THE NATURE OF BANKRUPTCY

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The word bankrupt is a good English word deliberately Latinized from the French. It was used in ordinary speech and writing almost as early as it was used in the law merchant, where, of course, it properly belonged. When it became a word of the common law it already had a history behind it and was little more fixed and precise in its connotations than it is now.

The accumulation of three hundred and more years have made the word even less precise because its use has become more extended and in no instance limited. When the phrase “on the subject of bankruptcies” was used in the Constitution, it had an aura of suggestion and emotion about it. But it had at least one definite implication. This was that a law on the subject of bankruptcies was a law similar to the statutes which had been passed on this subject in England and the colonies since the time of Henry VIII.

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1. The form banqueroute was the French version of the Italian banca rota and it came into mercantile usage from the French. Cotgrave, French-English Dict. (1611) terms it banqueroutte. The form “bankrupt” is by analogy with words like “abrupt”. Cf. New English Dicr. (Oxford) I, 655. Cowell’s etymology in The Interpreter (1637) from “route” in the sense of “way” is, of course, untenable, but it was close to the then commonest act of bankruptcy which was the absconding of the debtor. It is curious to note that Cowell’s fantastic etymology is accepted by Coke, 4 Inst. *277.

2. The first instance in law cited by the Oxford Dictionary is from a state paper of 1539. The instance cited from More, Apology, c. XXI, is dated 1533.

3. In Louisville Joint Stock Bank v. Radford, 295 U. S. 555 (1935), the Frazier-Lemke Act was declared unconstitutional not because it exceeded the bankruptcy power, but because it violated the Fifth Amendment. This is specifically stated. Id. at 589. The statement in Warren, Bankruptcy in United States History (1935) 9, needs a slight qualification.

4. 8 Holdsworth, History of English Law (1st ed. 1925) 229-245. The statute of 1542, 34-35 Hen. VIII, c. 4, seems to have been the first formal legislative enactment, although the Council had interfered earlier on behalf of both the creditors and the debtor.
There was no reason why the process of development should have ceased—indeed there was no way in which it could have ceased—on the adoption of the Constitution. Bankruptcy as a need of commercial life was bound to gather further experience and so to enlarge its tangible limits and would also necessarily intensify its emotional suggestiveness, since the background of new bankruptcy legislation or of new expansion of bankruptcy by decisions was almost certain to be that of commercial crisis.\(^5\)

One attempt at a definition was eminently scientific. It was that of Mr. Justice Catron in *In re Klein*:\(^6\)

> "Congress has general jurisdiction; and the true inquiry is—To what limits is that jurisdiction restricted?"

> "I hold it extends to all cases where the law causes to be distributed the property of the debtor among his creditors; this is its least limits. Its greatest is a discharge of the debtor from his contract. And all intermediate legislation, affecting substance and form, but tending to further the great end of the subject—distribution and discharge—are in the competency and discretion of Congress."

Story, many years earlier, in his commentary on this provision, declares:\(^7\)

> "Perhaps, as satisfactory a description of a bankrupt law as can be framed is, that it is a law for the benefit and relief of creditors and their debtors in cases in which the latter are unable or unwilling to pay their debts. And a law on the subject of bankruptcies in the sense of the Constitution is a law making provisions for cases of persons who fail to pay their debts."

Obviously, it is not a question of logic. The term "bankruptcy" may or may not be a category that can be separated *per genus et differentiam* from other related and similar categories. We are concerned with a legal process that is meant to perform an important commercial function.

What function? That of enabling creditors to get their debts paid after they have reduced them to judgment? Clearly not, since that is the function of the ordinary writs of execution and the many writs in aid of execution, both legal and equitable. May the function then

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6. 1 How. 277 (U. S. 1843) reversing the decision in the District Court [*Fed. Cas. No. 7,865 (D. Mo. 1843)*] which held a discharge from pre-existing debts to be unconstitutional.

be described as the attempt to prevent debtors from overreaching their creditors by concealing or disposing of their assets? This again is performed by processes, originally equitable in their nature but now generally gathered under statutes that seek to prevent fraud on creditors. Bankruptcy must add something new to these two types of process or else it would never have come into existence.

In his valuable little book on *Bankruptcy in United States History*, Mr. Charles Warren distinguishes three stages in the development of American bankruptcy, the "Period of the Creditor, 1789-1827", the "Period of the Debtor, 1827-1861", and the "Period of National Interest, 1861-1935". It is clear that the creditor, the debtor and the national interest were concerned with bankruptcy in all its American stages, although it may well be that one or another of these three elements was most considered at the different periods indicated by Mr. Warren. And if we follow the history of bankruptcy back into the experience of England, we shall find that while the "national" interest was at no time non-existent—since considerations of public morality were often enough alleged—the interest of the creditor was almost exclusively kept in view, until under Anne a more or less qualified discharge of the debtor was made possible.

How was the interest of the creditor served? After all, with *fieri facias*, *capias* and, later, with the Statute of Elizabeth at his command, what need did a creditor—so long as he was a single creditor—have of any new method of controlling an evasive debtor, the *decoctor* of the Roman law? That is, of course, just the point. A single creditor could have got along without a bankruptcy procedure. But if there were many creditors, any one stood in great danger of being left in the lurch by the greater good-fortune, insistence, harshness or skill in intrigue of some of his fellow-creditors. Equity could do something for him in the single case of collusion or fraud. But that was obviously not sufficient.

It will be well to keep in mind, therefore, that bankruptcy posits a plurality of creditors, although once established its process may well be used by a single creditor. If we follow the course of bankruptcy from the earliest statute—that of Henry VIII in 1542—to the Chandler Act, we shall find that whatever else was present or absent, there was always some method by which all the creditors were compelled to accept

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8. This was clearly the announced purpose of the earliest statutes of bankruptcy. *Cf.* HOLDSWORTH, *loc. cit. supra* note 4. It is still one of the purposes of bankruptcy since a fraudulent conveyance is one of the most important of the "acts of bankruptcy". But fraudulent conveyances can be reached in law and equity without the intervention of bankruptcy.

some arrangement or some disposition of their claims against the bankrupt's property, whether they all agreed to it or not.

Everything else is clearly incidental. The bankrupt might be stripped of all his property and thrown into prison. He might be allowed certain exemptions. He might be relieved of his debts or have them scaled down or postponed. All these are stages of increasing humanity toward an unsuccessful member of the commercial community. He might even be helped to reconstruct and carry on his business, and this, with a view to maintaining an economic unit that involved a great many persons who are not properly creditors.

But whatever happens to the debtor, in every case the creditors have been assembled in some formal way, their claims examined and classified, and assigned for satisfaction in definite proportions to an existing or prospective fund. The extent of the participation of the creditors in reaching a final disposition is also irrelevant. Whoever initiates the process and however it is done, the important thing is that the bankruptcy court or commission rounds up the creditors and compels them to adjust or discharge their claims in a particular way.

Evidently the correctness of this test of a bankruptcy law will depend on whether a purely and exclusively voluntary arrangement on the part of creditors is a bankruptcy process. Such voluntary arrangements are of course well known. They take the form of compositions. All the creditors may meet with the debtor and agree to accept a fraction of their claims and to release the debtor from the balance. Such compositions may be regulated by a specific statute giving validity to them only if certain forms are followed. Are they thereby made methods of bankruptcy and is a statute regulating them a statute on the subject of bankruptcy? Evidently not, so long as any creditor may refuse to take part in the arrangement and may refuse to agree to the release. If, on the contrary, the statute undertakes to bind him to agree whenever a definite number of creditors have done so, there ought to be no doubt that the statute is on the subject of bankruptcy, even if it sedulously avoids the words "bankrupt" or "discharge" in its entire extent.

The same thing may be said of conveyances for the benefit of creditors. A debtor may wish to liquidate his business privately. If he can induce all his creditors to cooperate in this, there is no reason to call it bankruptcy. The ordinary process of law and equity will

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11. Warren, op. cit. supra note 3 at 44-45, quoting the interesting statements of Hayne in 1837, in which the difficulty of getting consent of all creditors is emphasized.
carry out the purposes of the parties. But if a creditor—even a single one out of hundreds—is to be coerced into cooperation, that can be accomplished only through the intervention of bankruptcy.

The criterion becomes more difficult if the coercion takes the form of a sort of persuasion, that is almost if not quite coercive. A common form of “state insolvency law” which seeks to avoid being called a “law on the subject of bankruptcies”, is one that gives creditors who consent to a composition and sign the required release, all the property the debtor has at the time, leaving to non-consenting creditors in theory their claims intact but in fact merely a chance of getting paid if the debtor should get some more non-exempt property at some later time, provided he does not choose to go into bankruptcy proper before that. A choice of this type presented to the creditor is a poor example of persuasion, and is so close to legal coercion that realistically minded persons might find it difficult to call it anything else. If, however, it is taken to be less than a coercive measure it may save the statute from being classified as one “on the subject of bankruptcies”, which apparently was the purpose of those who had the statute enacted.

The essence of bankruptcy, accordingly, is not that the debtor’s property is impounded nor that the creditors are affected, nor even that all of them are affected. Something additional is required. Unless we intend to bring the creditors into one large group, and adjust their common claims to a fund consisting of a single debtor’s property, there is no reason to have recourse to bankruptcy.

12. Cf. Glenn, Liquidation (1935) § 187: “Minute statutory regulation of the general assignment does not destroy its original character of a trust.” It is in this connection that the effect of federal legislation on state “insolvency laws” has been most studied. Williston’s article on the subject in (1909) 22 Harvard L. Rev. 547 is the first careful survey, since the earlier article of I. J. Williams in (1902) 50 American L. Rev. 211 is merely a special plea for a restrictive interpretation. The most recent cases on the subject are Johnson v. Star, 287 U. S. 527 (1933), 42 Harvard L. Rev. 1140; Pobreslo v. Joseph M. Boyd Co., 287 U. S. 518 (1933), 32 Michigan L. Rev. 93; International Shoe Co. v. Pinkus, 278 U. S. 261 (1929), 42 Harvard L. Rev. 823. All of these cases have been much commented on in the law reviews. The fullest bibliography is in Hanna and McLoughlin, Cases and Materials on Creditors’ Rights (3d ed. 1939) 465-468.

13. Glenn, Liquidation (1935) § 187. The three cases mentioned above do not quite go to the length of saying that pressure of this sort placed upon creditors in order to secure their consent to a release of the debtor is essentially different from a discharge. There seems to be no doubt that if a discharge, or the equivalent of a discharge, is really effected, the statute is “on the subject of bankruptcies”. A discharge undoubtedly works a coercion on creditors. But the absence of a discharge can obviously not save the statute from being so classified. See Mulder and Solomon, Effect of the Chandler Act upon General Assignments and Compositions (1939) 87 U. of Pennsylvania L. Rev. 763.

14. Mr. Garrard Glenn in an able and brilliant article, Essentials of Bankruptcy (1937) 23 Virginia L. Rev. 373, finds that control of the debtor is an indispensable condition of bankruptcy jurisdiction and when this control is lacking, as in municipal bankruptcies, the bankruptcy power fails. Undoubtedly, English bankruptcy began with action directed against the bankrupt. And, undoubtedly, unless there is a debtor whose relations are to be adjusted, there is no occasion for bankruptcy. But the prevention of inequality of distribution, which involves coercion on some or all creditors, would seem to be as fundamental.
If the law simply wipes out the claims altogether, we may be dealing with an economic measure of the highest importance, but it is not bankruptcy. Such laws, let us remember, are not unexampled in history. At various times in ancient society there was a demand that all debts be cancelled as of a certain date. The Biblical Jubilee\(^\text{15}\) and the Athenian \textit{seisachtheia}\(^\text{16}\) seem to have been measures of this sort. The Roman \textit{tabulae novae} undoubtedly constituted one.\(^\text{17}\) Whether any emergency can justify so drastic a relief of insolvents may be disregarded for the present. The question of constitutionality under the due process requirement would certainly arise. Later courts might overrule the \textit{Radford} case\(^\text{18}\) and hold that the Fifth Amendment is qualified by the bankruptcy clause instead of vice versa. But what happens in a general cancellation of debts or a repudiation is not that all creditors of a single debtor have been assembled into a class to have their claims adjusted, but that the class of creditors has been wiped out. There are no creditors to assemble and there is no claim to adjust.

It may be well to remember that an effective cancellation can be obtained not only by the formal Roman expedient of \textit{tabulae novae}, but by a deliberate and immense inflation. This was the case in Germany before 1923, when the circulating medium was reduced in value below the paper it was printed on and was nonetheless legal tender for pre-existing debts. Whatever this method is called, it can scarcely be called one of bankruptcy.

The same must be said of a general moratorium. If all creditors are required for a definite or indefinite time to suspend the enforcement of their claims, that surely affects debtors and creditors and is an eminent and obvious relief for the former. But it is not a matter of bankruptcy. A moratorium like the German one of 1914 might in the United States be justified under the war power.\(^\text{19}\) Perhaps other

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15. \textit{Leviticus} c. 25; \textit{Deuteronomy} c. 15. The interminable controversies on the exact effect of these provisions need not concern us. That in \textit{Deuteronomy} at least a remission of debts was provided for seems likely enough.

16. \textit{See Linforth, Solon the Athenian (1919) 269.}

17. \textit{Lécrivain, Tabulae Novae (1914) 5 DAREMBERG-SAGLIO, DICT. DES ANTIQUITÉS} 13, 14; 4 MÖMMSEN, \textit{Hist. of Rome} (1898) 523, 524. Partial remissions of debts in Rome under stress of circumstances were frequent enough. An especially drastic one was the Valerian law of 86 B. C. The reactions of the time toward these drastic debtor relief laws were as violent as the passages quoted in \textit{Warren, op. cit. supra} note 3, at 31. The Valerian law of 86 B. C. that scaled all debts down to 75% was called "an utterly disgraceful law" by Velleius Paterculus, II, 23, 2. Cicero said of a general remission, \textit{Off.} c. II 84, "What reason can there be for a general remission except that if I give you money to buy an estate for me, you get the estate, but I lose the money."


19. Justice Brandeis calls attention to the fact that the war power has also been declared subject to the Fifth Amendment. \textit{Louisville Bank v. Radford, 295 U. S. 555 (1935)} n. 19, and cites \textit{Hamilton v. Kentucky Distillers, 251 U. S. 146 (1919)}. Moratoriums in the form of "stay-laws" have been frequently passed by the various states in times of economic stress. These were for the most part ultimately declared void by the courts. \textit{Cf. Feller, Moratory Legislation (1933) 46 HARV. L. REv. 1160-}
occasions for a moratorium might be secured under the treaty power, or even under the general welfare clause. But a moratorium immobilizes the class of creditors. It does not force them to adjust their claims. Indeed, it professes to leave their claims intact, even though a claim enforceable now is not the same as a claim enforceable in a year. The presuppositions, purposes, and machinery of a moratorium are essentially different from those of bankruptcy even if both may contain the common element of the relief of debtors.

The presence or absence of a coercive element as a test of a bankruptcy law is not to be confused with the contrast between the words "compulsory" ("involuntary") and "voluntary", as these terms are used, not only in the National Bankruptcy Acts but in most discussions of bankruptcy, notably in Mr. Warren's book. These terms are there used exclusively from the point of view of the debtor. Proceedings initiated by him are called "voluntary"; those initiated by creditors are called "involuntary". That at one time all proceedings were initiated by creditors and that it was only within recent times that the debtor was allowed to do so, is an important fact in legal and commercial history, but it does not affect the nature of bankruptcy. Every form of enforcement of a debt is "involuntary" as far as the debtor is concerned. But it is a different matter when coercion is applied to one or more recalcitrant creditors. This involves the exercise of a judicial control that could not be readily carried out under either the equity or the law powers of the Anglo-American court system, and necessitates a special and peculiar apparatus designated by the special and peculiar name of bankruptcy.

And the coercive element is obviously not lacking in compositions made under the old bankruptcy laws or under Chapter XI of the Chandler Act. It was the need of justifying a composition provision in bankruptcy that induced Justice Blatchford to fall back unnecessarily on the expansive rhetoric of Story's assertion in the Commentaries. In all compositions under a bankruptcy act the composition is effective when a specified fraction of the creditors agree. The re-
mainder are bound willy-nilly. Even if all agreed, it would only be after they had all been assembled with or without their consent under supervision of the court and instructed to find a formula. If they had not found one, the court would have found one for them. The coercive element is open and unmistakable.

If we turn to the two definitions which have so frequently been cited on this question, it is clear that Story's is scarcely usable even as a general guide. It is a tempting refuge, when a law is challenged, to place it in a category so wide that almost anything will fit into it. So, when Story says that a law that makes "provision for the cases of persons who fail to pay their debts" is on the subject of bankruptcies, he cannot quite mean what he says, unless he wishes to include laws dealing with executions, attachments, fraudulent conveyances, and the like.

Indeed the case of "debtors who fail to pay their debts" or, as Mr. Warren puts it, are unable to, cannot be the essence of bankruptcy, since under the law, perfectly solvent persons, i.e., who both can and wish to pay their debts, can be adjudicated bankrupts. But if they do, they certainly are putting into motion a process that coerces creditors into accepting settlements arrived at in a way different from that which, except for bankruptcy, they might have chosen.

The repetition of this definition both in cases and in legal literature omits to take into account the fact that the subject of bankruptcy is either a special phase of commercial regulation or it has no excuse for existence. And in all the cases in which Story's definition has been cited, the actual law has conformed to the determining test here suggested, a coercive force on one or more creditors, as indicated primarily in grouping the creditors into a complex class whose rights in the debtor's property are to be determined.

The definition of Justice Catron, on the other hand, while eminently scientific in assigning maximum and minimum limits of extension will not quite serve our purpose. The maximum limit, the discharge of debtors, is a little too large, since it would include cancellation or repudiation of all debts or a general moratorium. The mini-

24. The Chandler Act has incorporated the Uniform Fraudulent Conveyance Act, since a fraudulent conveyance is an act of bankruptcy. Obviously that has no effect on the fraudulent conveyance statutes of the several states.

25. WARREN, op. cit. supra note 3 at 8: "... any national law which deals with inability to pay debts and which is uniform throughout the country is a law 'on the subject of bankruptcy'."

Mr. Warren is supported by the statement he cites (p. 176) of Justice Cowen in Kuntzler v. Kohans, 5 Hill 317, 321 (N. Y. 1843): "'I read the Constitution thus—'Congress shall have the power to establish uniform laws on the subject of any person's general inability to pay his debts throughout the United States.'"

26. See note 6 supra.
THE NATURE OF BANKRUPTCY

mum limit again does not go quite far enough. We do not need to transfer the debtor's property—the Roman *cessio bonorum*—at all. If the creditors are required to readjust their claims to the property he has or may later acquire, that is enough. The test is satisfied.

It is stated frequently in the discussion of the nature of bankruptcy that a bankruptcy law has certain definite purposes and that the relief of distressed debtors may well be called the most important of them. Certainly this fact was most prominently mentioned in the agitation for bankruptcy laws in the United States, even in the period that Mr. Warren calls "The Period of the Creditor". The fullest statement of this purpose is perhaps that of Mr. Justice Day in *Stellwagen v. Clum*. It is equally a fact that the bankruptcy is as Justice Waite says, one of many examples in which the general welfare of the community is achieved by mutual sacrifices of various groups in it.

But while the purposes of a statute are of paramount importance in interpreting its provisions, we cannot merely by knowing these purposes learn what a bankruptcy system is. History and semantics may perhaps be snubbed but we hardly dare snub functionalism. And the function of a legal system is not to be separated from the way in which it works. Whatever purposes bankruptcy attempts to carry out, it does by working on the creditors primarily, by compelling them to reorganize their relations to the debtor or to each other in regard to the debtor's property. No extension of the bankruptcy power has in fact attempted anything else, whatever the words used may have been. In the course of this process, bankruptcy can adopt whatever incidental device may serve the economic and social ends so often brought out in discussion of the subject. But we need not lose ourselves in large generalities which might bring the entire law merchant within the range of Congressional power. That was not even Story's intention, with all his eagerness to create a federal common law. It is an indifferently honest way of achieving a result that should honestly be arrived at by deliberate amendment if we need it at all.

27. 245 U. S. 605, 617 (1917) : "... a main purpose of the Act intends to aid the unfortunate debtor by giving him a fresh start in life, free from debts, except of a certain character, after the bankruptcy has been administered for the benefit of creditors."
