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Discharge: The Prime Mover of Bankruptcy

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COMMENTS

DISCHARGE: THE PRIME MOVER OF BANKRUPTCY

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During the fiscal year of 1960, 110,034 bankruptcy cases were filed in the United States district courts.[1] Thus, there was approximately one bankruptcy for every 895 people of working age, *i.e.*, 18 years to 65 years. During the first quarter of the 1961 fiscal year, 32,766 bankruptcy cases were filed reaching an all time high and increasing 35.3 per cent over the first quarter of the 1960 fiscal year. Thus, the possibility that this year's figures will be quite staggering is apparent.[2] Out of the total number of cases filed, 10.4 per cent (3,393) were business bankruptcies, while 89.6 per cent (29,373) were nonbusiness bankruptcies. This distribution agrees with the trend of recent years; nonbusiness bankruptcies have been increasing at a faster pace than business bankruptcies.[3] In addition, figures from the 1960 fiscal year show that approximately 98.8 per cent of the bankruptcy cases commenced were voluntary. Further, out of the total number of cases concluded after a declaration of bankruptcy, discharge[4] was denied in only 1.3 per cent, waived in 2.8 per cent, and granted in 95.9 per cent. The net result was that only 6.3 per cent of the total liabilities ($705,314,302.86) was paid to the creditors ($44,150,278.62).[5] Such statistics can point to only one conclusion, *viz.*, the primary purpose of the great majority of bankruptcies is the obtaining of the bankrupt's discharge from his debts.

A few years after the passage of the present Bankruptcy Act,[6] an article appeared in the *Harvard Law Review*[7] warning against inter-

[1] Rep. Director Adm. Office U. S. Courts, Memorandum No. 197 (Sept. 1960).

[2] Ibid.

[3] Rep. Director Adm. Office U. S. Courts, Memorandum No. 197 (Sept. 1960).

[4] A discharge is the release of a bankrupt from all of his dischargeable debts which are provable in bankruptcy. Bankruptcy Act § 1(15), 52 Stat. 840 (1938), as amended, 11 U.S.C.A. § 1(15) (Supp. 1960). A discharge does not extinguish the bankrupt's debts, but affords him an affirmative defense which can be plead in any subsequent action. In re Innis, 140 F.2d 479 (7th Cir.), cert. denied, 322 U.S. 736 (1944). There is a possibility of the bankruptcy court issuing an injunction for protection when a court refuses to recognize a discharge as a defense. Local Loan Co. v. Hunt, 292 U.S. 234 (1934). Furthermore, an order that fails to discharge the bankrupt's debts for any reason is res judicata as to those debts in future bankruptcy proceedings. In re Bacon, 193 Fed. 34 (5th Cir.), cert. denied, 225 U.S. 701 (1912), with the exception of § 14c(5), 52 Stat. 850, as amended, 11 U.S.C.A. § 32 (c)(5) (1953), which stands on a different footing from a refusal on any other ground. Prudential Loan & Fin. Co. v. Roberts, 52 F.2d 918 (5th Cir. 1931).

[5] Rep. Director Adm. Office U. S. Courts, Tables of Bankruptcy Statistics (ending June 30, 1960).

[6] Bankruptcy Act of 1898, 30 Stat. 544, as amended, Chandler Act of 1938, 52 Stat. 883, as amended, 11 U.S.C.A. §§ 1-1200 (Supp. 1960).

[7] Olmstead, Bankruptcy—A Commercial Regulation, 15 Harv. L. Rev. 829, 843 (1903).

preting the act in the nature of a "Hebrew Jubilee,"[8] for an interpretation of this nature would result in the Bankruptcy Act's repeal as on numerous prior occasions.[9] The article's thesis was that the bankruptcy law is "essentially a *commercial regulation*, and that its main objects are administration or distribution, rather than the relief of the debtor." Although this warning has not been heeded, as evidenced by the above statistics, the Bankruptcy Act has survived over six decades and apparently will continue in the future.

The primary purpose of this Comment is to examine the purpose of the discharge in bankruptcy in the light of our highly complex credit economy. A discussion of the history, procedure, and provisions of the discharge section of the present Bankruptcy Act[10] will necessarily be included in this endeavor.

I. History of Discharge

The bankruptcy laws, being purely statutory in nature, developed slowly. Bankruptcy laws were originally creditors' laws, with no thought of affording any relief to the bankrupt by freeing him from further molestation by his creditors.[11] A criminal approach was prominent in the early Roman times as expressed in the Twelve Tables (451-450 B.C.). The latter provided that if one was unable to pay his debts, his creditors were entitled to cut up his body, dividing the pieces among themselves, or merely to sell the debtor into slavery.[12] The criminal approach, although reduced to debt-slavery, existed in Rome until the passage of the law of *Cessio Bonorum* in the time of Julius Caesar.[13] This law, relating to an assignment for the benefit of creditors, provided that if an honest debtor forfeited all his property for the benefit of creditors, he would not be subject to capital punishment, imprisonment, or slavery. *Cessio Bonorum* did not provide for a discharge of outstanding obligations, but merely for immunity from personal punishment. Another distinguishing factor from modern bankruptcy law is that *Cessio Bonorum* was purely voluntary and could not be invoked by creditors.

[8] The "Hebrew Jubilee" refers to the Jewish Sabbatical Year which came every seven years and released debtors from their debts. It was instituted more than 3000 years ago. Deuteronomy 15:1-3.

[9] The first act, the Bankruptcy Act of 1800, 2 Stat. 19, was repealed Dec. 19, 1803, 2 Stat. 248; the second, the Bankruptcy Act of 1841, 5 Stat. 440, was repealed Mar. 9, 1843, 5 Stat. 614; and the third, the Bankruptcy Act of 1867, 14 Stat. 517, as amended, 18 Stat. 178 (1874), was repealed June 7, 1878, 20 Stat. 99.

[10] Bankruptcy Act § 14, 30 Stat. 550 (1898), as amended, 11 U.S.C.A. § 32 (Supp. 1960).

[11] In re Neely, 134 Fed. 667, 669 (S.D. N.Y. 1904).

[12] Moore, Debtors' and Creditors' Rights 1 (1955).

[13] 1 Remington, Bankruptcy 5 (5th ed. 1950).

Modern American bankruptcy law, although not criminal, had its origin in quasi-criminal statutes passed by the English Parliament in the sixteenth century.[14] These statutes were applicable only to traders of fraudulent debtors, and provided for imprisonment and pro rata distribution of assets. No relief through discharge of a debtor's debts was provided. These statutes were mitigated somewhat by the late seventeenth century's insolvency laws which allowed a debtor's release from prison (but not discharge of indebtedness) if he surrendered up his estate or took an oath that he had no estate.[15] In the eighteenth century, two hundred and fifty years after the first English bankruptcy act, the English Parliament modified the bankruptcy law by deleting the criminal sanctions and for the first time allowed a discharge to the debtor.[16] The debtor's discharge was qualified from time to time through the addition of various requirements, *e.g.*, his assets should equal a certain percentage of his debts and a certain percentage of his creditors should assent to his discharge.[17] Thus, the theory of bankruptcy law at the time of the American Revolution was protection of creditors with incidental release of debtors.

The United States Constitution[18] gives the federal government the power to regulate bankruptcy in the United States. The United States has had four bankruptcy acts, each allowing for discharge of indebtedness, if specified objections available to the creditors were not sustained. The first act, the Bankruptcy Act of 1800,[19] applied only to merchants and traders as debtors in involuntary proceedings. The discharge sections[20] required the consent of two-thirds of the creditors in number and in value who had proven their claims of fifty dollars or more. In addition, there were specified objections available to creditors, *e.g.*, failure to comply with the act, concealment of assets, fraud, losses in gambling, and others. The second act, the Bankruptcy Act of 1841,[21] added provisions for voluntary proceedings for all persons, but continued to restrict the involuntary proceedings to merchants, retailers, bankers, factors, and underwriters. The discharge section[22] provided for discharge to all debtors allowing certain objections, *e.g.*, fraud, concealment of assets, preference of creditors,

[14] Bankruptcy Act, 1542, 34 & 35 Hen. 8, c. 4 (repealed); Bankruptcy Act, 1570, 13 Eliz. 1, c. 7 (repealed); Bankruptcy Act, 1603, 1 James 1, c. 15 (repealed); Bankruptcy Act, 1624, 21 James 1, c. 19 (repealed).

[15] Moore, op. cit. supra note 12, at 2.

[16] Bankruptcy Act, 1705, 4 Anne, c. 17.

[17] 1 Remington, op. cit. supra note 13, at 14.

[18] U.S. Const. art. I, § 8.

[19] 2 Stat. 19.

[20] Sections 34, 35, 36, 37.

[21] 5 Stat. 440.

[22] Section 4.

willful omission or refusal to obey orders of the court, misappropriation of trust funds, or failure by a merchant, banker, factor, broker, underwriter, or marine insurer to keep books of account. In addition, if a majority of the creditors in number and amount filed a written dissent upon a ground found by the judge to be just, a discharge could be barred. The third act, the Bankruptcy Act of 1867,[23] provided both voluntary and involuntary proceedings for all persons. This act denied a discharge if the debtor (1) willfully swore falsely in a proceeding, (2) concealed assets, (3) was fraudulent or negligent as to his property, (4) destroyed or falsified his books, (5) secreted his assets with intent to defraud, (6) gave a fraudulent preference, (7) made a fraudulent transfer, (8) lost in gambling, (9) admitted or failed to disclose a fictitious debt, (10) did not keep proper books of accounts if the debtor were a merchant or tradesman, (11) obtained discharge consent from creditors by pecuniary consideration, (12) was convicted of a crime under the Bankruptcy Act, or (13) committed any fraud contrary to the true intent of the law.[24] Further, the debtor's assets had to equal fifty per cent of the claims unless a majority of the creditors in number or amount consented.[25] The fifty per cent requirement was modified by an amendment in 1874[26] which abolished the requirement in involuntary proceedings and reduced the requirement to thirty per cent in voluntary proceedings unless one-fourth of the number of creditors, providing this number owned at least one-third of the proven claims, consented to the discharge.

The present act, the Bankruptcy Act of 1898,[27] omitted the prerequisites of consent of creditors or minimum asset requirements, but permitted creditors' objections on the following grounds: (1) the bankrupt had committed an act against the Bankruptcy Act punishable by imprisonment; or (2) the bankrupt "with fraudulent intent to conceal his true financial condition and in contemplation of bankruptcy destroyed, concealed or failed to keep books of accounts or records from which his condition might be ascertained." The amendatory act of 1903[28] added four additional grounds for objections: (1) the bankrupt obtained property on credit from any person by a materially false statement in writing; (2) within four months of filing of a petition, the bankrupt transferred, destroyed,

[23] 14 Stat. 517.
[24] Section 29.
[25] Section 33.
[26] Section 338, 18 Stat. 178.
[27] § 14b(1)-(2), 30 Stat. 550, as amended, 11 U.S.C.A. § 32(c)(1)-(2) (Supp. 1960).
[28] § 14b(3)-(6), 32 Stat. 797, as amended, 11 U.S.C.A. § 32(c)(3)-(6) (Supp. 1960).

or concealed his property with intent to hinder, delay, or defraud his creditors; (3) the bankrupt obtained a discharge in voluntary proceedings within six years; and (4) the bankrupt refused to obey a lawful order of the bankruptcy court or refused to answer a material question approved by the bankruptcy court. The amendatory act of 1926[29] added an additional ground, *viz.*, the bankrupt's failure to explain satisfactorily any losses of assets or deficiencies of assets to meet liabilities. Under the Chandler Act of 1938,[30] the grounds of discharge remained practically unchanged.

II. Procedure for Discharge

The Chandler Act of 1938 defined the term "court" in the act to mean the judge or referee of the court in which a proceeding is pending.[31] The implication from this definition, in light of the language of the statute, is that in most matters of bankruptcy the referee exercises full jurisdiction in the first instance subject only to review by the district judge in the small proportion of cases in which review is requested.[32] In other words, the referee is authorized to perform the duties of the bankruptcy court, with few exceptions, and all proceedings are required to be before the referee that are not required to be before a judge.[33] The referee is the judicial officer charged with the responsibility of nearly all decisions of substantive law and procedure in the first instance; therefore, there is little that does not go before him in a complete proceeding.[34] He has a duty to maintain an adequate and correct file in the case.[35] Generally, the referee can (1) adjudicate debtors bankrupt, (2) grant or deny discharges,[36] (3) appoint or remove (for cause) trustees, (4) authorize trustees to carry on business, (5) rule on claims for exemptions, (6) allow or disallow claims for creditors, (7) cause an estate to be collected, reduced to money, and distributed, (8) determine controversies concerning property claimed by the estate, and (9) confirm or reject arrangements or plans. In addition, a referee may issue

[29] § 14b(7), 44 Stat. 663, as amended, 11 U.S.C.A. § 32(c)(7) (Supp. 1960).

[30] § 14c, 52 Stat. 850, as amended, 11 U.S.C.A. § 32(c) (Supp. 1960). This was a broad, sweeping reform of the Bankruptcy Act of 1898.

[31] § 1(9), 52 Stat. 840, as amended, 11 U.S.C.A. § 1(9) (Supp. 1960).

[32] Chandler, The Beginning of a New Era in Bankruptcy Administration, 1939-1947, 34 Ref. J. 3 (1960).

[33] General Order 12, 172 U.S. 653, 657 (1898), as amended, 305 U.S. 681, 686 (1938).

[34] MacLachlan, Bankruptcy 70 (1956).

[35] Id. at 116.

[36] Prior to 1938, an application for discharge went directly to the judge since the referee had no power to grant the discharge. However, by section 38(4) of the Chandler Act of 1938, 52 Stat. 857, as amended, 11 U.S.C.A. § 66(4) (1943), the referee is now expressly given the power to grant, deny, or revoke a discharge.

process, make orders, and enter such judgments as may be necessary to enforce the Bankruptcy Act.[37] A referee cannot, however, enforce his orders by commitments for contempt, but rather must certify the facts to a district judge for enforcement.[38]

The adjudication of bankruptcy operates automatically as an application for discharge in the case of any natural person unless the right of discharge is waived. A corporation has six months after adjudication in which to apply for a discharge.[39] The referee then fixes a date for the creditors' meeting at which the bankrupt may be examined, and fixes a time limit for filing objections to the bankrupt's discharge; notice is given to all parties and to the United States Attorney for the district.[40] At the expiration of the time limit the discharge is granted provided no objections have been filed; if objections are filed, a hearing is held thereon,[41] during which the bankrupt's right to a discharge is determined.[42] Beyond certain exceptions, *viz.*, upholding discharge until termination of contempt proceedings pending against the bankrupt[43] and allowing creditors to protect judgments against third parties,[44] the referee is not in the position of an opposer.[45] Rather, the referee is charged with the duty of granting the discharge without conducting an inquisition or allowing personal sentiment or a sense of justice to dictate a decision.[46] The referee shall grant the discharge unless satisfied that the bankrupt is disqualified on any one of the seven different grounds specified in section 14c of the Bankruptcy Act, and these grounds must be specified in duly filed objections.[47] A fortiori, the referee should discharge the bankrupt from the debts if no objection has been filed.[48]

The substance of objections to discharge must be plead with great

[37] Bankruptcy Act § 2, 30 Stat. 545 (1898), as amended, 11 U.S.C.A. § 11 (Supp. 1960).

[38] Bankruptcy Act §§ 2(16), 38(2), 41b, 30 Stat. 545, 555, 556 (1898), as amended, 11 U.S.C.A. §§ 11(16) (Supp. 1960), 66(2), 69b (1943).

[39] Bankruptcy Act § 14a, 30 Stat. 550 (1898), as amended, 11 U.S.C.A. § 32(a) (1953).

[40] Bankruptcy Act § 14b, 30 Stat. 550 (1898), as amended, 11 U.S.C.A. § 32(b) (Supp. 1960).

[41] The referee sets a date for the hearing to give all concerned a reasonable time to be heard. Bankruptcy Act § 14b, 30 Stat. 550 (1898), as amended, 11 U.S.C.A. § 32(b) (Supp. 1960). The hearing is in the nature of a separate civil suit, and amounts to a trial in equity, In re Amer, 228 Fed. 576 (E.D. Pa. 1915), and the bankrupt may, if he wishes, waive his discharge. Bankruptcy Act § 14a, 30 Stat. 550 (1898), as amended, 11 U.S.C.A. § 32(a) (1953). The referee may rule on the admissibility of evidence, administer oaths, and examine the bankrupt. General Order 22, 172 U.S. 653, 661 (1898), as amended, 305 U.S. 681, 692 (1938).

[42] Laube, Collier Bankruptcy Manuel 177 (rev. ed. 1960).

[43] In re Kretsch, 172 Fed. 523 (S.D. N.Y. 1909).

[44] Ingram v. Wilson, 125 Fed. 913 (8th Cir. 1903).

[45] In re Walsh, 256 Fed. 653 (7th Cir. 1919).

[46] 7 Remington, Bankruptcy 94 (6th ed. 1955).

[47] In re De Cillis, 83 F. Supp. 802 (D. Mass. 1949).

[48] In re Miller, 39 F.2d 919 (D. Minn. 1930).

particularity, as mere general averments of fact are not sufficient, *i.e.*, the objecting creditor should plead the facts, not just the subdivision.[49] Thus, the objecting creditor must allege a statutory ground, showing freedom from laches[50] and verification.[51] The bankrupt is not obligated to answer.[52]

The party objecting to the discharge has the initial burden of proof[53] even if the bankrupt does not answer.[54] In order for the burden to shift to the bankrupt, the objector must make out a prima facie case[55] showing that there are "reasonable grounds" for believing that the bankrupt has committed an act which would prevent his discharge.[56] Suspicious circumstances alone are not "reasonable grounds" and do not warrant a shifting of the burden.[57] After the burden shifts to the bankrupt, he must show by a preponderance of the evidence that the allegations of the specifications are untrue.[58] If evidence is in equilibrium, the discharge must be denied.[59] Thus, the referee must dispose of the case according to the standard of persuasiveness supplied by the requirement that the objector must show "to the satisfaction of the court" reasonable grounds for believing that the bankrupt has committed an act which would be a ground for denying his discharge. Moreover, this standard has a well-accepted meaning in ordinary civil cases.[60]

The referee is vested by the Bankruptcy Act with jurisdiction "subject always to review by the judge."[61] He is not "endowed with any independent judicial authority" and "is not in any sense a separate court."[62] Nevertheless, the referee's findings of fact, conclusions of law, and orders are upheld unless deemed "clearly erroneous."[63] The referee's findings should not be set aside lightly because judges should give due weight to the referee's advantage in observing the witness while testifying.[64]

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[49] Remmers v. Merchants'-Laclede Nat'l Bank, 173 Fed. 484 (8th Cir. 1909).
[50] In re Ruhlman, 279 Fed. 250 (2d Cir. 1922).
[51] Manson v. Inge, 13 F.2d 567 (4th Cir. 1926).
[52] Laube, op. cit. supra note 42, at 180.
[53] In re Leichter, 197 F.2d 955 (3d Cir. 1952), cert. denied, 344 U.S. 914 (1953).
[54] Laube, op. cit. supra note 42, at 181.
[55] Jones v. Gertz, 121 F.2d 782 (10th Cir. 1941).
[56] Dixwell v. Scott & Co., 115 F.2d 873 (1st Cir. 1940).
[57] In re Tumen, 58 F. Supp. 210 (D. N.J.), aff'd, 146 F.2d 268 (3d Cir.), cert. denied, 324 U.S. 878 (1944).
[58] In re Melniker Hammock Mfg. Co., 45 F.2d 703 (2d Cir. 1930).
[59] In re Rolland, 43 F. Supp. 208 (E.D. La. 1942).
[60] In re Smatlak, 99 F.2d 687 (7th Cir. 1938).
[61] Bankruptcy Act § 38, 30 Stat. 555 (1898), as amended, 11 U.S.C.A. § 66 (1943).
[62] Weidhorn v. Levy, 253 U.S. 268, 271 (1920).
[63] General Order 47, 286 U.S. 573 (1932), as amended, 305 U.S. 681, 702 (1939).
[64] MacLachlan, op. cit. supra note 34, at 89.

III. Grounds for Denial of Discharge

One referee in bankruptcy stated, "There are seven statutory grounds for denying a discharge. . . . Most of them involve moral turpitude in one way or another. If your client is honest, he will almost certainly receive a discharge."[65] It is well settled that the discharge provisions merely provide an opportunity to the *honest* bankrupt to reinstate himself in the business world,[66] and they are not intended to be available to the dishonest bankrupt. In other words, only the honest bankrupt who used good faith in dealing with his property[67] and gave a true and honest presentation of his financial affairs reflecting his entire business[68] is entitled to a discharge. Thus, as the aim of the discharge provisions is to prevent frauds, one court has aptly stated that it is not so much the acts of the bankrupt that prevent his discharge, but rather the intention with which he acts.[69] Hence, the following have been held insufficient reasons for denying a discharge: the giving of a preference;[70] the failure to file schedules within the proper time;[71] an illegal change of name;[72] and misconduct as a fiduciary.[73] A close look at each of the seven statutory grounds for denial of discharge[74] will support the above statements.

A. *Criminal Acts*

The provision for denial of discharge because of criminal activity is found at 14c(1) of the Bankruptcy Act:

> The court shall grant the discharge unless satisfied that the bankrupt has (1) committed an offense punishable by imprisonment as provided under title 18, United States Code, section 152. . . .

Section 152[75] provides punishment by imprisonment for eight criminal offenses dealing with the concealment of assets, false oaths and claims, and bribery in connection with bankruptcy proceedings. The commission by the bankrupt of any one of the eight offenses constitutes a ground for a creditor's objection to discharge.[76]

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[65] Smith, They Ask the Referee, 34 Ref. J. 105, 113 (1960).
[66] Personal Fin. Co. v. Day, 126 F.2d 281 (10th Cir. 1942).
[67] Harris v. Baker, 86 F.2d 936 (9th Cir. 1936).
[68] In re Underhill, 82 F.2d 258 (2d Cir.), cert. denied, 299 U.S. 546 (1936).
[69] In re Caseldine, 104 F. Supp. 645 (S.D. Ohio 1952).
[70] Rutter v. General Motors Acceptance Corp., 70 F.2d 479 (10th Cir. 1934).
[71] In re Bauknight, 14 F.2d 674 (S.D. Fla. 1926).
[72] In re Dynamic Mfg. Co., 276 Fed. 408 (E.D. Mich. 1921).
[73] In re Gara, 190 Fed. 112 (E.D. Pa. 1911).
[74] Bankruptcy Act § 14c, 30 Stat. 550 (1898), as amended, 11 U.S.C.A. § 32(c) (Supp. 1960).
[75] 62 Stat. 689 (1948), 18 U.S.C.A. § 152 (Supp. 1960).
[76] 1 Collier, Bankruptcy 1305 (14th ed. 1956).

First, section 152 offenses dealing with concealment require that the concealment be "knowingly and fraudulently" done, *i.e.*, there must be proof of the fraudulent intent.[77] To bar a discharge, the bankrupt must intend either to profit by an offense or to deprive his creditors of their legal right to an apportionment of all the property.[78]

A bankrupt's failure to schedule or surrender to the trustee property belonging to the bankrupt's estate does not necessarily constitute "knowingly and fraudulently" concealing property.[79] For example, failure to include property in the schedules through honest mistakes of law or fact,[80] failure to include worthless property or personal property of little value,[81] belief by the bankrupt that he did not own the property[82] or that it would not pass to the trustee,[83] or failure to schedule property pursuant to an attorney's advice[84] usually will not be made the basis of a refusal to discharge. If such omission is not satisfactorily explained, however, the court may interpret the omission as being due to a prior fraudulent conveyance.[85] Moreover, proof of concealment need be shown only by a fair preponderance of the evidence and not beyond a reasonable doubt.[86]

Secondly, offenses dealing with a false oath under section 152 consist of (1) a false statement or omission in the bankrupt's schedules, or (2) a false statement by the bankrupt at an examination during the course of the proceeding.[87] The false oath must have been knowingly and fraudulently made,[88] *i.e.*, the statement must contain matter which the bankrupt knew to be false and he must have included it wilfully with intent to defraud.[89] Hence, a discharge cannot be denied merely upon the ground that the testimony of the bankrupt was evasive and may have been false.[90] Furthermore, the false oath must relate to a material matter.[91] Therefore, testimony concerning trivial matters or concerning property which can have

[77] Tancer v. Wales, 156 F.2d 627 (2d Cir. 1946).
[78] 1 Collier, op. cit. supra note 76, at 1315.
[79] Dilworth v. Boothe, 69 F.2d 621 (5th Cir. 1934).
[80] In re Hope, 18 F.2d 958 (W.D. Mich. 1926).
[81] In re Kolsrud, 34 F.2d 831 (D. Minn. 1929).
[82] In re Servel, 30 F.2d 102 (E.D. Idaho 1928).
[83] In re Buchanan, 219 Fed. 492 (2d Cir. 1914).
[84] In re Topper, 229 F.2d 691 (3d Cir. 1956). But the advice must be taken in good faith. In re Perel, 51 F.2d 506 (S.D. Tex. 1931).
[85] In re Carter, 32 F.2d 186 (2d Cir. 1929).
[86] In re Merritt, 28 F.2d 679 (9th Cir. 1928).
[87] 1 Collier, op. cit. supra note 76, at 1325.
[88] Morris Plan Industrial Bank v. Henderson, 131 F.2d 975 (2d Cir. 1942).
[89] Arnofsky v. Bostian, 133 F.2d 290 (8th Cir. 1943). The requisite intent may be inferred from the facts. In re Royal, 112 Fed. 135 (E.D. N.C. 1901).
[90] In re Marcus, 192 Fed. 743 (S.D. N.Y. 1911), aff'd, 203 Fed. 29 (2d Cir. 1913).
[91] Tancer v. Wales, 156 F.2d 627 (2d Cir. 1946).

no bearing on the estate's condition is immaterial in a proceeding under the Bankruptcy Act.[92]

A close look at some examples in this area may be helpful. A frequent use of false oaths occurs where the bankrupt knowingly and fraudulently omits assets from his schedule of property and swears that the schedule "is a statement of all my property, real and personal."[93] Also, a failure to list property which has been fraudulently conveyed may constitute a false oath.[94] Generally speaking, items omitted (1) by mistake,[95] (2) upon honest advice of counsel,[96] and (3) small items omitted without fraud[97] do not constitute a false oath. It follows that if a bankrupt knowingly and fraudulently omits the name of a creditor from his schedule of debts and swears that the schedule "is a true statement of all my debts," he is guilty of making a false oath.[98] Also a false statement under oath on examination at a hearing, if the statement is knowingly and fraudulently false, will bar a discharge,[99] *e.g.*, a bankrupt's false testimony that he listed all his assets in the schedule[100] or his false testimony that he never made a statement of financial condition[101] will bar a discharge. As in offenses involving concealment, a false oath must be knowingly and fraudulently made in order to constitute grounds for denial of a discharge.[102] Likewise, false testimony caused by honest mistakes or advice of counsel will not cause a denial of a discharge.[103]

B. *Inadequate Records*

Subsection 14c(2) of the Bankruptcy Act reads as follows:

> The court shall grant the discharge unless satisfied that the bankrupt has . . . (2) destroyed, mutilated, falsified, concealed, or failed to keep or preserve books of account or records, from which his financial condition and business transactions might be ascertained, unless the court deems such acts or failure to have been justified under all the circumstances of the case; . . .

Prior to the amendment of 1926[104] subsection 14c(2) read "with

[92] In re Taub, 98 F.2d 81 (2d Cir. 1938).
[93] 1 Collier, op. cit. supra note 76, at 1327.
[94] In re Gammon, 109 Fed. 312 (N.D. Iowa 1901).
[95] Kansas Fed. Credit Union v. Niemeier, 227 F.2d 287 (10th Cir. 1955).
[96] In re MacFarlane, 45 F.2d 994 (9th Cir. 1930).
[97] In re Taub, 98 F.2d 81 (2d Cir. 1938).
[98] Stim v. Simon, 284 F.2d 58 (2d Cir. 1960).
[99] In re Marshall, 47 F.2d 209 (2d Cir. 1931).
[100] Poff v. Adams, Payne & Gleaves, 226 Fed. 187 (4th Cir. 1915).
[101] In re Zoffer, 211 Fed. 936 (2d Cir. 1914).
[102] Willoughby v. Jamison, 103 F.2d 821 (8th Cir.), cert. denied, 308 U.S. 588 (1939).
[103] In re Stafford, 226 Fed. 127 (D. Conn. 1915).
[104] 44 Stat. 663, as amended, 11 U.S.C.A. § 32(c)(2) (Supp. 1960).

intent to conceal his financial condition. . . ."[105] Hence, since 1926, no moral turpitude has been required.[106] The present provision "as compared with the act of 1898 . . . is partly a liberalization in that the bankrupt may justify his conduct by mitigating circumstances, and partly a restriction upon the grant of discharges in that proof of an 'intent to conceal' is no longer an essential element of proof to sustain an objection."[107] Thus, if a bankrupt breaches his duty to creditors by failing to keep or preserve proper books and records and if he fails to establish justifying facts and circumstances, discharge will be denied.[108] It follows that the cases prior to 1926 are unreliable as precedent for the present provision[109] because many are based on the issue of intent.[110] Yet, it has been said that the early cases are helpful in determining the standard of conduct to which the bankrupt is bound and the circumstances under which a failure to conform are justified.[111] This is true especially in cases requiring a voluntary act similar to intent to conceal, *e.g.*, concealment,[112] mutiliation, falsification, or destruction.[113] Where a failure to keep or preserve books or records is proven to have been done with an intent to conceal, the discharge should be barred, because such action never can be justified.[114] Under the present subsection 14c(2), the objector must merely show that there are reasonable grounds to believe that the bankrupt committed the act, and the burden of proof then shifts to the bankrupt.[115] Thus, if there has been a failure to maintain and preserve adequate records, the bankrupt must show reasons justifying the inadequate[116] or missing records.[117]

C. *False Financial Statements*

Regarding a businessman's obtaining credit through the use of false financial statements, subsection 14c(3) provides:

[105] Bankruptcy Act, 30 Stat. 550 (1898), (amended by 32 Stat. 797 (1903), as amended, 11 U.S.C.A. § 32(c)(2)(Supp. 1960)). Prior to 1903, in the Bankruptcy Act of 1898, the clause read "with *fraudulent* intent to conceal his *true* financial condition and *in contemplation of bankruptcy* . . ." The italicized words were omitted by the amendatory act of 1903, and the word "intent" was omitted by the amendatory act of 1926 which added the clause "unless the court deem such failure or acts to have been justified under all circumstances of the cases."

[106] White v. Schoenfeld, 117 F.2d 131 (2d Cir. 1941).

[107] 1 Collier, op. cit. supra note 76, at 1338.

[108] Texas Nat'l Bank v. Edson, 100 F.2d 789 (5th Cir. 1939).

[109] In re Weismann, 1 F. Supp. 723 (S.D. N.Y. 1932).

[110] Example of requirements of intent: In re Idzall, 96 Fed. 314 (S.D. Iowa 1899).

[111] 1 Collier, op. cit. supra note 76, at 1347-48.

[112] In re Weinberg, 42 F.2d 218 (E.D. N.Y.), aff'd, 42 F.2d 219 (2d Cir. 1930).

[113] In re Hodge, 205 Fed. 824 (N.D. N.Y. 1913).

[114] In re Anderson, 35 F. Supp. 717 (W.D. N.Y. 1940).

[115] In re Di Palo, 218 F.2d 816 (2d Cir. 1955).

[116] Baker v. Trachman, 244 F.2d 18 (2d Cir. 1957); In re Herzog, 121 F.2d 581 (2d Cir. 1941), cert. denied, 315 U.S. 807 (1942).

[117] In re Muss, 100 F.2d 395 (2d Cir. 1938).

> The court shall grant the discharge unless satisfied that the bankrupt has . . . (3) while engaged in business as a sole proprietor, partnership, or as an executive of a corporation, obtained for such business money or property on credit or as an extension or renewal of credit by making or publishing or causing to be made or published in any manner whatsoever a materially false statement in writing respecting his financial condition or the financial condition of such partnership or corporation; . . .

Under this provision an intent to defraud or deceive is an essential element,[118] *i.e.*, there must be a materially false[119] statement in writing, intentionally untrue,[120] or made so recklessly as to warrant a finding that the bankrupt acted fraudulently[121] with the view to deceive or mislead.[122] Further, the bankrupt must have obtained money or property on credit or an extension or renewal of credit[123] because his creditors relied on the false statement.[124] The bankrupt does not have to receive a direct benefit from the false statement;[125] a third-party may be the recipient.[126] A discharge will not be barred if the bankrupt made the false statements negligently or inadvertently,[127] or if the facts stated therein were honestly thought to be true.[128] There are cases[129] under subsection 14c(3) which hold a discharge barred if the statement is false when made, even though the falsity consisted of an omission of an indebtedness which was released prior to bankruptcy or an omission of indebtedness in the belief that the persons to whom the bankrupt was indebted would not press for payment. Note should be made that subsection 14c(3) was modified by the 1960 amendment[130] to the Bankruptcy Act. The amendment provides that the use of false financial statements as a bar to discharge should be limited to businessmen, because "a complete denial of discharge is too severe a penalty for the non-commercial bankrupt . . ."[131] who has little experience with accounting procedures.

[118] In the Matter of Barbiere, 192 F.2d 1018 (3d Cir. 1951).
[119] Gerdes v. Lustgarten, 266 U.S. 321 (1924).
[120] In re Schweizer, 271 F.2d 95 (7th Cir. 1959).
[121] In re Santos, 211 F.2d 887 (7th Cir. 1954).
[122] In re Josephson, 229 Fed. 272 (D. Ore. 1916).
[123] Rogers v. Gardner, 226 F.2d 864 (9th Cir. 1955).
[124] Banks v. Siegel, 181 F.2d 309 (4th Cir. 1950).
[125] In re Marcus, 253 F.2d 685 (2d Cir. 1958).
[126] In re Haydu, 105 F. Supp. 859 (E.D. N.Y. 1952).
[127] In re Matthews, 272 Fed. 263 (7th Cir. 1921).
[128] Baash-Ross Tool Co. v. Stephens, 73 F.2d 902 (9th Cir. 1934).
[129] See, e.g., Industrial Bank of Commerce v. Bissell, 219 F.2d 624 (2d Cir. 1955).
[130] 74 Stat. 408, 11 U.S.C.A. § 32(c)(3) (Supp. 1960).
[131] Laube, Collier Pamphlet Edition of the Bankruptcy Act A30 (1960 ed.). This does not completely relieve the noncommercial bankrupt as he may find himself with a non-chargeable debt under § 17(2), 74 Stat. 408, 11 U.S.C.A. § 35 (Supp. 1960).

D. *Fraudulent Activity Regarding Property*

Subsection 14c(4) of the act reads as follows:

> The court shall grant the discharge unless satisfied that the bankrupt has . . . (4) at any time subsequent to the first day of the twelve months immediately preceding the filing of the petition in bankruptcy, transferred, removed, destroyed, or concealed, or permitted to be removed, destroyed, or concealed, any of his property, with intent to hinder, delay or defraud his creditors; . . .

This subsection requires a showing that the acts complained of were done with an intent to delay, hinder, or defraud the bankrupt's creditors.[132] Intent to defraud need not be proven when the allegations are that the creditors are being hindered or delayed. If intent to hinder, delay, or defraud is proven,[133] the bar to a discharge need not be based on actual fraud of the creditor.[134] The fact that valuable property has been gratuitously transferred raises a presumption of fraudulent intent,[135] whereas the fact that the property transferred is of small value seems to negate the intent.[136] This subsection is not applicable to assignments for the benefit of creditors, which do not constitute grounds for denial of a discharge.[137]

E. *Frequent Discharges*

Subsection 14c(5) provides:

> The court shall grant the discharge unless satisfied that the bankrupt . . . (5) in a proceeding under this act commenced within six years prior to the date of the filing of the petition in bankruptcy had been granted a discharge, or had a composition or an arrangement by way of composition or wage earner's plan by way of composition confirmed under the act; . . .

The purpose of subsection 14c(5) is to prevent frequent use of the Bankruptcy Act as a means of avoiding honest debt.[138] Obviously, there is no requirement of bad faith or fraudulent intent. This provision applies equally to the honest and dishonest bankrupt.

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[132] In re Finder, 61 F.2d 960 (2d Cir.), cert. denied, 289 U.S. 736 (1932). This must be an actual and not a constructive intent, Roberts v. Henry V. Dick & Co., 275 F.2d 943 (4th Cir. 1960); and an intent to prefer does not constitute the requisite intent. In re Richter, 57 F.2d 159 (2d Cir. 1932).

[133] In re Beggs, 93 F. Supp. 863 (N.D. Ohio 1950).

[134] In re Feynman, 77 F.2d 320 (2d Cir. 1935).

[135] Rothschild v. Lincoln Rochester Trust Co., 212 F.2d 584 (2d Cir. 1954).

[136] In re Rice & Reuben, 43 F.2d 378 (D. Me. 1930).

[137] Feder v. Goetz, 264 Fed. 619 (2d Cir. 1920).

[138] In re Johnson, 233 Fed. 841 (S.D. Ala. 1916).

F. *Uncooperative Conduct*

Full cooperation from the bankrupt is encouraged by subsection 14c(6), which reads as follows:

> The court shall grant the discharge unless satisfied that the bankrupt has . . . (6) in the course of a proceeding under this Act refused to obey any lawful order of, or to answer any material question approved by the court; . . .

This provision has no requirement of bad faith or fraudulent intent. The question asked must be material,[139] approved by the court, and lawful. If the order is authorized by statute, then it is lawful.[140] Thus, ignoring a lawful order resulting in contempt of court, *e.g.*, refusal to appear when subpoenaed, may justify a bar to discharge.[141] Furthermore, refusal to answer on the grounds of self-incrimination will not prevent a bar[142] and a resultant barred discharge will not be violative of the fifth amendment because bankruptcy is not criminal in nature.[143]

G. *Unsatisfactory Explanation Regarding Assets*

The final ground for objecting to a discharge, subsection 14c(7), provides:

> The court shall grant the discharge unless satisfied that the bankrupt . . . (7) has failed to explain satisfactorily any losses of assets or deficiency of assets to meet his liabilities: . . .

One source[144] states that subsection 14c(7) "is broad enough to include any unexplained disappearances or shortages of assets[145] as well as mere insolvency itself, *i.e.*, an insufficiency of assets to meet liabilities."[146] Furthermore, subsection 14c(7) does not contemplate petty losses, but rather a sudden depletion in assets immediately before bankruptcy indicating a desire by the bankrupt to defraud his creditors.[147] Most of the cases are concerned with the question of whether the bankrupt has explained satisfactorily any losses or deficiencies of assets,[148] *i.e.*, an explanation which convinces the court

[139] In re Kolb, 151 F.2d 605 (2d Cir. 1945).
[140] In re Presnick, 48 F. Supp 685 (S.D. N.Y. 1941).
[141] In re Simon, 297 Fed. 942 (2d Cir. 1924).
[142] In re Bauknight, 14 F.2d 674 (S.D. Fla. 1926).
[143] In re Dresser, 146 Fed. 383 (2d Cir. 1906).
[144] 1 Collier, Bankruptcy 1401 (14th ed. 1956).
[145] Morris Plan Industrial Bank v. Schorn, 135 F.2d 538 (2d Cir. 1943).
[146] The opinion has been expressed, however, that since the primary purpose of subsection 14c(7) is to deny a discharge to the dishonest debtor and therefore mere insolvency should not mean denial of a discharge. Herzog, Failure to Satisfactorily Explain Loss of Assets or Deficiency of Assets to Meet Liabilities, 34 Ref. J. 100 (1960).
[147] In re McNay, 58 F. Supp. 960 (S.D. Cal. 1945).
[148] 1 Collier, op. cit. supra note 144, at 1402.

of good faith and businesslike conduct.[149] Hence, the explanation must be neither a mere general statement[150] nor a mere estimate.[151]

Some examples under subsection 14c(7) will be informative. The following were held not sufficient to cause a bar: a man living beyond his means,[152] indefinite account of the expenditure of a bankrupt's salary,[153] decline in gross sales or net earnings,[154] petty losses,[155] and a shrinkage in commercial value.[156] Examples of inadequate explanations causing disallowances of discharge are: loss of a particular asset,[157] reduction in total assets,[158] heavy losses,[159] and an accounting shortage.[160]

IV. The Discharge in Bankruptcy—Right or Privilege?

Anglo-American bankruptcy law has evolved through three phases: (1) quasi-criminal with no provision for discharge; (2) discharge only on consent of the creditors; and (3) automatic discharge, provided no objections are filed.[161] Although all four of the United States acts have provided for discharges in various forms, the discharge provisions have not been free from attack. On the contrary, especially since the evolution of the third phase, the discharge has been the subject of much debate as evidenced by various texts,[162] articles,[163] and reports.[164]

The dichotomy of views expressed in the articles and reports also have been prevalent in the courts. Although there is little dispute over the fact that a bankrupt is entitled to a discharge in bankruptcy

[149] Rameson Bros. v. Goggin, 241 F.2d 271 (9th Cir. 1957). For what is required of a bankrupt sufficiently to explain, see Shaiman, Bankruptcy—Section 14c(7), Another Milestone on the Historical Road Toward Protecting the Creditor Against Dishonest Petitions, 33 Temp. L.Q. 210, 215 (1960).

[150] In the Matter of Korman, 172 F. Supp. 193 (E.D. Pa. 1959).

[151] In re Beckman, 6 F. Supp. 957 (W.D. N.Y. 1934).

[152] In re Weismann, 1 F. Supp. 723 (S.D. N.Y. 1932).

[153] In re Roberts, 169 F.2d 151 (4th Cir. 1948).

[154] In re Simon, 216 F.2d 339 (7th Cir. 1954), cert. denied, 348 U.S. 964 (1955).

[155] In re McNay, 58 F. Supp. 960 (S.D. Cal. 1945).

[156] In re Gerson, 35 F.2d 539 (E.D. Pa. 1929).

[157] In re Sperling, 72 F.2d 259 (2d Cir. 1934).

[158] Koufman v. Sheinwald, 83 F.2d 977 (1st Cir. 1936).

[159] In re Zimmerman, 6 F. Supp. 693 (E.D. N.Y. 1934).

[160] In re Gerson, 35 F.2d 539 (E.D. Pa. 1929).

[161] See section on history, supra pp. 309-12.

[162] Maclachlan, Bankruptcy 88 (1956); Nadler, Bankruptcy 664 (1948).

[163] Conditioning or Suspending Discharges, 18 Ref. J. 40, 76 (1944), 19 Ref. J. 45 (1945); Oldham, Conditioning or Suspending Bankruptcy Discharges, 7 Texas B.J. 107 (1944); Radin, Discharge in Bankruptcy, 8 Ref. J. 160 (1934); Willis, Discharge in Bankruptcy—A Suggested Change, 3 Va. L. Reg. (n.s.) 489 (1917).

[164] Att'y Gen. Rep., Strengthening of Procedure in the Judicial System, S. Doc. No. 65, 72d Cong., 3d Sess. 10-25 (1932); Donovan Rep., Administration of Bankrupt Estates, 71st Cong., 3d Sess. 20-22 (Comm. Print 1931).

when he surrenders into court all of his non-exempt property for the benefit of his creditors[165] and has not breached one of the seven grounds under section 14c, there is an academic question whether a discharge is a privilege or a right. The question is academic in that the referee is no longer required to investigate the merits of an application for discharge, but according to the language of the statute the referee *must* grant the discharge unless satisfied that one or more of the seven statutory grounds for objection exist.[166] Further, the referee's requisite satisfaction must not be based upon his whimsical or capricious judgment, but rather the referee must apply the various tests (each having a well-accepted meaning) as set out in the decisions construing the various subsections under section 14c.[167] The fact that the referee cannot be arbitrary supports the contention that the bankrupt has a *legal right* to a discharge[168] unless guilty of one of the acts which constitute grounds for denial. The theory that discharge is a matter of right is well exemplified in the case of *Hardie v. Swatford Bros. Dry Goods Co.*,[169] which states "that the release of the honest, unfortunate, and insolvent debtor from the burden of his debts and his restoration to business activity, in the interest of his family and the general public, are the main, if not the most important, objects of the law." Yet, some courts continue to speak in the language of the civil law nations, *i.e.*, a discharge is a great privilege and even a prize.[170] Moreover, other courts following this view state that the primary purpose of the Bankruptcy Act is the collection of the debtor's estate and its distribution to his creditors,[171] with the discharge as a mere incidental or secondary purpose.[172] Judge Ray, who was a member of the House Judiciary Committee when the Bankruptcy Act of 1898 was enacted, epitomized this type of thinking in the case of *In re Leslie*.[173] Judge Ray's language was as follows:

> The main purpose of the bankruptcy law is to prevent preferences, and secure a fair and equitable division of the bankrupt estate among the creditors, not to grant a discharge from all his debts. The attainment of the first is not to be sacrificed to the accomplishment of the last.

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[165] Moore, Debtors' and Creditors' Rights 13 (1955).
[166] 1 Collier, op. cit. supra note 144, at 1251.
[167] In re Smatlak, 99 F.2d 687 (7th Cir. 1938).
[168] In re Pinkston, 93 F. Supp. 942 (N.D. Tex. 1950).
[169] 165 Fed. 588 (5th Cir. 1908).
[170] In re Bryant, 188 Fed. 530 (M.D. Pa. 1911); see Dixwell v. Scott & Co., 115 F.2d 873 (1st Cir. 1940), where the court described the discharge in bankruptcy as a privilege.
[171] Williams v. United States Fid. & Guar. Co., 236 U.S. 549 (1915).
[172] In re Levenstein, 180 Fed. 957 (D. Conn. 1910).
[173] 119 Fed. 406, 410 (N.D. N.Y. 1903).

In light of the fact that, concerning discharges, Congress may prescribe any regulations or restrictions which are not unreasonable,[174] the academic question of whether a discharge is a right or privilege becomes practical from the standpoint of considering the question of whether Congress should change, revise, or retain the present discharge section of the Bankruptcy Act. As previously stated, this question has been the subject of much debate and, as in most cases of legislation, Congress will try to meet the needs of the people.

V. Purpose of the Discharge

The statistics recorded in the introduction suggest that an examination of the purpose of the discharge section should be made. The main reasons for the discharge are that it (1) is just and humane to the debtor; (2) aids creditors in discovering and recovering assets; and (3) gives effect to the sound public policy of not keeping a debtor bound to his debts, but rather of restoring him to the business community.[175] At present the language of the statute states that the referee "*shall* grant the discharge, unless . . ."[176] the bankrupt be guilty of one of the seven specified grounds set out in section 14c. (Emphasis added.) The grounds for objection under section 14c are to be strictly construed[177] while the Bankruptcy Act is liberally construed in favor of granting the discharge.[178]

A careful reading of the seven grounds for objection under section 14c will reveal how the three reasons are given effect. A lack of fraudulent intent alone will not guarantee a discharge. Out of the seven grounds, only three [(1), (3), and (4)] require a definite finding of fraudulent intent. Ground (1) requires a fraudulent intent to profit and to defraud creditors by commission of an offense punishable by imprisonment. Thus, an honest bankrupt would have no problem. Ground (3) requires an intent to defraud when the bankrupt obtains credit, and this subsection is occasionally harsh for it will prevent a discharge even if the debt was released prior to bankruptcy. The 1960 amendment,[179] however, limits subsection (3) to businessmen, and thereby grants partial relief to noncommercial bankrupts.[180] Ground (4) requires an intent to delay, hinder, or de-

[174] U.S. Const. art. I, § 8; Hanover Nat'l Bank v. Moyses, 186 U.S. 181 (1902).

[175] 7 Remington, Bankruptcy 43 (6th ed. 1955).

[176] Bankruptcy Act § 14c, 30 Stat. 550 (1898), as amended, 11 U.S.C.A. § 32(c) (Supp. 1960).

[177] In re Groth, 36 F.2d 41 (7th Cir. 1929).

[178] Roberts v. Ford & Son, 169 F.2d 151 (4th Cir. 1948).

[179] § 14c(3), 74 Stat. 408, 11 U.S.C.A. § 32(c)(3) (Supp. 1960).

[180] The noncommercial bankrupt is still limited by § 17(2) which prohibits the discharge of a debt obtained by a materially false statement in writing.

fraud a creditor in conjunction with a transfer of property within one year of the filing of the petition. At times, this provision produces harsh effects on the bankrupt because it is accompanied by a presumption that a gratuitous transfer is fraudulent.

On the other hand, three other subsections under section 14c [(2), (5), and (6)] require the referee to use his discretion in deciding the merits of the charge, according to various tests set out in the cases. Ground (2), which formerly required fraudulent intent when dealing with the failure to keep or preserve books or records, now uses the test of whether the failure was "justified under all circumstances of the case." This change in tests is a step in the direction of restraining the bankrupt by not giving him a clear cut test as to when he will be denied a discharge. On the other hand, as stated earlier, the new test now allows the bankrupt an opportunity to justify his conduct. Ground (6), likewise, requires no fraudulent intent because the referee may deny discharge by merely finding that the bankrupt refused to answer a material question. Again, harsh results may occur because the privilege against self-incrimination under the fifth amendment is not available in bankruptcy proceedings. Ground (7) has been termed a "catch-all"[181] because it allows refusal of a discharge when the referee thinks refusal is justified simply because there is no satisfactory explanation for insolvency or for unexplained shortages. On the other hand, there is argument that subsection (7) is not a "catch-all" because the referee cannot follow his own whim or caprice.[182]

The last ground for consideration, (5), is clear. No fraud is necessary because subsection (5) is purely for the creditors' sake, so that a bankrupt will not try to be released from debts too often by bankruptcy discharges.

Due to the large percentage of bankruptcies in the United States, there is a definite need for economic rehabilitation through discharge. In this respect the discharge is one of the most beneficial features of the Bankruptcy Act. Hence, a noted writer wrote:[183]

> Statistically speaking, the debtor relief aspect of bankruptcy looms large. . . . The discharge implements a well established public policy in favor of preventing debtors from being permanently engulfed by a single failure. . . . [T]he discharge in bankruptcy is generally recognized as having definite social value.

In this light laymen, legislators, lawyers, and jurists have come to recognize bankruptcy as a haven for poor debtors extended for the

[181] Shaiman, supra note 149, at 218.
[182] For an enlightening discussion on this point, see Herzog, supra note 146.
[183] Maclachlan, op. cit. supra note 162, at 16-17.

purpose of terminating existing liabilities upon surrender of their estates.[184]

The relative ease of obtaining discharges has also brought about certain abuses worth weighing against the act's social value. A large number of persons have gone into bankruptcy and obtained discharges when they could have worked out a plan for future payments that would enable the creditor to receive a greater percentage of his money. There is also the situation in which a corporation will obtain a discharge in bankruptcy and dissolve; then the old shareholders will form a new corporation, often under the same conditions and in the same locality. Although questionable, this practice is obviously a most effective way of handling corporate debts.

One may view the discharge provisions as socialistic and as creating a most formidable danger to our capitalistic economy.[185] The argument is that bankruptcy at present is somewhat of an insurance policy for the debtor and that the creditor pays the premiums. The better view, however, appears to be that the Bankruptcy Act is not socialistic, but is merely a necessary adjustment factor of our complex credit system. Refusing to release debtors would place a much greater burden on society than releasing them, for the obvious reason that a large percentage of the debtors, unable to rehabilitate themselves or their families and with no chance of returning and contributing to the economy, would be forever a burden on the community. Thus, the end result of refusing to release debtors would necessitate a resort to some extreme form of socialism. Consequently, the discharge in bankruptcy actually serves to ward off, rather than encourage socialism.

Discharge is one of the mainsprings of our capitalistic economy. In the past, when a man failed financially, he moved West and started a new life. The span of many miles and the poor transportation acted as an effective release from creditors. As the frontier faded into history, the discharge took its place. Thus, the discharge serves as another link in one of America's greatest traditions, *i.e.*, the right to fail and to start over again. This right has been one of the main factors in giving our country its high economic standard.

VI. Conclusion

The courts should continue to apply the principle that the discharge is a matter of right. Further, construction of the statute should

[184] 1 Collier, op. cit. supra note 144, at 1254.

[185] See the recent article discussing the problems and presenting the statistics on noncommercial bankruptcy. Snedecor, Consumer Credit and Bankruptcy, 35 Ref. J. 37 (1961).

be pursuant to definite, ascertainable tests and there should be no judicial discretion placed in the hands of the referee to allow or disallow the discharge on purely equitable grounds. Furthermore, the statute should only be modified for the purpose of rehabilitating the honest debtor rather than being harsh on him.

It is apparent that the present Bankruptcy Act reaches a high sophistication of legislation, commensurate with our highly complex credit economy's great need for rehabilitation of the honest debtor, by combining the "Hebrew Jubilee" idea of debtor relief with the strong desire to safeguard the creditors' rights.