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A FLAGRANT INJUSTICE LEGALIZED BY THE BANKRUPTCY LAW[1]

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IT IS popularly presumed that in most bankruptcy proceedings the Act was or is invoked by one who had engaged in an extensive business and became unduly vexed or oppressed by rapacious creditors. Lawyers know, however, that petitions in voluntary bankruptcy have been filed by persons who never had a business which at any time required indebtedness not easily paid. In such instances the creditors were more in need of the law's solicitude than were the petitioners.

When one has been regularly receiving sufficient income to supply necessaries for himself and family and yet, with an undiminished earning capacity, plans to obtain a "discharge" in bankruptcy, it is not difficult to suspect that he willfully intends to evade payment to those who furnished such goods and services as contributed to his comfort. In any event, it is likely that his dentist, grocer, landlady, automobile mechanic and others can ill afford to remain unpaid and have their just claims forever barred by the "discharge."

An individual voluntary bankrupt is frequently one who has always been, still is, and will continue to be sumptuously fed, well dressed, comfortably housed, and surrounded by friends able and willing to aid him in making business contacts and profits. Occasionally it may be said of one that his legalized evasion of debts and prior activities may have forced, or may drive, *others* into pauperism, but he himself is never in the economic category of those whom he derisively calls "bums."

For the protection of some of the trusting victims of the seemingly prosperous individual who seeks, through bankruptcy, to repudiate his obligations to those who furnished him with goods or services, the statute purports to prevent one form of thievery. It is provided that a discharge shall not release a bankrupt from "liabilities for obtaining property by

[1]Revision of article first published in *American Bankruptcy Review* (N. Y., Nov., 1935).

false pretenses or false representations." Since the guilty swindler always denies, with pretended indignation, having made any false pretenses, and since the burden of proof is on the injured creditor, the practical operation of the protective clause in question is obviously impeded. If it was easy for the bankrupt to cheat an unsuspecting friend, it is not too difficult for the culprit to testify falsely. Moreover, if the creditor had been entrapped by artful concealments, it may be impossible for him to prove to the admitted satisfaction of a court that the non-disclosure of relevant circumstances was intentional or fraudulent.

Furthermore, many creditors are precluded from showing even the most palpable fraud, because the clause in question literally and actually aids only those who have been deprived of "property" as the direct result of the bankrupt's falsehoods. Accordingly, if one obtains by fraudulent representations the indorsement of his promissory note, the claim of the indorser or surety is barred by the maker's "discharge" in bankruptcy.[2] The indorsement is not "property," within the meaning of the statute, though it does ultimately result in the loss of money.

When a schemer first conceives the idea of evading his financial obligations in the way permitted by the Act, the plan is, like a plot for an intended perfect crime, kept a secret long enough for the hatching and consummation of selfish and dishonest schemes. The unscrupulous individual contemplating bankruptcy may pretend to believe that for him there is legitimate prosperity just around the corner, and with that pretense proceed to utilize his credit to a full and unconscionable limit. He shows that he is not without all luxuries enjoyed by solvent persons, even flaunting a latest model automobile in the hope that it may excite the envy of his frugal neighbors.

With secret knowledge of his insolvency and impending bankruptcy, the miscreant in question applies for loans from industrial banks. These wary institutions take no chances, and require sureties who will give satisfactory answers to an elaborate financial questionnaire. The applicant, by the aid of the past and current manifestations of friendship, influences

[2]Barnes v. Frost (Miss.), 133 So. 119.

a number of his acquaintances to become sureties on his promissory notes. The money is then received by, and the consequential benefits therefrom inure to, this wily borrower and no one else. When it is no longer possible to continue such fiscal operations, he shamelessly files a petition in voluntary bankruptcy. His air of respectability is not diminished.

The sureties have been, or eventually will be, compelled to pay the notes of their immune principal. They have no remedy against a bankrupt without assets. A "discharge" relieves the latter of the obligations he owes to his sureties, even if he had obtained their suretyship by false or fraudulent representations. Obviously, therefore, a flagrant injustice may be perpetrated within, and permitted by, the Bnakruptcy Act.

It will be possible to find at some first meeting of creditors before the referee that the bankrupt himself is serene and happy, anticipating enjoyment from his future income, while keen distress is manifested by the wives of some hapless sureties. One may imagine, if not cite, cases where such women were aggrieved because they realized that through no fault of their own the future earnings of their respective husbands would, in part, be diverted to the banking payees of the bankrupt's notes. In such situations, while the bankrupt was complacently preparing to make rosy his own future, he was darkening that of his former accommodating, and lately betrayed, associates. Not the once spendthrift and high living bankrupt, but these honest, industrious and frugal victims were in danger of becoming embarrassed besiegers of a charitable relief agency. Those who stand in a bread line are not those to whom a bankruptcy court has granted a "discharge."

If any amendment of the law is contemplated or imminent, the bankrupt's personal sureties and guarantors are entitled to the first consideration. Under the present law, at the same time that a bankrupt is relieved by a discharge of a "burden of debt" his surety, who never had anything to gain from his principal's prior transactions, is saddled with a part of this burden and without receiving, as the bankrupt received, any part of the consideration which moved from the third party. If the suretyship was obtained by fraud, the situation becomes still more distressing to the surety. The average person would prefer to have his money stolen directly by an execrated thief and thereafter remember only the monetary loss, than to have his funds conventionally filched by a supposedly upright citizen and then be compelled not only to bear the tangible loss but also to contemplate the surprising perfidy of the trusted acquaintance.

One possible and just way of amending the law would be to enact a provision which would relieve the surety of his duty to the obligee or payee at the same time that the bankrupt is discharged. Then the burden would fall on the creditor who in some way profited or expected to profit from his transaction with the bankrupt. This sort of amendment would conform to the salutary principle that where one of two innocent parties must suffer from the fraud of a third, he who furnishes the means to commit it must bear the loss.

Inasmuch as the plan above suggested would in some cases be unjust to an obligee or payee, a better amendment would be one which would make a discharge inapplicable to any obligation which a bankrupt has incurred with respect to his sureties or guarantors. When one assumes the status of a surety, he generally does so because of pressure brought to bear upon him by the prospective principal. Furthermore, the latter represents, expressly or impliedly, that he will fulfil his obligation to the third party and thus save harmless all concerned. The personal surety usually believes that he is, in effect, but a well-advised character witness for his principal. The latter often makes representations and concealments which induce that belief. When a prospective principal so commercializes the friendship of an associate as to induce the latter to assume the burden and responsibility of a surety, he, the principal, ought to be willing to demonstrate the genuineness of his own professed friendship and the truthfulness of his representations by striving even for a lifetime, if necessary, to reimburse his surety whenever the latter is compelled to pay the debt. An honest principal will do this in spite of a discharge permitting the contrary. A dishonest or an indifferent one ought to be compelled to remain liable to his surety or guarantor. This would not be inconsistent with any other reform, heretofore suggested by others, intended to discourage dishonesty and to aid creditors.