or inheritance shall vest in the trustee and his successor and successors, if any, upon his or their appointment and qualification, as of the date when it vested in the bankrupt, and shall be free and discharged from any transfer made or suffered by the bankrupt after bankruptcy. All property in which the bankrupt has at the date of bankruptcy, an estate or interest by the entirety, and which within six months after bankruptcy becomes transferable in whole or in part solely by the bankrupt, shall, to the extent it becomes transferable, vest in the trustee and his successor and successors, if any, upon his or their appointment and qualification, as of the date of bankruptcy. . . .”

See Weinstein, op. cit. supra note 7, at 158: “If, within six months after bankruptcy, the contingency or event occurs so that any such right or interest becomes assignable by the bankrupt, or gives rise to a power in him to acquire an assignable interest or estate, then such right, interest or estate passes to the trustee, upon the happening of such contingency or event.”

\footnote{133} § 14 (a); 1 Collier, Bankruptcy (14th ed. 1940) 1256.
\footnote{134} Matter of Farrow, 28 F. Supp. 9 (S. D. Cal. 1939); 1 Collier, Bankruptcy (14th ed. 1940) 1256.
\footnote{135} § 14 (b); 1 Collier, Bankruptcy (14th ed. 1940) 1266, n. 3.
\footnote{136} Bankruptcy Act of 1898, 30 Stat. 550 (1898), 11 U. S. C. A. 106 (1934) § 14 (b); 1 Collier, Bankruptcy (14th ed. 1940) 1266, n. 3.
fication of the criminal provisions of the Act, as well as those relating to grounds for objecting to discharges, are calculated to make more difficult the obtaining of a discharge by the dishonest bankrupt.\textsuperscript{137} The bankruptcy court may now request the United States Attorney to investigate the affairs of a bankrupt and to oppose his discharge if probable grounds for so doing are discovered.\textsuperscript{138} Whether or not this provision will prove efficacious is open to doubt. Its success depends upon the extent to which it is utilized. In at least one instance it has already been the means of discovering a very large sum of concealed assets.\textsuperscript{139}

These are but a few of the many innovations in the Act which are designed to improve the efficiency of bankruptcy administration, to provide increased dividends for creditors, and to reduce dishonesty to a minimum. It is, as yet, too early to determine the extent to which they will be successful. At best they will probably be no more than partial aids, for in at least two respects they fail to strike at fundamental questions. The defects and evils of bankruptcy administration have existed for years not entirely because of a faulty statute but partially because of characteristic lack of interest displayed by creditors.\textsuperscript{140} When dividends are prevalently small, the ordinary business man is prompted to write off a debt as a loss when the debtor becomes bankrupt, or to turn over his claim to agencies which in turn dominate bankruptcy proceedings.\textsuperscript{141} The draftsmen of the Chandler Act have made some efforts to stimulate creditor-participation. They have recognized the

\textsuperscript{137} § 29; \textsc{Moore's Bankruptcy Manual} i10; \textsc{Weinstein}, \textit{op. cit. supra} note 7, at 70.

\textsuperscript{138} § 14 (d); 1 \textsc{Collier, Bankruptcy} (14th ed. 1940) 1269, n. 4, 1385.

\textsuperscript{139} In the federal court, Eastern District of Pennsylvania, one Mr. Schireson was convicted on a criminal charge and the case is now pending on appeal.

\textsuperscript{140} "The breakdown in practice of the theory that the creditors can be relied on to control and intelligently manage administration is strikingly shown by the abuses surrounding the machinery of electing the trustee."

"This machinery is as follows: After the adjudication of the bankrupt the referee sends out notices to the creditors of a first meeting, at which the bankrupt may be examined and the trustee elected. The referee does not send out proofs of claim with these notices.

"Blank proofs of claim are sent through the mail by claim solicitors or trade associations or, frequently, attorneys. Accompanying these proofs of claim are letters stating that if the proof of claim is returned, the sender will take care of filing it, of collecting the dividend and remitting the proceeds to the particular creditor. Usually, in the body of the proof of claim, embedded in technical verbiage, is a proxy authorizing the sender to vote the creditor's claim at all meetings and to collect the creditors' dividends.

"Creditors who receive these communications, glad to be relieved of the nuisance of obtaining the necessary form, sign the proof of claim, often ignorant of the fact that a stranger has been thereby authorized to vote for the election of a trustee. Creditors rarely attend meetings, with the result that since Section 56 of the Act permits a majority in number and amount of those present or represented to control, it generally happens that a handful of proxies will be sufficient to control the election of a trustee."

\textsc{Donovan, Report on the Administration of Bankrupt Estates} (1930) 13, 14.

right of creditors' committees to appear and be heard.\(^{142}\) They have attempted to curb the control of bankruptcy proceedings by credit agencies for their own selfish ends.\(^{143}\) This domination by credit agencies is in itself a very controversial question. It is sometimes for the good, but too frequently for the bad. It is undemocratic and expensive, resulting in reducing ultimate dividends to creditors. Its very existence, however, is made possible by the inertia of creditors. On the other hand, it is the recognized practice of some agencies to take only the hopeless cases into bankruptcy. When there is hope, more economical out-of-court adjustments are utilized.\(^{144}\)

It is doubtful whether the Chandler Act has done enough to stimulate creditor-participation. Yet it is difficult to discover what more could be done. The vicious circle must somehow be broken. Creditors refuse to participate because the smallness of dividends makes participation unprofitable. Yet non-participation is in itself undoubtedly a cause of reduced dividends. It makes possible the control of proceedings by selfish interests. If the reforms of the Chandler Act succeed in increasing dividends, there is hope for a break in the circle which will end the apathy of creditors and stimulate their interest. To be sure, the appointment of permanent, licensed trustees with virtually complete control over proceedings might well result in increased efficiency, greater economy of administration, and correspondingly larger dividends.\(^{145}\) But such a step would be the end of creditor-control. There is a feeling that the creditors among whom the pot is to be divided should have a voice as to how that should be done. A theory of trustee-control sounds so undemocratic that serious objections to its adoption would undoubtedly be voiced.\(^{146}\)

The lack of interest of creditors in turn breeds another of the fundamental evils which the Chandler Act has probably failed to curb. It is a sad commentary upon our judicial system that the practice of bankruptcy law is not in the best of repute. In metropolitan centers too much of it is concentrated in a very small group of attorneys. Too many of them have no sincere interest in proper administration—bank-

\(142\) § 57 (d).
\(143\) "Claims of $50 or less shall not be counted in computing the number of creditors voting or present at creditors' meetings, but shall be counted in computing the amount." § 56 (c).

"This is a new provision. It is intended to overcome the domination of a proceeding by collection agencies and self-serving coalitions. By coralling and combining a preponderating or controlling number of the smaller claims, these groups were frequently enabled to run a proceeding and defeat the wishes of the fewer but substantial creditors." WEINSTEIN, op. cit. supra note 7 at 106.

\(144\) Mulder and Solomon, note 29 supra, n. 1.
\(145\) Supra p. 33.
\(146\) Supra p. 33.
ruptcy is too frequently utilized as a racket for collecting attorney’s fees. On the other hand, the opinion has been expressed that conditions are improving under the Chandler Act, that the practice of bankruptcy law is acquiring a cloak of respectability. Such is undoubtedly true as to the rehabilitation features of the Act, and its expansion to all fields of bankruptcy is greatly to be desired.

CONCLUSION

The defects of the Chandler Act which have been mentioned, as well as others, are by no means fatal. Eventually they will be corrected by sensible courts and by amendment. The Act itself is indeed a work of art. The scientific effort which went into its formation, the same attitude which is characterizing its administration, are worthy of a happy fate. It is fortunate that there has as yet been no concerted drive for change; instead there seems to be general willingness not to tamper until experience justifies alteration. The reforms have been accepted with good grace; there is no disposition to emasculate.

Bankruptcy today is more important than it has ever been. It must therefore be administered with constant awareness of the lofty objectives of the Chandler Act. There will always be evils. There will always be the great mass of no-asset cases, of debtors who are beyond rehabilitation. But administration can be efficient, dividends can be increased, and bankruptcy need not be forever a haven for the dishonest. The Act has gone far in that direction. The rest depends upon sympathetic and sensible courts, upon a vigilant Congress, upon the ethics of the practicing lawyers, and upon a continuation of the scientific attitude.

147. Layton, Practical Workings of the Chandler Act (Address before the American Bar Association Section on Commercial Law, September 10, 1940).

148. This seemed to be the general feeling manifested at the Bankruptcy Symposium of the American Bar Association Convention on September 11, 1940.