"METHODES PREVENTIVES DE FAILLITE": AN AMERICAN REPORT ON "PROCEEDINGS SHORT OF BANKRUPTCY."*

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According to the official statistics compiled by Honorable Edwin L. Covey, Chief of the Bankruptcy Division of the Administrative Office of the United States Courts, there were 73,761 cases filed under the several chapter provisions of the National Bankruptcy Act during the fiscal year ending on the 30th day of June, 1957. No reliable statistics, however, are available regarding the subject matter of this report, "Methodes Preventives De Faillite" (a French term of art meaning "Proceedings Short of Bankruptcy"). To what extent the proceedings in bankruptcy are the more popular means of liquidation of an insolvent debtor is obviously due to the discharge features of the National Bankruptcy Act, because through this legal device the deserving debtor is given the opportunity of starting anew his economic life free from the millstone of his accumulated old debts.[1] Even where the financially embarrassed debtor seeks rehabilitation rather than liquidation, the National Bankruptcy Act provides him with a club to force the acceptance of his plan or "arrangement" by a minority of his creditors.[2] All he needs for court approval and confirmation (assuming of course that he has met the other specific statutory requirements)[3] is the acceptance by only a majority in "number and amount" of his general creditors.[4] Here, furthermore, the creditors are faced with the alternative prospect that, the arrangement or plan failing, the proceedings will be converted into straight bankruptcy, with the attendant benefit of a discharge to the debtor and probable shrinkage of the dividend to his creditors. It needs but to be noted in passing that these popularizing benefits of the bankruptcy devices are the results of legislative action, i.e., creatures of enabling federal statutes. Obviously, where the status of the debtor is such as to make these bankruptcy benefits

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1. Stellwagon v. Clum, 245 U.S. 605, 38 S.Ct. 215, 62 L.Ed. 507 (1918).
2. *E.g., In re* Carolina Mills, Inc., 97 F.Supp. 793 (E.D. S.C. 1950).
3. National Bankruptcy Act § 14, 11 U.S.C. § 32.
4. See NADLER, THE LAW OF DEBTOR RELIEF, § 321, p. 339 (1954).

merely academic or comparatively unimportant, the harassed debtor may look to and employ other legal devices where either liquidation or rehabilitation is his objective. Such vehicles available to him, short of bankruptcy, are found primarily in the common law and in codifying statutes, except that receiverships are grounded in equity. The most common non-bankruptcy liquidating devices are (1) *General Assignments for the Benefit of Creditors,* and (2) *Bulk Sales,* while *Compositions* and *Extensions* are the means by which the insolvent debtor may work out his rehabilitation within the frame work of the common law. It must be emphasized that each of these "short-of-bankruptcy" devices has the same underlying disadvantage, in that no one of them offers the discharge benefits that are legally available to the debtor through the National Bankruptcy Act. However, in order to obtain these bankruptcy privileges, the debtor must meet all the statutory requirements, go through all the legal red tape, and possibly incur a more or less form of stigma. Accordingly, time, inconvenience and money become secondary factors, but are readily sacrificed at the beneficient altar of the bankruptcy discharge. On the other hand, much time and money may be saved and inconveniences may be avoided through the utilization of one of these other debtor devices. Again, the debtor may find himself vulnerable to any objection to the granting of his discharge because (a) he had been discharged within six years in a prior bankruptcy proceeding, or (b) he had given out financial statements whose correctness the debtor may find difficult, if not impossible, to show, or (c) for many other "becauses" that add up to a situation wherein the disadvantages outweigh the advantages even to an individual, as distinguished from a corporate debtor.

In this connection, it may be well to distinguish a debtor who is a natural person from a debtor that is a corporation. A discharge of his provable debts may be of primary importance to the former type of debtor whereas a corporate debtor may have no practical use for its discharge where its liquidation amounts to its going out of business permanently and results in terminating its future acquirement of assets that would be available to its erstwhile creditors. Although the cessation of its operations and the liquidation of its assets do not result in the legal demise of a corporation, the reality of the situation is that generally such a corporation is through for all intents and purposes. When such is the case, the matter of obtaining a discharge is of no importance. Obviously, therefore, where the discharge is either unobtainable or nonconsequential, and much time and money can be saved, and embarrassments or inconveniences of one kind or another may be minimized or avoided, why follow the bankruptcy route?

General Assignment for Benefit of Creditors

The general assignment for benefit of creditors springs from the same concept of the common law which recognizes the right of a debtor to "devote his whole estate to the satisfaction of the claims of creditors."[5] Such inherent right results "from that absolute ownership which every man claims over what he owes."[6] Upon, and since 1570, the enactment of the Statute of Elizabeth, the exercise of this free right of alienation has been restricted to not hindering, delaying or defrauding his creditors. However, a general assignment, when made in compliance with relevant law, is deemed not to be a fraudulent conveyance because, as goes the rationale, the beneficiaries of this procedure are the creditors.[7] Furthermore, each of these devices is non-contractual and non-consensual. Whereas a composition settlement or extension is grounded in contract and requires the consent of the participating creditors (except under Massachusetts and Texas law), the general assignment does not depend upon the consent of creditors nor is it effectuated by agreement of the parties.

A general assignment is a transfer of all the property and assets of a debtor, (known as the assignor) to another person in trust by him (known as the assignee), to be expeditiously liquidated and the funds therefrom distributed among his debtor's creditors, (the beneficiaries). It is important to note that a valid assignment (i.e., one that will not be deemed a fraudulent conveyance) must (1) convey all, and not merely a portion, of debtor's assets, (2) be so made for the purpose of immediate or expeditious liquidation.[8]

Any debtor who owes anything is, of course, eligible. The debtor need not necessarily be insolvent in either the bankruptcy sense (i.e., liabilities exceed assets) or within the equity meaning of the word (i.e., unable to pay debts as they mature, regardless of the ratio between assets and liabilities).

To distinguish the transfer from a mere agency or from a mortgage or other form of qualified conveyance, the transfer must be uncon-

5. Reed v. McIntyre, 98 U.S. 507, 25 L.Ed. 171 (1878).
6. Brashear v. West, 7 Pet. 708, 8 L.Ed. 801 (1833).
7. Musingwear Corp. v. Harris, 294 Ill. App. 194, 13 N.E.2d 637 (1938).
8. United States v. Gotwok, 156 F.2d 692 (10th Cir. 1947).

ditional and absolute.[9] The debtor transfers all title out of himself, the legal title going to the assignee (trustee) and the equitable title to the creditors. A general assignment, otherwise valid, will be declared a fraudulent conveyance where the debtor reserves unto himself any rights to or benefits from or control over the property and assets thereby transferred. The debtor, of course, has a resulting trust as to any surplus which may remain after all his debts have been paid, and he is entitled to withhold from the conveyance such property and assets as are exempt under the laws of the state of his residence, but he has no equity or redemption in the assigned assets.

The assignee (trustee) takes legal title to the assigned property, subject to all valid equities, liens and encumbrances with which the assets are burdened and charged.[10] The assignee is neither a purchaser nor an encumbrancer but steps into the shoes of the debtor. Although he is the "legal" owner of the assigned property his *personal* interest extends therein only to his compensation therefrom. Being the trustee for the benefit of debtor's creditors, he is responsible to them for any acts of malfeasance or misfeasance. He derives his power and authority from the instrument of assignment, and he must be guided, and is bound, by the terms thereof, unless there are any statutory mandates to the contrary. Under the common law, his primary duty is to liquidate the assets and distribute the proceeds to the creditors as expeditiously as possible. Under the statutory law, by which some states have codified the common law and have created "statutory" assignments for the benefit of creditors, limited operation of debtor's business by the assignee is permissible. But more about statutory assignments for benefit of creditors, later.

Important to remember is that the trustee, by virtue of the general assignment, is the sole and exclusive owner of the assigned assets, and that such property becomes immunized from the claims, attachments, judgments and levies of the debtor's creditors.[11] The legal rights of the creditors become transformed by operation of law to their equitable right of their respective distributive share in the funds realized from the liquidation of the assigned assets.

Although as previously noted, a general assignment does not require the consent of the debtor's creditors (except under the laws of Massachusetts and Texas), the general law seems well established that any

9. Means v. Dowd, 128 U.S. 273, 9 S.Ct. 65, 32 L.Ed. 429 (1888).
10. *In re* Caruso-Sturcey Corp., 200 Misc. 936, 107 N.Y.S.2d 693 (1952).
11. Johnson v. Sharp, 31 Ohio St. 611 (1877).

creditor who either expressly or impliedly assents to or accepts the same is bound thereby, and is estopped from subsequently attacking the same or from acting as a petitioning creditor in the filing of an involuntary petition in bankruptcy against the debtor grounded on said assignment as an "act (the fourth) of bankruptcy."[12] Estoppel, however, will not operate where the creditor acted without the knowledge of the existence of such facts as would constitute concealed legal fraud. Only non-assenting creditors have the right to attack the validity of an assignment for the benefit of creditors.[13]

Since the common law permitted preferential payments to creditors, a common law (as distinguished from a statutory) general assignment is not deemed to be a fraudulent conveyance which provides for preferences to designated creditors.[14] However, all the states, except Georgia, Montana and Utah, have enacted statutes changing this common law rule, so that now preferences are almost universally prohibited.

STATUTORY ASSIGNMENTS FOR BENEFIT OF CREDITORS

Many states did a more extensive job than merely modifying the common law rule relating to preferences. Full-fledged statutes have been enacted which in general are a codification of the common law of general assignments.[15] The form of the state statute is either "regulatory" or "mandatory" as to compliance with its provisions.[16] This distinction is of extreme importance because a general assignment statute that is merely "regulatory" may or may not be followed, and when not so complied with, is deemed a common law general assignment. Where, however, the state statute is "mandatory", the failure to abide by its provisions will render the general assignment invalid. Generally stated, the determination of whether a given general assignment statute is regulatory or mandatory, lies in the absence or presence in the statute of the term "void" or its legal equivalent. In other words, where the statute expressly provides that the general assignment shall be void as to creditors, etc., unless its provisions are or have been complied with, a general assignment must follow the statutory provisions in order to be valid.[17] Where

12. Queen City Shoe Co. v. Commonwealth Loan Co., 134 F.2d 422 (1st Cir. 1943).
13. McKoin v. Rosenfelt, 66 Cal. App. 2d 757, 153 P.2d 55 (1944).
14. Brashear v. West, 7 Pet. 608, 8 L.Ed 801 (1833).
15. *E.g.,* GA. CODE ANN. § 28-3 (1933).
16. McKelvey v. Striker, 108 Colo. 320, 116 P.2d 921 (1941).
17. *In re* Forty Wall Street Corp., 258 App. Div. 108, 15 N.Y.S.2d 554 (1939).

the statute does not specifically denounce a general assignment as void for its failure to comply therewith, such a statutory assignment is valid whether it does or does not comply with the regulatory statutory provisions. Where it does so comply, it is a statutory assignment, and where it does not comply with the statute, it is a common law assignment. Some states recognize the validity of both a common law or a statutory general assignment.[18] Where the debtor resides in one of the few states which has no statute relating to an assignment for benefit of creditors, the common law is operative.

As was previously pointed out and here reiterated for emphasis, neither a common law nor a statutory general assignment for benefit of creditors operates as a discharge.[19] The debtor is still liable for the difference due his creditors between the amount he owed them and the amount of the pro-rata dividend or disbursement received by them. However, the debtor may expressly condition the receipt of the distributive dividend to his creditors upon their granting him his discharge; and where the state law has upheld the validity of such a common law general assignment, the Supreme Court felt bound to follow the state law.[20] It therefore seems established[21] that creditors who do accept such distributive dividends upon the condition that by doing so they are granting the debtor his discharge are estopped from objecting to the assignment on that ground, and that non-assenting creditors cannot be compelled to accept but may retain their respective claims and pursue their legal remedies. Obviously, therefore, the debtor may obtain his discharge but only if and to the extent that his several creditors are willing to grant it to him.

BULK SALES ACT AS A DEBTOR RELIEF DEVICE

The utilization of the universal statutes of the several states regulating the sale in "bulk" of all of debtor's property as a device short of bankruptcy has also met with a degree of popularity in appropriate factual situations.[22] Its major disadvantage of no discharge and its great advantages as to time, money and inconvenience are the reasons why this particular device is frequently the alternative choice of a debtor whose objective is "lawful" but speedy liquida-

18. Jones v. Fidelity Nat. Bank and Trust Co., 362 Mo. 712, 243 S.W.2d 970 (1951).
19. Swift & Co. v. Novotny, 28 N.Y.S.2d 562 (1941).
20. Brashear v. West, 7 Pet. 608, 8 L.Ed. 801 (1833).
21. *E.g.*, Tribune Co. v. Congor Floral Co., 312 Ill. App. 149, 37 N.E.2d 907 (1941) and numerous other cases.
22. See *Harris, The Bulk Sales As A Vehicle*, 55 COMM. L.J. 317, 321 (1950).

tion.[23] "Bulk Sales Acts", now in effect in every state, is a generic term descriptive of a class of statutes designed to prevent creditors from being defrauded by a secret or sudden sale in bulk of all or substantially all of a debtor's stock of goods.[24]

The general scheme of these statutes is to declare a sale in bulk of a debtor's business either fraudulent and void to the creditors of the vendor, or presumptively so, unless specified statutory formalities are observed.[25] Failure to comply with the state "Bulk Sales" statute is deemed to result in a fraudulent conveyance, and among other remedies creates an "act (first) of bankruptcy." Non-assenting creditors can, thereupon, utilize it as a basis for filing an involuntary petition in bankruptcy against an insolvent debtor.[26] However, compliance with the statute negatives a fraudulent conveyance.

Although every state in the Union has its "Bulk Sales Act",[27] their several provisions vary to such an extent that generalization is futile. Obviously, therefore, an examination of the statute and of the case law of the state of residence of the debtor (vendor) must be made to determine the nature and the extent of its applicability.[28] Thus, some states provide that failure of compliance renders the sale void per se, while other states make it voidable. The purchaser's status varies accordingly, but it is basically that of trustee for the benefit of debtor's (vendor's) creditors. Again, some states include a transfer of all or substantially all of the assets of the debtor, while other states cover specific forms of property, such as merchandise only, or debts contracted by the business only, etc.

For the purpose of emphasis, it must be remembered that compliance with the Bulk Sales Act saves the purchaser from any trouble with the debtor's (vendor's) creditors but, like the assignment for the benefit of creditors, the debtor is not discharged from his provable debts.[29] The debtor is still liable for the difference due his creditors between the amount he owes them and the size of the pro rata dividend or disbursement checks that each of them receives.

23. See Klaw v. Famous Players-Lasky Corp., 207 App. Div. 211, 201 N.Y.S. 691 (1923).
24. A. J. Long Cigar and Grocery Co. v. Harvey, 33 Ga. App. 236, 125 S.E. 870 (1924).
25. Thorpe v. Pennock Mercantile Co., 99 Minn. 22, 108 N.W. 940 (1906).
26. Jubas v. Sampsell, 185 F.2d 333 (9th Cir. 1950).
27. *E.g.*, GA. CODE ANN. § 28-2 (1933).
28. Lemieux v. Young, 211 U.S. 489, 29 S.Ct. 174, 53 L.Ed. 295 (1909).
29. Schwartz v. King Realty and Investment Co., 93 N.J.L. 111, 107 A. 154 (1919).

Interesting to note is that where there is noncompliance with the Bulk Sales Act, the statutes of several but not all states provide that creditors lose all rights to proceed against the purchaser unless affirmative action is taken within a stated period of time (usually ninety days) from the date of transfer.

COMMON LAW COMPOSITIONS

Legal historians are of the opinion that the composition settlement is probably the oldest form of rehabilitation, having its genesis in the customs and usages of ancient commerce.[30] An examination of textbook writers and judicial utterances[31] seems to correlate the essential elements of a common law composition into some such definition as this: a composition is an arrangement or agreement, voluntarily made by or entered into, between any type of debtor, generally insolvent or financially embarrassed, as one of the parties, and two or more of his creditors, secured and/or unsecured, as a second of the parties, and between such affected creditors themselves, as the third of the parties, by the terms of which the debtor offers, and the affected creditors accept, each for himself and for one another, either (a) a lesser amount in money or its equivalent than is due each of them, or (b) an extension of time within which the full amount will be paid, or (c) a combination of a scaling down of the original amount, payable part immediately and the remaining percentage over a stated period of time, in full payment and satisfaction of their respective debts, demands and claims; provided, however, that all such affected creditors are treated alike and that there is neither fraud on the part of the debtor nor secret preferences given to any of the participating creditors.[32]

Although a common law composition has been, and may be, used for the purpose of liquidation and concurrent discharge, its primary use envisages a retention and a continuation by the debtor of his business. Thus the debtor is given a fresh start, in the expectation that through this rehabilitory process, he will have solved his financial difficulties.

An extension, under the common law, is very much the same as a general composition.[33] The basic variation lies in the fact that

30. HOLDSWORTH, HISTORY OF ENGLISH LAW, p. 97.
31. *E.g.*, Myers v. International Trust Co., 273 U.S. 380, 47 S.Ct. 372, 71 L.Ed. 692 (1926.)
32. See Brown Shoe Co. v. Rowell, 237 Ala. 404, 187 So. 498 (1939).
33. Fisher Supply Co. v. Northwestern Gravel Co., 216 Iowa 909, 249 N.W. 664 (1933).

the arrangement contemplates payment in full, but extended over a period of time. Since an extension usually involves continued operation of the business by the debtor, the extension agreement should, and generally does, contain provisions aimed at protecting the creditors against possible deleterious dissipation of the assets left with and under the interim control of the debtor. Primarily, however, an extension is merely a variation (as to amount and time of payment) of the common law composition, and its validity and other legal implications are controlled by and have the same effect.

Another form of a common law composition is somewhat more specialized, in that it relates exclusively to a corporate debtor.[34] With cooperative stockholders and not-too-many creditors, a corporate debtor may reorganize itself by a reshuffling of the proprietary stock interests of its shareholders so as to make available a new issue of either preferred stock or other type of corporate securities to be exchanged for and with its creditors' claims.

The basic fact to remember is that a valid common law composi tion can only be brought into existence by the voluntary agreement of the debtor and those of his creditors (two or more) who choose to become parties thereto.[35] Any creditor who, for any reason or for no reason, does not care to participate in the arrangement, cannot be compelled to do so. A composition is "man-made," not "law-made". It is not statutorily created; nor is it imposed by "operation of law".

Courts are unanimous in insisting that a common law composition can only be valid where all the affected creditors are treated equally. That does not mean that such special type of creditors as those entitled to priority and those holding securities must divest themselves of their statutory benefits. In other words, a valid composition must not and need not treat all types of creditors, unsecured, secured, or priority, alike, and in the same class. "Equally" does not mean that. Nor does it mean that preferential treatment is prohibited as to any group of creditors of any one or all types. The sin does not lie in the manner of classification of, nor in the giving of preferences to, certain of debtor's creditors, but only in the failure to fully acquaint all participants with the fact of the preferences or the basis of favored classification, because the law implies that all creditors are being treated equally and that the participants are accepting the composition on

34. Klaw v. Famous Players-Lasky Corp., 207 App. Div. 211, 201 N.Y.S. 691 (1923).
35. Cumberland Glass Mfg. Co. v. Dewitt, 237 U.S. 447, 35 S.Ct. 636, 59 L.Ed. 1042 (1915).

that implication.[36] Obviously, the arrangement being the creature of voluntary agreement may, by express provision, nullify and negate this legal implication. So long as the creditors have full knowledge that all the participants are not to be treated equally, they cannot complain where they have voluntarily and knowingly acquiesced thereto.

Obviously, there must be an offer or plan or arrangement, on the one hand, and acceptance on the other.[37] These basic elements of a contract must exist, and all matters relevant thereto are governed by simple contract law. As with the offer, so with the acceptance, no formality is required to make the composition binding.[38] The point of primary importance is that there is a "meeting of the minds". No meeting of creditors nor formal promise is necessary, because the creditors are deemed to have communicated with one another through the debtor.

Obviously, a composition, being in the nature of a contract, must be bottomed on a valid consideration.[39] At the same time, it must be remembered that the agreement is (a) not only between the debtor and his creditors, but also (b) between the creditors themselves. It is on that basis that the courts hold valid an agreement to take a lesser amount where two or more creditors have accepted, as distinguished from an "accord and satisfaction" involving only one creditor, which has been held to be a nudum pactum for want of consideration.

Always to remember is that the terms and conditions of the composition are what are contained in the offer and acceptance taken together.[40] If it is contemplated that not all, but a described group (representing amounts, or percentages of number, etc.) of the creditors shall participate, a failure to so state that fact will cause the law to imply that the arrangement is not valid unless all have consented. If the debtor wants to classify his creditors for preferential and several treatment, the offer must so state specifically, or else the law will imply equal treatment for all creditors and a secret attempt to do otherwise will vitiate the composition.[41] If time of acceptance and/or effectiveness is to be of the essence, the offer

36. Hanover Nat. Bank of City of New York v. Blake, 142 N.Y. 404, 37 N.E. 519, 27 L.R.A. 336 (1894).
37. Johnson v. Parker, 34 Wis. 596 (1874).
38. Boudoin v. Giruard, 164 So. 430 (1st Cir. La. App. 1935).
39. Levine v. Blumenthal, 117 N.J.L. 23, 186 A. 457 (1936).
40. Atlas Engine Works v. First Nat. Bank, 50 Ind. App. 549, 97 N.E. 952 (1912).
41. Town of Dundee v. Pressgrove, 153 Fla. 671, 15 So.2d 448 (1943).

must specifically state such time, or else the law will imply a "reasonable time".[42] If good faith on the part of the debtor requires the making of any disclosures, knowledge thereof imported to the creditors destroys the implication of the law that bad faith or fraud is being perpetrated on unknowing creditors.

The universal legal principal that fraud taints and vitiates what it touches also finds application in a common law composition.[43] The law demands fairness and honesty on the part of the debtor. Where, therefore, the debtor's conduct embraces the traditional "five points" of actionable fraud, the aggrieved creditors may void the agreement. Materiality of the fact or facts involved, however, poses a question of fact rather than of law, and therefore, there has been and will continue to be a divergence of judicial opinion on what constitutes actionable fraud.[44]

COMMON LAW EXTENSIONS

Probably due to the fact that the common law has endowed an extension with most of the characteristics of a composition, the one term has seemingly become synonomous with the other.[45] However, there are some fundamental differences in objective, applicability and in legal implication. Furthermore, where the "composition" is an "extension" a more or less specialized procedure and modus operandi has been developed.

Philosophically, the consideration for the new agreement is the same, whether the arrangement proposes a scaling down of the liabilities or the mere postponement of their full payment. The agreement of the participating creditors, one with the other to be treated alike, is sufficient. There is a variance, however, in what they agree to do. Instead of the acceptance of a lesser amount, the mutual agreement relates only to extension of time for payment and forbearance from enforcing collection. The traditional provision reads in substance that they, the participating creditors, agree with the debtor and with one another to accept the schedule of payment set forth, and that, so long as the debtor performs the covenants and conditions required of him, they and each of them, collectively and severally, for themselves, their heirs, successors, and assigns, agree to forbear all

42. Bailey v. Union Central Life Insur. Co., 221 Iowa 1195, 268 N.W. 173 (1936).
43. Burgess. v. Simpson Grocery Co., 128 Ga. 423, 57 S.E. 717 (1907).
44. Boas v. Bank of America—National Trust and Savings Ass'n., 51 Cal. App.2d 592, 125 P.2d 620 (1942).
45. *In re* Thompson, 51 F.Supp. 12 (W.D. Va. 1943).

suits, actions or proceedings of any kind whatsoever for the collection or enforcement of their demands, and to stay any and all pending proceedings, and to accept payment of their several claims as provided in said arrangement agreement, often called the "trust deed".[46] Where the extension plan involves a corporate debtor, or a debtor whose reorganization contemplates the organization of a corporation as his successor, the proposal may provide for an immediate extension. Such an "on-the-spot" extension will be effected by the immediate issuance of bonds and/or debentures, and/or preferred or other type of senior stock. Obviously, the consideration for this form of extension is not stated as "extension-and-forbearance," but rather, the expression of mutuality is tailored according to the factual requirements of the plan.

Where the arrangement contemplates a postponement of payment of the debts for an extended period of six, and/or, twelve and/or more months, or where the payments are to be made in small percentage installments over a long period of time, the problem of the continued possession and control of his assets by the debtor becomes real and important.[47] Not so much because the debtor may wantonly and wilfully dissipate his assets, but rather because the creditors want a veto power over continued operation, has it become the usual and general thing for the creditors to insist, as a condition of acceptance of the extension proposal, that the creditors be given supervisory control of varying degrees and forms over the operation of the business during the life of the extension agreement. The stipulation relating to possession and control most frequently set forth in a common law extension agreement provides for the creation of a creditors' committee, or of a trustee, or of an administrative agent, or of an attorney-in-fact. Whatever form it takes, its function is the creation and appointment of some one or more representatives of the creditors who are contractually endowed with stated powers and defined duties.

CREDITORS' COMMITTEE

The creditors' committee is the agent of the participating creditors. Naturally, its authority is derived from these creditors. Generally, the simple rules of agency apply. Specifically, the extension agreement may spell out its authority, and thereupon, the committee, like any

46. National Bank of LaCrosse v. Funke, 215 Wis. 541, 255 N.W. 147 (1934).
47. A. F. Meyer Mfg. Co. v. Iowa Valley Sugar Co., 199 Iowa 797, 202 N.W. 570 (1925).

other agent, is bound thereby. Its members, moreover, are individually liable each for their own malfeasance or misfeasance. Honest mistake or the exercise of poor judgment is not actionable so long as it measures up to the "reasonable man" rule. Nonfeasance is measured by the "prudent man" rule. Generally, the agreement will endow the creditors' committee with sole and full discretion. Either the creditors will merely file their claims with the committee and subsequently express their authorization on specifically requested problems, or the creditors, at the outset, will absolutely assign their respective claims to the committee. Whatever powers and duties are entrusted to the creditors' committee by the debtor are also a matter of agreement. Generally, the first concern of the creditors, and therefore of their committee, is to set up some kind of protective machinery against dissipation or depreciation of assets, or against mismanagement of the business, during the period of extension-and-forbearance time. Veto power of varying degrees of extent and effectiveness is usually granted to the committee by the debtor. Power of liquidation during the extension period and before the expiration date is generally conceded by the debtor under stated conditions. Restrictions as to new credits and as to returns of merchandise are frequently included. The more concessions toward the protection of the participating creditors against future exigencies that may affect the full payment of their accounts, the easier the approval and acceptance of the arrangement.