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THE CORPORATE REORGANIZATIONS ACT

By Stanley Law Sabel*

"Owing to the delicacy of the situation and the judgment required, corporate reorganization is the most intricate phase of the whole field of finance, and one in which generalizations and precedents are least significant."1

With this warning in mind, let us analyze somewhat the new Corporate Reorganizations Act and venture, perhaps, some prophecies as to the future.

Reorganization law is difficult.2 In spite of this, the law as to the reorganization of corporations gradually became formulated.3 The equity receivership and the foreclosure sale served

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*Member of the New York Bar.
2It is assumed that the reader has some familiarity with the economic and legal problems involved in corporate reorganizations as well as with the general scheme of sec. 77-B of the Bankruptcy Act.
3This section, added by way of amendment to the Bankruptcy Act of 1898, was approved by the president June 7, 1934. Originally the act was contained in H. R. 5884 which subsequently became Pub. No. 296 of the 73rd Congress, second session, 11 U. S. C. A., sec. 207.

In general the new act allows corporations which could become bankrupt and railroads other than those engaged in interstate commerce to reorganize if they are insolvent in the equity or bankruptcy sense. It provides for voluntary and, when certain additional facts are shown, involuntary proceedings. Any substantial interest may propose a plan of reorganization. When the requisite number of various classes of creditors (two-thirds) or stockholders (one-half) assent to a plan, the minority of the assenting classes become bound thereby. Consent is not necessary for classes of creditors or stockholders not affected by the plan, and in the case of stockholders it is not necessary if the corporation is found to be insolvent in the bankruptcy sense. Provisions are made for securing the value of their claim when necessary to classes of creditors or stockholders of which less than the requisite number assent to a given plan. When a plan has been proposed in compliance with the machinery of the act, it must be passed upon by the court which must also decide whether or not "... it is fair and equitable and does not discriminate unfairly in favor of any class of creditors or stockholders, and is feasible. ..." If a plan is found by the court to be fair and to have been proposed in compliance with the act, it confirms the plan which thereupon becomes binding, and the reorganization is then effected.

This short sketch of the most essential steps necessary in a reorganization under sec. 77-B must not be taken as exhaustive or as a substitute for reading the provisions of the act in full.

3Rohrlich, Creditor Control of Corporations, Operating Receiverships, Corporate Reorganizations, (1933) 19 Corn. L. Q. 35.
for the mechanics of the reorganization process. The necessity of complying with the Boyd Case and the presentation of reorganization plans to the Court became law. More recently, the question of value and the need for enlightened judicial scrutiny have been emphasized by the courts. Detailed problems of administration were gradually worked out.

During the depression, this reorganization process was put to a greater test than ever before. Whether from over-expansion or the sheer force of compound interest, the debt structure of many companies was larger than they could bear. The cycle of liquidation caused many corporate failures. The criticisms which followed the increased volume of reorganizations were largely procedural in their nature. The jurisdictional ghost bothered some. Fictitious sales bothered a few. Ancillary proceedings


Northern Pac. Ry. v. Boyd, (1913) 228 U. S. 482, 33 Sup. Ct. 554, 57 L. Ed. 931 to the general effect that stockholders can not come ahead of creditors. Actually the Boyd Case was not new law but followed logically from Chicago, R. I. & P. Ry. Co. v. Howard, (1868) 7 Wall. (U.S.) 392, 19 L. Ed. 117.

The first large reorganization after the Boyd case practically required this as a condition precedent to the court confirming the foreclosure sale. See St. Louis-San Francisco Ry. v. McElvain, (D.C. Mo. 1918) 253 Fed. 123, 126.

For discussions of this phase of reorganization law, see Swaine, Reorganization of Corporations: Certain Developments of the Last Decade, in Some Legal Phases of Corporate Financing, Reorganization and Regulation, (1931) 133. Billig, Corporate Reorganization; Equity vs. Bankruptcy, (1933) 17 MINNESOTA LAW REVIEW 237, 259 et seq.


For the dual use of the term "jurisdiction" in this connection, see Sabel, Equity Jurisdiction in the United States Courts with Reference to Consent Receiverships, (1934) 19 IOWA L. REV. 406 et seq.

Rosenberg, Reorganization—The Next Step, (1922) 22 Col. L. Rev. 14, 26: 'If a sale is but a 'step in reorganization,' why not bury the fore-
were objected to by others, and so on down the line. The end result of the recapitalized corporation was objected to by none, while most people at all familiar with the subject realized that determining the capital structure of a particular reorganized company was a business rather than a legal problem.

The chief difficulty with the old methods was the same difficulty that always adheres in the haphazard development of procedural machinery. Some of the awkward results in the development of reorganization law were due to our particular governmental set-up. In essence, the mischief which existed and which was sought to be remedied by The Corporate Reorganizations Act was not substantive. This is borne out by a reading of the act. Questions which have long bothered contentious but possibly over-zealous reformers of the reorganization processes such as how far agreements with protective committees may bind depositors are not fully settled under the new act. Section 77-B does contain such provisions as the one providing for the preparing of a list of bondholders, creditors and stockholders which closure among the ancient relics of outworn practice?" But see, Swaine, Reorganization—The Next Step: A Reply to Mr. James N. Rosenberg, (1922) 22 Col. L. Rev. 121; cf. Phipps v. Chicago, R. I. & P. Ry. Co. (C.C.A. 8th Cir. 1922) 284 Fed. 945, certiorari granted (1923) 261 U. S. 611, 43 Sup. Ct. 363, 67 L. Ed. 826, dismissed, per stipulation, (1923) 262 U. S. 762, 43 Sup. Ct. 701, 67 L. Ed. 1221. 12Laughlin, Extraterritorial Powers of Receivers, (1932) 45 Harv. L. Rev. 429. See also Sabel, Suits by Foreign Receivers, (1934) 19 Corn. L. Q. 442; Rose, Extraterritorial Actions by Receivers, (1933) 17 MINNESOTA LAW REVIEW 704.

13This point of view is brought out in an able article, Phillips, A Business Tribunal for Corporate Reorganizations, (1933) 11 Harv. Bus. Rev. 178.

14An example of this is the necessity in federal receivership proceedings of having federal jurisdiction based upon diversity of citizenship. See Warren, Corporations and Diversity of Citizenship, (1933) 19 Va. L. Rev. 66.

15The Act provides that acceptance of a plan may be filed "on behalf of creditors ... and ... on behalf of stockholders." Sec. 77-B subdivision (e) clause (1). On the other hand, it is provided that "... the judge shall scrutinize and may disregard any limitations or provisions of any depositary agreements, trust indentures, committee or other authorizations affecting any creditor acting under this section and may enforce an accounting thereunder or restrain the exercise of any power which he finds to be unfair or not consistent with public policy and may limit any claims filed by such committee member or agent, to the actual consideration paid therefor." Sec. 77-B subdivision (b). This latter provision probably does not change the prior law which always recognized the fact that deposit agreements were contracts and that their terms could not be disregarded at will. See Habrishaw Electric Cable Co. v. Habrishaw Electric Co., (C.C.A. 2nd Cir. 1924) 296 Fed. 875; Cox v. Stokes, (1898) 156 N. Y. 491, 51 N. E. 316; Sabel, Unauthorized Expenditures by Bondholders’ Protective Committees, (1934) 18 MINNESOTA LAW REVIEW 784, 786.
may be inspected by any creditor or stockholder. As regards the list of bondholders, this is a reform designed possibly to weaken the position of bankers who underwrite the bonds or act as paying agents for the coupons. It is a minor reform that would probably have taken place without the new Act. That it was not the moving force behind the enactment of section 77-B is seen from the fact that a plan of reorganization may be accepted and presumably committees formed before the filing of a petition or answer. Certainly, the act does not take away the banker's eminence with the sweeping strokes of a reform measure. Rather, it seems that this provision as to lists of bondholders is comparable to the provisions at the end of the Act guaranteeing to present or prospective employees of the debtor corporation the right to belong to unions of their own choice. Neither of these provisions can be construed as the moving force behind the enactment of the act taken as a whole. They merely show us that would-be reformers are not above log-rolling.

In many of the controversial phases of reorganization law the prior practice is adopted in toto under the new act. This is true in the case of the "six months' rule." The act provides that unsecured claims which would have been preferred "over existing mortgages" in an equity receivership shall be entitled to "such priority" in proceedings under section 77-B. At its best, this adopts the prior practice. At its worst, a court could almost interpret this priority away. Certainly a court could say that this provision would not apply to supply claims, etc., which under the "six months' rule" as worked out did not have priority over existing mortgages as to corpus but only had priority as to

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19 The act provides that the judge "... may direct the debtor, or the trustee or trustees if appointed to prepare (a) a list of all known bondholders and creditors of, or claimants against, the debtor or its property, and the amounts and character of their debts, claims, and securities, and the last known post-office address or place of business of each creditor or claimant, and (b) a list of the stockholders of each class of the debtor, with the last known post-office address or place of business of each, which lists shall be open to the inspection of any creditor or stockholder of the debtor, during reasonable business hours, upon application to the debtor, or to the trustee or trustees, if appointed, and the contents of such lists shall not constitute admissions by the debtor or trustees in a proceeding under this section or otherwise." Sec. 77-B subdivision (c) clause (4).


18 Sec. 77-B subdivision (e) clause (1).

19 Sec. 77-B subdivisions (1) and (m).

20 Sec. 77-B subdivision (b).
income and secondarily as to corpus where the income was diverted so as to benefit bondholders. At any rate, the "six months' rule" is not reformed, sed quaere if it is crystallized in its present unsettled form.

Similar to this is the provision as to receivers' certificates. The new act provides that the court may authorize the issuance of certificates "with such security and such priority in payment over existing obligations, secured or unsecured, as may be lawful in the particular case." A literal interpretation of this language would be to the effect that the lien of such certificates could only come ahead of prior mortgagees without the mortgagees' consent in the case of ordinary mercantile corporations in the relatively few cases that this priority had hitherto been regarded as necessary. Here again it looked as if prior law may have been adopted in its present unsatisfactory form by section 77-B.

A trustee, when one is appointed under section 77-B, in addition to his powers as a bankruptcy trustee may be given by the judge the powers of a "receiver in equity," so far as consistent with other provisions in the new act. The court itself is given the powers which a federal court would have if it had appointed

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22How indefinite this rule remains at present is shown by FitzGibbon, The Present Status of the Six Months' Rule, (1934) 34 Col. L. Rev. 230. See also Fordham, Preferences of Prereceivership Claims in Equity Receiverships, (1931) 15 MINNESOTA LAW REVIEW 261.

23Sec. 77-B subdivision (c) clause (3).

24In Lockport Felt Co. v. United Box Board & Paper Co., (1908) 74 N. J. Eq. 686, 70 Atl. 980 the issuance of prior lien certificates was regarded as necessary in order to obtain money with which to make sinking fund payments on prior obligations, and the certificates thus issued were held valid. Usually in the case of an ordinary mercantile corporation receivers' certificates can not displace the mortgage lien without the consent of the mortgagees.

In the case of railroads and other public utilities the public interest in uninterrupted service (as well as the value of the property—its earning capacity depending on this) has long made it proper for a court to issue certificates to borrow money with which to operate the property and give a lien ahead of secured creditors. Union Trust Co. v. Illinois Midland Ry. Co., (1886) 117 U. S. 434, 9 Sup. Ct. 809, 29 L. Ed. 962. See Cutcheon, Recent Developments in Federal Railroad Foreclosure Procedure (1927) in Some Legal Phases of Corporate Financing, Reorganization and Regulation, (1931) 79, 99-105.

25Sec. 77-B subdivision (c) clause (2). This provision has been held to empower the court to authorize the trustee to make a cash settlement with a claimant if for the best interest of the estate notwithstanding the fact that the proposed reorganization may not ever be consummated. In re Paramount Publix Corp., (D.C. N.Y. 1934) 7 F. Supp. 988.
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an equity receiver because of the debtor's inability to pay its debts as they mature.26 The alternative basis of jurisdiction adopted by section 77-B, i.e., the debtor being "unable to meet its debts as they mature"27 is the definition of insolvency which always applied in equity.28 In short, all these provisions incorporate rather than reform the prior law.

Let us consider, on the other hand, the situations in which the new act makes substantial progress. Under section 77-B, it is permissible for the debtor corporation29 to admit all the allega-

26Sec. 77-B subdivision (a). This provision, too, was invoked in In re Paramount Publix Corp., (D.C. N.Y. 1934) 7 F. Supp. 988.
27Sec. 77-B subdivision (a).
28Glenn, Fraudulent Conveyances 364. This is the so-called "commercial definition" of insolvency; it resembles closely the definition of insolvency found in modern European codes, i.e., a cessation of payment. See Hanna, Cases on Creditors' Rights 527, note 2.

The present U. S. Bankruptcy Act (1898) defines insolvency as an excess of liabilities over assets at a fair valuation. Bankruptcy Act, sec. 1 subdivisions (15), 11 U. S. C. A. sec. 1 (15). This definition is very favorable to debtors. It was not contained in earlier bankruptcy legislation. For example, the Bankruptcy Act of 1867 did not define insolvency, but the judicial test applied was inability to pay debts as they matured in the course of business. See Buchanan v. Smith, (1873) 16 Wall. (U.S.) 277, 21 L. Ed. 280.

29By definition the act applies to "any corporation which could become a bankrupt under section 4 of this Act, and any railroad or other transportation corporation, except a railroad corporation authorized to file a petition or answer under the provisions of section 77 of this act. . . ." (Sec. 77 provides for reorganization of railroads engaged in interstate commerce. It was added to the Bankruptcy Act in 1933 by the first session of the 73rd Congress. 47 Stat. at L. 1474, 11 U. S. C. A. sec. 205. With the exception of the part played by the Interstate Commerce Commission in passing on the various proceedings, sec. 77 is similar, though less worked out in detail, to sec. 77-B. The most important single difference between these two sections is that in proceedings under sec. 77 the court must appoint a trustee while in proceedings under sec. 77-B the court can let the debtor corporation retain control of its property). For a critical study of the railroad reorganization section see Rogers and Groom, Reorganization of R. R. Corporations under Sec. 77 of the Bankruptcy Act, (1933) 33 Col. L. Rev. 571; Lowenthal, The Railroad Reorganization Act, (1933) 47 Harv. L. Rev. 18.

Sec. 4 of the Bankruptcy Act provides that any person, except a municipal, railroad, insurance, or banking corporation, or building and loan association, may become a voluntary bankrupt. This section further limits involuntary bankruptcy in the case of corporations so as to apply only to "moneied, business, or commercial" corporations. The incorporation of sec. 4 in Sec. 77-B thus raises an interesting question. Sec. 77-B provides for "involuntary" proceedings thereunder instituted by creditors against "any corporation." Sec. 77-B, subdivision (a). If the definition of corporation as including any corporation which could become a bankrupt under sec. 4 is accepted, it looks as if involuntary proceedings might be brought under Sec. 77-B against charities etc. which were not previously subject to involuntary bankruptcy.

See In re Union Guarantee & Mortgage Co., (D.C. N.Y. 1934) 26 Am. B. R. (N.S.) 13, holding a guarantee and mortgage company to be in
tions in an involuntary petition. Likewise, the debtor itself may file a petition, or answer if bankruptcy proceedings have already been begun, seeking the benefits of section 77-B. There is no question of equity jurisdiction in whatever sense that word is used. Ancillary proceedings are eliminated as the jurisdiction of the court includes the property of the debtor wherever located. The court may continue the debtor in possession of its

fact an insurance company and not entitled to reorganize under sec. 77-B. The court said, "The guarantee of mortgages is a type of insurance." To the same effect, In re National Surety Co., (D.C. N.Y.) 7 F. Supp. 959.

"If such answer [by the debtor] shall admit (a) the jurisdiction of the court and (b) the material allegations of the petition, the court shall enter an order approving the petition as properly filed under this section if satisfied that it complies with this section and has been filed in good faith, or dismiss it if not so satisfied." Sec. 77-B subdivision (a).

"Any corporation... may file an original petition, or, before adjudication in an involuntary proceeding, an answer, or in any proceeding pending in bankruptcy, whether filed before or after this section becomes effective, provided the present operations of such corporation do not exclude it hereunder, and whether or not the corporation has been adjudicated a bankrupt, a petition... etc." Sec. 77-B subdivision (a). In this connection consider the broad bankruptcy definition of "Corporations" as meaning "All bodies having any of the powers and privileges of private corporations not possessed by individuals or partnerships..." This includes joint stock companies, unincorporated companies and associations and some types of business trusts. Bankruptcy Act sec. 1, subdivision (6); In re Lloyds of Texas, (D.C. Texas 1930) 43 F. (2d) 383. Apparently such organizations would come within Sec. 77-B.

The broadness of the term "corporation" as used in Section 77-B is illustrated by In re 211 East Delaware Place Building Corporation (D.C. Ill. 1934) 7 F. Supp. 892, 895, 26 Am. B. R. (N.S.) 198. In that case, after the approval of a creditors' petition under Section 77-B, the Illinois supreme court upon application of the Attorney General of Illinois dissolved the debtor for failure to pay the annual franchise taxes. The district court nevertheless held that the paramount jurisdiction of the bankruptcy court continued. The court said: "Notwithstanding such declaration of forfeiture, the corporation's property must be properly distributed. It cannot be constitutionally distributed, liquidated or administered if this paramount jurisdiction of the bankruptcy court is to be maintained in any forum other than the bankruptcy court itself.

"Congress, by recent legislation, has extended the district court's jurisdiction to reorganization of the res, and it cannot, by any logical process of thought, be concluded that it was the purpose of Congress to surrender any of the court's paramount jurisdiction, namely, the administration, liquidation, and distribution of the property of a corporation, even though the state authorities have taken away the charter of the corporation."

See Sabel, Equity Jurisdiction in United States Courts with Reference to Consent Receiverships, (1934) 19 Iowa L. Rev. 406 et seq.

Sec. 77-B subdivision (a). See H. R. Rep. of the Judiciary Committee on H. R. 5884. This report was subsequently adopted by the Senate Judiciary Committee. The elimination of ancillary proceedings is referred to therein as one of the chief objectives to be achieved by the new Act. The economic absurdity of always requiring ancillary proceedings is pointed out in Sabel, Suits by Foreign Receivers, (1934) 19 Corn L. Q. 442, 452. The new procedure is certainly more efficient. Under the new act, how-
property instead of appointing a trustee.\textsuperscript{34} The debtor corporation itself may be the reorganized company.\textsuperscript{35} These provisions are clearly for the most part procedural, in so far as the distinction between procedure and substance means anything at all.

There remain the two chief features of section 77-B to be considered before we can form a precise view of the nature of this section. First, the new Act binds minorities to a given plan to which the rest of a particular class have assented. If two-thirds of any class of creditors or a majority of any class of stockholders assent to a plan of reorganization, the rest of the class are bound.\textsuperscript{36} Provision is also made in the act for the alternative satisfaction of dissenters where less than the requisite number of a class assent.\textsuperscript{37} Assent or alternative satisfaction is ever, proceedings must be brought in the proper jurisdiction as provided in the act. “The petition shall be filed with the court in whose territorial jurisdiction the corporation, during the preceding six months or the greater portion thereof, has had its principal place of business or its principal assets, or in any territorial jurisdiction in the State in which it was incorporated.” Sec. 77-B, subdivision (a). Likewise a transfer of proceedings to a jurisdiction not included in the statute will not be allowed. In re Midland United Co. (D. Del. 1934) 8 F. Supp. 92; see also In re Syndicate Oil Corp. (D. Del. 1934) 8 F. Supp. 213. See also In re Con. Gas Utilities Co., (D.C. Del. 1934) (not yet officially reported) holding that the principal place of business of a corporation in receivership is the state of primary receivership proceedings.\textsuperscript{38} Apparently this may only be done temporarily. The act provides that the judge “...may, after hearing upon notice to the debtor and to such others as the judge may determine, temporarily continue the debtor in possession or appoint a trustee or trustees of the debtor’s estate...” Sec. 77-B, subdivision (c). The railroad reorganization section of the Bankruptcy Act contains no such provision authorizing the judge to continue a railroad in possession of its property. See Sec. 77.

\textsuperscript{35}Sec. 77-B subdivision (b) clause (9). See H. R. Rep. of the Judiciary Committee on H. R. 5884.

This idea is not new. This was done in the much discussed case of Phipps v. Chicago, R. I. & P. Ry. Co., (C.C.A. 8th Cir. 1922) 284 Fed. 945, certiorari granted (1923) 261 U. S. 611, 43 Sup. Ct. 353, 67 L. Ed. 826, dismissed, per stipulation, (1923) 262 U. S. 762, 43 Sup. Ct. 701, 67 L. Ed. 1221. This case probably rests upon its own peculiar facts.\textsuperscript{39}

A plan will not be confirmed unless it has been accepted by the requisite number of all classes of creditors or stockholders, their acceptance excused or their claims otherwise satisfied. Sec. 77-B subdivision (f). Thus, when a plan has been confirmed, the act simply provides that it then becomes binding on “(1) the debtor, (2) all stockholders thereof, including those who have not, as well as those who have, accepted it, and (3) all creditors, secured or unsecured, whether or not affected by the plan, and whether or not their claims shall have been filed, and, if filed, whether or not approved, including creditors who have not, as well as those who have, accepted it.” Sec. 77-B subdivision (g).

\textsuperscript{37}Sec. 77-B subdivision (b) clauses (4) and (5). In such a case their assent to the plan is then dispensed with. Sec. 77-B subdivision (e) clause (1).
not needed as to classes of claimants which will not be affected by the plan, or in the case of stockholders if the corporation is insolvent in the bankruptcy sense. The judge must see that these provisions are complied with before he confirms a given plan of reorganization. Hitherto, the dissenting bondholders, other creditors and probably stockholders, so far as there was any equity in the property for them, had a right to cash. That is, in the case of the usual reorganization which involved a foreclosure of one or more of the mortgages on the debtor's property, the dissenters had a right to their distributive share of the amount bid at a foreclosure sale. The upset price at which the property was sold, or more realistically speaking taken over by the foreclosing bondholders, was practically always sufficiently low so that this distributive share of the proceeds of the sale would be less than the market value of the securities offered under the reorganization plan. This was one function of the upset price—to force dissenters of a particular class into a reorganization. It did not always work as beautifully as this statement would seem to indicate, for another function of the upset price, to be referred to later on in this article, might sometimes tend to cause a price too high to force in all dissenters. There was a certain leeway for judicial discretion in deciding how much pressure should be used by way of low upset price to force dissenters into a reorganization. It was said under the old practice that there existed

38Sec. 77-B subdivision (e) clause (1).  
39Sec. 77-B subdivision (e) clause (1). This must mean insolvent in the bankruptcy sense as where the equity meaning is intended the act uses the phrase "unable to meet its debts as they mature." See subdivision (a).  
40Swaine, Reorganization—The Next Step: A Reply to Mr. James N. Rosenberg, (1922) 22 Col. L. Rev. 121.  
41Frank, Some Realistic Reflections on Some Aspects of Corporate Reorganization, (1933) 19 Va. L. Rev. 541, 553. This function of the upset price seems limited by First Nat'l Bk. of Cinn. v. Flershem, (1934) 290 U. S. 504, 54 Sup. Ct. 298, 78 L. Ed. 388, at least where insolvency is only prospective. According to In re South Coast Co. (D.C. Del. 1934) 8 F. Supp. 43, the test would be whether or not the corporation is "in need of reorganization."  
42Weiner, Conflicting Functions of the Upset Price in a Corporate Reorganization, (1927) 27 Col. L. Rev. 132. Cf. the procedure previously adopted in reorganizations which were conducted under the older sections of the Bankruptcy Act. In re Prudential Outfitting Co. of Delaware, Inc. (D.C. N.Y. 1918) 250 Fed. 504.  
43Even after First Nat'l Bk. of Cinn. v. Flershem, (1934) 290 U. S. 504, 54 Sup. Ct. 298, 78 L. Ed. 388, it is submitted, a certain amount of pressure could be used where the corporation was clearly insolvent and therefore in need of reorganization. See In re South Coast Co. (D.C. Del. 1934) 8 F. Supp. 43.
an absolute right on the part of dissenters to have a judicial
sale. That question was never finally determined, and its
answer now would depend upon how a majority of nine old gentle-
men in Washington would vote on a question which probably
now will never arise. At any rate, under the old practice a dis-
tributive share of the proceeds of a judicial sale was never an
alternative in any true sense of the word. What change then
is wrought by the provisions of section 77-B? The point at
which the alternative ceases and the minority become bound is
now determined by legislative declaration—two-thirds of each
class of creditors, a majority of each class of stockholders. De-
termination of this point which had hitherto been vague, accom-
plishing under the bankruptcy power what had hitherto been
done by the upset price, does not change greatly the substance
of the situation.

Secondly, the new act should be considered as it bears on the
relationship between the different classes of creditors and stock-
holders. Before the judge is authorized to confirm a plan of re-
organization, he must find, in addition to the fact that the consent
of the requisite number of all classes has been obtained or dis-
pensed with as noted above and certain other more or less routine
findings, that the plan "is fair and equitable and does not dis-
criminate unfairly in favor of any class of creditors or stock-
holders . . ." This involves, among other things, an appli-
cation of the doctrine of the Boyd Case to the general
effect that creditors come ahead of stockholders. It also would
seem to involve application of another function of the upset price,
i.e., that even the underlying bondholders, in a reorganization
which did not include stockholders, should not obtain the prop-
erty on foreclosure at a price so disproportionately low as to shock
the conscience of the equity court. In this connection, it has
been said that section 77-B should take the emphasis from the
foreclosure sale and place it on the reorganization plan. It is
submitted that this is not so.

44Swaine, Corporate Reorganization Under the Federal Bankruptcy
Power, (1933) 19 Va. L. Rev. 317, 324.
45Though of course under the old procedure some cash would be paid
out in any reorganization. Analytically this may be looked at as an expense
of reorganization, which is now eliminated.
46Sec. 77-B subdivision (f).
554, 57 L. Ed. 931.
48Weiner, Conflicting Functions of the Upset Price in a Corporate
Reorganization, (1927) 27 Col. L. Rev. 132.
49Frank assumes this possible. Frank, Some Realistic Reflections on
A plan of reorganization involves apportioning certain assets among certain claimants. To do this, claims must be evaluated and so must assets. Once these values are arrived at, a plan may be shown by simple mathematics to be demonstrably fair. This does not mean that the plan of reorganization ultimately adopted must in all respects be identical with the simplest type of plan that can be demonstrated mathematically to be fair. This yardstick type of plan in any situation is only one of many that might meet the requirement of fairness. The plan adopted can be quite complicated. It may involve many classes of securities possessing various conversion rights and subject to various redemption provisions. It may also involve the setting up of subsidiaries and subsidiary parents of sub-subsidiaries and the transferring of some of the debtor's assets to one and some to another of these companies so set up. If we were possessed of foresight, such plans would be inequitable precisely so far as they ultimately would give any class of creditors or stockholders a share in the totality of what was formerly the debtor's assets different from what such class would have been entitled to under a yardstick plan. If we could so forecast the future, reorganizations would never be necessary, as the corporation would never have become overcapitalized in the first place. We are thus forced to conclude that inasmuch as we are not possessed with foresight, plans differing from the yardstick type of plan cannot per se be said to be inequitable if each class of creditors and stockholders has a reasonable chance under such a plan of faring as well as it would have fared under the yardstick type of plan. The judicial sale has always served to educate the court on the values necessary to formulate a yardstick plan in a given case and thus to enable the court to pass more readily on the fairness of the plan presented. (If all the property is sold, we have a value for the assets. If only the mortgaged property is sold—to the bondholders qua mortgagees—a claim becomes evaluated.\(^5\)) From this point of view the sale was never the empty ritual which the uninitiated claim it to have been.

True, under the new act, the court's determination that a plan

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\(^5\) Weiner, Conflicting Functions of the Upset Price in a Corporate Reorganization, (1927) 27 Col. L. Rev. 132, 147 refers to the fact that the upset price also serves to determine the amount of the bondholders' claim against unmortgaged assets qua deficiency judgment.
is fair and equitable is probably more binding than before. The
in rem proceedings bind the whole world, and no question akin
to fraudulent conveyances can ever arise.51 Like any jurisdictional
problem, this is procedural. The fact remains that it is not true
that section 77-B takes the emphasis away from valuation. In
fact, what appear to be four distinct tests of value, to be used for
different purposes, are laid down in the new act. If some or all of
this possible valuation has taken place, a court can pass more
easily on the fairness of a plan. Of these tests, "fair value,"52
upset price,53 appraisal value54 and the value of security according

51 In re 211 East Delaware Place Building Corporation (D.C. Ill. 1934)
7 F. Supp. 892, 895 referred to the new jurisdiction as "reorganization of
the res." Chicago, R. I. & P. Ry. Co. v. Lincoln Horse & Mule Commission
Co., (C.C.A. 8th Cir. 1922) 284 Fed. 955 under the old procedure held a
barring order effective as to a nonresident creditor who received notice
thereof. It would seem that, apart from the new act, such an order would
not be effective as to a nonresident who did not have such notice. See
Frank, Some Realistic Reflections on Some Aspects of Corporate Reorgani-
zation, (1933) 19 Va. L. Rev. 698, 706.

52 In determining whether the corporation is insolvent in the bankruptcy
sense so that stockholders' assent may not be needed in order to effectuate
a reorganization, the court will apply the bankruptcy definition of insolvency.
This definition provides that a person shall be deemed insolvent when his
assets shall not "... at a fair valuation, be sufficient in amount to pay
his debts." Bankruptcy Act Sec. 1. subdivision (15). In applying this
test the court seeks to apply the "fair value" test to assets. See Bonbright
and Pickett, Valuation to Determine Solvency Under the Bankruptcy Act.
(1929) 29 Col. L. Rev. 582. Where there is only enough equity in the
property for the preferred or for a prior class of stockholders, logic would
 dictate that the assent of the common or the deferred stockholders, as the
case may be, should be dispensed with; however, the act does not so provide.

53 This is applied as one of the means of providing for dissenting stock-
holders realizing the value of their equity "... by a sale of the property at
not less than a fair upset price. ..." Sec. 77-B subdivision (b) clause
(4). It is also applied as one of the means of providing for dissenting
creditors realizing the value of their interest "... by a sale free of such
interests, claims, or liens at not less than a fair upset price and the transfer
of such interests, claims, or liens to the proceeds of such sale. ..." Sec.
77-B subdivision (b) clause (5). (As already noted such methods of
alternative satisfaction are not necessary where the requisite number of a
class assent or their assent is otherwise dispensed with.)

54 This is applied as one of the means of providing for dissenting stock-
holders realizing the value of their equity "... by appraisal and payment in
cash of the value either of their stock, or at the objecting stockholders' 
election, of the securities allotted to such stockholders under the plan, if
any shall be so allotted. ..." Sec. 77-B subdivision (b) clause (4). It is
also applied as one of the means of providing for dissenting creditors realizing
the value of their interest "... by appraisal and payment either in cash
of the value either of such interests, claims, or liens, or, at the objecting
creditors' election, of the securities allotted to such interests, claims, or
liens under the plan, if any shall be so allotted. ..." Sec. 77-B subdivision
(b) clause (5). (As already noted such methods of alternative satisfaction
are not necessary where the requisite number of a class assent or their as-
sent is otherwise dispensed with.)
to section 57 (h), the last will be the most important. As noted at greater length further on in this article, the court in applying section 57 (h) can conveniently use "litigation" either in, or outside of, the bankruptcy court to determine the value of the security under a corporate mortgage. Value thus found can well form a basis both for determining the terms upon which the mortgagees who are foreclosing, and whomever else they let in with them, get the mortgaged property and for determining the extent of their claim qua deficiency against other assets of the debtor corporation.

Value found for other purposes, as dispensing with stockholders' consent or securing to non-assenting stockholders or creditors the value of their claim, though of somewhat less importance, may likewise be used by the court in determining the fairness of a plan. It is thus impossible to say that the new act shifts the emphasis from value to fairness. The two are inseverably connected, and, practically, such a shift could only be one of degree. That the emphasis is not so shifted is so even

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55The act provides that the judge shall determine "... for the purpose of the plan and its acceptance, the division of creditors and stockholders into classes according to the nature of their respective claims and interests; and may, for the purpose of such classification, classify as an unsecured claim, the amount of any secured claim in excess of the value of the security therefor, such value to be determined in accordance with the provisions of section 57, clause (h), of this act. ..." Sec. 77-B subdivision (c) clause (6). See also subdivision (b) to the effect that in the case of secured claims entitled to alternative satisfaction the value of their security should be determined by applying sec. 57 subdivision (h) and the excess classified as an unsecured claim.

Sec. 57 subdivision (h) provides: "The value of securities held by secured creditors shall be determined by converting the same into money according to the terms of the agreement pursuant to which such securities were delivered to such creditors or by such creditors and the trustee, by agreement, arbitration, compromise, or litigation, as the court may direct, and the amount of such value shall be credited upon such claims, and a dividend shall be paid only on the unpaid balance."

56Sec. 77-B subdivision (e) clause (1).
57Sec. 77-B subdivision (b) clauses (4) and (5).
58It is not always necessary to dispense with stockholders' assent or secure to stockholders or creditors the value of their claim as in many cases the consent of a sufficient number of each class may be obtained. On the other hand, in a reorganization of any size there will be secured creditors. For the important part played by secured creditors in most reorganizations, see Dewing, Financial Policy of Corporations, 3rd ed., 1205. It seems to the present writer that it would often be convenient to classify such creditors.

59While no shift in emphasis is made, the purpose for which each valuation is made becomes more apparent under the new Act. Even this is not entirely true as a valuation made in order to give alternative satisfaction to stockholders or creditors of a class of which less than the requisite number have assented to a given plan might later be used in connection with the fairness of the plan.
though the reorganization managers can now rely, to some extent at least, on a presumption of fairness from having complied with the machinery of the act. Again the end result is procedural. Tests of value hardly more definite than before may be used in steps along the line. In all such cases, the standards are those which a court could have used before in like situations. Their detailed application, we repeat, is procedural.

Our conclusion thus arrived at that the new act is adjective must not be taken as an adverse criticism. In previous articles, the writer has commented favorably on the act while in its formative stages and advocated its passage. An analysis of the reorganization processes under the new Act shows that it largely involves a question of fitting business expediency into legal machinery. The conclusion that the new Act is largely a procedural, though an important, change should be of aid in its interpretation. The whole of the new act, as a description of the reorganization processes, cannot be found within the four corners of section 77-B. The true meaning of all but the simplest of statutes is seldom so found. Interpreting the new act as procedural, we

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60 An analogy for this can be found in compositions under sec. 12 of the Bankruptcy Act. The court must find that a proposed composition under that section is for the best interest of all the creditors. This question has been treated as primarily for the decision of the creditors themselves, and the assent of a majority is prima facie evidence that the composition will be for the best interest of all. Such assent throws the burden of proof on those who oppose the composition. Black, Handbook on the Law and Practice in Bankruptcy 655. A similar approach has been made to this problem in reorganization law. In Jameson v. Guaranty Trust Co. of N. Y., (C.C.A. 7th Cir. 1927) 20 F. (2d) 808, 815, arising out of the Chicago, Milwaukee & St. Paul Ry. Co. reorganization, the court said: "While in such matters majorities do not govern, the approval thus signified by this vastly greater number, whose interests are identical in kind with those of the objectors, is entitled to much weight in determining whether or not the plan is equitable and fair."

61 See Sabel, Suits by Foreign Receivers, (1934) 19 Corn. L. Q. 442, 451 note 43; Sabel, Unauthorized Expenditures by Bondholders' Protective Committees, (1934) 18 MINNESOTA LAW REVIEW 784, 791, where the author said in note 31: "The very theory underlying modern statutory schemes of reorganization is that of taking away too much power from the dissenter in cases where a substantial majority favor a given plan." This was said in support of the proposition that "theoretical jurisprudence does not always function so well in these days of obstreperous minorities."

62 The old law of receivership-reorganizations, though admittedly imperfect in many respects and not fully formulated in others, may be taken as representing a judicial balancing of the various interests involved.


64 An example of this is seen in the recent brilliant article by Neville, Tying Clauses and Resale Price Maintenance Under the Patent and Anti-Trust Laws, (1934) 4 DETROIT L. REV. 143.
have a formula for judging decisions rendered thereunder: The efficacy of a particular decision interpreting section 77-B varies directly with its favoring majority rule and speeding up the adoption of a plan and inversely with the possibility of holdups and tendency to cause delay.65

Whether our approach to the act is the result of the legal desire to avoid change, such as the legal inertia which made previous generations cling to forms of actions in spite of code provisions abolishing them, or whether our approach will be the one ultimately adopted by the courts can be answered to some extent at least by attempting to apply it to a few of the early decisions rendered under section 77-B.

In re Laclede Gas Light Co.,66 involved an interpretation of an ambiguous clause in the new act. The act provides that, in the case of "involuntary"67 proceedings instituted by creditors,68 in order to have the petition approved by the court, the petitioners must allege and prove, among other things and in addition to the fact that the debtor is insolvent or unable to meet its debts as they

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65This approach has been applied in other phases of adjective law. See Chaffee, Progress of the Law, 1919-1922 Evidence, II, (1922) 35 Harv. L. Rev. 428. That it is applicable to our problem is sustained by In re South Coast Co. (D. Del. 1934) 8 F. Supp. 43, 45, where the court said: "Whether reorganization should be effected in equity or in bankruptcy was a choice of means." See also In re Flamingo Hotel Co. (D.C. Ill. 1934) (not yet officially reported) where the court said in speaking of sec. 77-B, "This act, obviously, is remedial in character."

66(D.C. Mo. 1934) (not officially reported).

67This word is used advisedly. The act in this connection simply refers to creditors filing a petition. Sec. 77-B subdivision (a). In such cases the answer by the debtor may admit the jurisdiction of the court and the material allegations of the petition. Sec. 77-B subdivision (a).

68Such proceedings may be initiated by "three or more creditors who have provable claims against any corporation which amount in the aggregate, is excess of the value of securities held by them, if any, to $1,000 or over." Sec. 77-B subdivision (a). Just what constitutes one a creditor has received some interpretation. In re Prudence-Bonds Corporation (D.C. N.Y. 1934) (not yet officially reported) held that mortgage certificate holders who held certificates issued by the debtor secured by property deposited with a trustee or with a depositary were creditors. In re 1030 North Dearborn Bldg. Corp., (D.C. Ill. 1934) 7 F. Supp. 896, 25 Am. B. R. (N.S.) 519 held that neither a corporation claiming its own property, a bondholders' committee which did not show that it was the owner of the requisite amount of securities (i.e. more than $1,000 in excess of the values of securities held by them), nor the corporate trustee under a deed of trust securing the debtor's bonds were creditors within the meaning of the provision of subdivision (a) of section 77-B authorizing creditors to appear and controvert the allegations in a petition. In re Draco Corp. (D.C. N.Y. 1934) (not yet officially reported) held that a mortgagee was not a creditor of a grantee of the mortgaged premises who took subject to but not assuming the mortgage.
that the corporation has committed an act of bankruptcy within four months of the filing of the petition. It is not necessary to prove such an act of bankruptcy where a prior proceeding in bankruptcy or an equity receivership is pending. When is a prior proceeding in bankruptcy or an equity receivership pending? Would the simple device of either filing a petition in bankruptcy the day before or filing a bill asking incidentally the appointment of a receiver serve to comply with this requirement? If so, the requirement of an act of bankruptcy in the cases of most involuntary proceedings could be easily circumvented. Temporary embarrassments or times of panic would be of aid to the striker. A device doubtless put in the new act to prevent holdups would become of little effect.

One aspect of the problem thus presented was before the court in the Laclede Case. A bill had been filed seeking foreclosure which incidentally prayed that a foreclosure receiver be appointed. The creditors who filed the petition under section 77-B claimed that this constituted a prior receivership pending. The court, however, took the more sensible view of the situation and held that pending means in existence or going on rather than undecided or dependent. The soundness of this decision as to re-

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69 This requirement must be complied with. Bryan v. Welsh (C.C.A. 10th Cir. 1934) 72 F. (2d) 618.

70 Although the act does not say that the four months should run from the filing of the petition, the provisions in other sections of the Bankruptcy Law so providing make it practically certain that such an interpretation would be adopted here. A literal interpretation of the words as meaning that the act of bankruptcy must have been completed within four months would be silly. As much as we may feel like it at times, we are not to import a sporting intent to Congress.

71 The petition must state "... that such corporation is insolvent or unable to meet its debts as they mature and, if a prior proceeding in bankruptcy or equity receivership is not pending, that it has committed an act of bankruptcy within four months. . . ."

72 An act of bankruptcy would not, of course, be required where there was a receivership pending; on the whole it seems this alternative of a receivership proceeding first will become progressively less usual.

73 See, however, In re Flamingo Hotel Co. (D.C. Ill. 1934) (not yet officially reported) where the debtor corporation had been "subject to a foreclosure proceeding on a bond issue in the state court" which had been going on for some time and the bankruptcy court approved a petition which apparently did not allege an act of bankruptcy thus holding such bond foreclosure proceedings a "receivership pending." See also In re Surf Bldg. Corp. (D.C. Ill. 1934) (not yet officially reported). But see In re Rialto Properties Co., (D.C. Cal. 1934) 8 F. Supp. 57 denying a creditors petition under section 77-B where an act of bankruptcy, which was there necessary, was not shown.

The rule of the Laclede case is apparently approved by Judge Mack, who observed in his oral opinion in In re Associated Gas & Electric Co,
ceiverships is not open to much question. That the holding of the
district court on this will be affirmed if the case ever comes before
a higher court seems self-evident. Under our test, the holding
is good—it favors majority rule and prevents holdups.

However, the etymological approach adopted by the district
court for the eastern district of Missouri will not solve the rest
of the problem even though we assume that a like holding would
follow where the bill prayed for the appointment of a receiver of
all of the debtor's property. The further problem still remains:
a bill seeking the appointment of a receiver may not be "... a
prior ... equity receivership ... pending ...", but isn't a peti-
tion in bankruptcy "... a prior proceeding in bankruptcy ... pending ..."? The sharpshooter will ask this, relying on a verbal
interpretation of the act. It is not an answer to this objection to
say that, unless the debtor corporation has committed an act of
bankruptcy, the petition in bankruptcy would be decided adversely
to the petitioning creditors. It may nevertheless be pending.14

Applying our procedural interpretation of the act, we would reach
a result similar to the Laclede Case, but on broader grounds.
Bankruptcy as a static condition is not "in existence or going on"75
till there has been an adjudication.76 Provisions in section 77-B
designed to favor majority rule and to prevent holdups should be
liberally construed.77 In the last analysis, the question is similar
to that involved in the provisions relating to the "good faith" with
which a petition must be filed.78

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14There is the analogy to questions of federal jurisdiction in cases
involving constitutional questions, i.e., whenever such cases are decided
adversely to the constitutional right claimed, they are not dismissed for lack
of jurisdiction. Furthermore, there seems to be an added reason for the
provision in sec. 77-B, as an act of bankruptcy may have been committed
within four months of the prior petition in bankruptcy but not within four
months of the petition under sec. 77-B.

75This wording is taken from In re Laclede Gas Light Co. (D.C. Mo.
1934) (not officially reported).

76This reasoning might even be carried a step further and bankruptcy
not considered in existence till the trustee is appointed. However, for
other purposes, the Bankruptcy Act considers bankruptcy in existence from
the time of the adjudication. Bankruptcy Act, Sec. 70, subdivision (a).

77This wording is taken from In re Laclede Gas Light Co. (D.C. Mo.
1934) (not officially reported).

78Certainly, where the first petition in bankruptcy was filed in order to
get "a prior proceeding in bankruptcy ... pending," a court might well say
The early use made by the courts of these somewhat vague provisions as to "good faith" is interesting. Section 77-B requires that before a judge may approve a petition or answer thereunder, he must be satisfied that it has been filed in "good faith." This requirement looks vague; yet it has already been invoked by the courts. In In re Coronado Hotel Co., foreclosure proceedings had been pending in the state court for about three years and were about to be consummated. Creditors holding less than 1 per centum of the outstanding bonded indebtedness of the Hotel Company filed a petition under section 77-B. A large majority of the bonds were held by a bondholders' committee which opposed the plaintiff's petition. The court said that there was no showing that the petitioner could acquire or represent sufficient interest even to propose a plan of reorganization. For this reason, the court concluded that the petition had not been filed in "good faith." In thus declining to approve the petition, the court said:

"Now the purpose of this statute, or at least one purpose of this statute, as we have an understanding of it, is to simplify, expedite and economize the reorganization of properties similar to that in issue here. The approval of this petition would have the that the second petition relying on the former was not filed in "good faith."

Likewise, it is possible that if proceedings under sec. 77-B could be instituted by creditors without any act of bankruptcy or receivership having taken place the new act would be unconstitutional; thus such an interpretation should be avoided.

78By the debtor or by creditors. Sec. 77-B, subdivision (a).

79By the debtor "in any proceeding pending in bankruptcy." Sec. 77-B, subdivision (a).

80Sec. 77-B, subdivision (a); cf. Harkin v. Brundage, (1928) 276 U. S. 36,-48 Sup. Ct. 268, 72 L. Ed. 457, indicating that "good faith" was necessary in consent receiverships.

81(D.C. Mo. 1934) (not yet officially reported).

82Only substantial interests can propose a plan; the Act provides: "A plan of reorganization which has been approved by creditors of the debtor, whose claims would be affected by the plan, being not less than 25 per centum in amount of any class of creditors, and not less than 10 per centum in amount of all the claims against the debtor, or, if the debtor is not found by the judge to be insolvent, but is found unable to meet its debts as they mature, by stockholders whose interests would be affected by the plan, provided said amount is not less than 10 per centum of any class of stock outstanding and not less than 5 per centum of the total number of shares of all classes of stock outstanding, may be proposed by any creditor or by any stockholder, or without such approval by the debtor, at a hearing duly noticed for its consideration or for the consideration of any other plan of reorganization similarly proposed." The debtor may propose a plan without it being otherwise approved. In re National Department Stores (D.C. Del. 1934) 8 F. Supp. 19. Sed Quaere whether the debtor could propose a plan where such proposal was merely for delay.
contrary effect; it would complicate and confuse and delay a re-
organization, and add to the expense of it."

Certainly this decision interpreting the "good faith" require-
ment favors majority rule and prevents the new act from being
used for purposes of delay.

This "good faith" requirement is one of the many elastic pro-
visions of the new act. When the court is not satisfied that a
petition or answer complies with this requirement, it may require
affirmative evidence. Judging by the early decisions, this sub-
division of the act will be the subject of much judicial inter-
pretation.

8See also In re Texas Gas Utilities Co. (D.C. Tex. 1934) (not yet officially reported), holding that "good faith" includes the possibility of a successful reorganization. Cf. In re Missouri-Pansas Pipe Line Co. (N.D. Ill. 1934) (not yet officially reported); In re Surf Bldg. Corp. (D.C. Ill. 1934) (not yet officially reported). On the other hand, Judge Mack, according to an oral opinion delivered in In re Associated Gas & Electric Co. (S.D. N.Y. 1934) (not officially reported) would require the petitioner to make less of a showing of the possibility of a successful reorganization than would other courts. He said, "... it seems to me that good faith primarily means an honest desire to save the company and its creditors from liquidation and a desire to keep the company going as a going concern, to save whatever value there may be in it as a going concern as distinguished from a liqui-
dating concern. But even more than that, I think the requirement of good faith was intended to prevent strike suits against corporations. The re-
quirement of good faith is aimed more than anything else at the racketeers both in and out of the legal profession, or to prevent racketeering through the use of legal process in the case of corporations which have because of the times reached a state of insecurity for the creditors." In spite of Judge Mack's language his rule seems fraught with the danger he seeks to elimi-
nate. It is submitted that a petition which does not present some pos-
sibility of a successful reorganization is not filed in "good faith." It should
be borne in mind, however, that the plan need not be proposed by the peti-
tioner. It has been held that petitioning creditors are not in a favored
class as regards the submitting of a plan of reorganization; they, like other
creditors, must comply with the provisions of subdivision (d). In re Na-

An example of other elastic provisions in the act can be found in the
several provisions providing for the alternative satisfaction of dissenting
stockholders or creditors. Sec. 77-B, subdivision (b), clauses (4) and (5).

Thus in Matter of 1030 North Dearborn Building Corp. (E.D. Ill.
1934) 7 F. Supp. 896, 898, 25 Am. B. R. (N.S.) 519, the court, after denying
the owner of the property, the trustee under a deed of trust and a bond-
holders' committee which did not show the ownership of sufficient securities
the right to intervene in the proceedings and oppose the petition, said: "This
memorandum, however, is not an approval of the petition. It is the court's
duty to determine whether or not the same has been filed in good faith and
no evidence has as yet been submitted upon that question."

See In re Flamingo Hotel Co. (D.C. Ill. 1934) (not yet officially
reported), treating the "good faith" requirement as important and saying:
"... the fact there are three comparatively small petitioning creditors has
little or no weight on the question of good faith." In In re South Coast Co.
(D.C. Del. 1934) 8 F. Supp. 43, 44, 45 the court said, "In equity, a cred-
itors' bill for the purpose of reorganizing a corporation is deemed filed in
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In re St. Louis Public Service Co., is a case adopting a method of approach to other provisions of the act similar to that adopted by the cases relating to the "good faith" requirement. A creditor's petition under section 77-B was pending before the court. The debtor corporation then filed a voluntary petition. The court approved the debtor's petition on the ground that "the adjudication should be made in that proceeding in which, under all the circumstances, it appears to be for the best interest for the entire estate." In deciding to approve the debtor's petition, the court said:

"Such a course will encourage speedy action, it will be less expensive, avoid conflicts, and likely discourage costly litigation." Here again we have a decision favoring the cheapest and quickest method of procedure. Judged by our standards, it is very wise.

good faith when brought for that purpose against a corporation in need of reorganization. When brought with respect to a corporation not in need of reorganization, it is brought in bad faith. . . . The same holds good with respect to a petition for reorganization in bankruptcy." The court continued, "Bad faith cannot attach to adopting a course afforded by Congress." In re Philadelphia Rapid Transit Co. (D.C. Pa. 1934) 8 F. Supp. 51, 54 the court held a petition filed by "creditors" who had bought bonds for the purpose of filing a petition not to have been filed in good faith, and said, "Good faith means, as we have said, a real creditors' petition, not merely a petition signed by three persons who have the technical status of creditors." See also In re Prudence-Bonds Corporation, (D.C. N.Y. 1934) (not yet officially reported) mentioning the "good faith" requirement.

See also In re Ambassador Properties, Inc. (S.D. N.Y. 1934) (not yet officially reported) to the effect that even where it is found that a petition is filed in "good faith" (here the question involved the permanent appointment of the trustee, and the "good faith" requirement was referred to apparently by analogy) the court will take further action to prevent holdups. The petitioner requested an expensive reference as to the fitness of the trustee. The court granted the reference on the condition of the petitioner paying the cost if unsuccessful in proving his contentions.

88(D.C. Mo. 1934) 8 F. Supp. 83.

88See In re National Department Stores (D.C. Del. 1934) 8 F. Supp. 19, which went further and held that a debtor's petition per se takes preference over a creditors' petition; the court said, "In the absence of any showing that the rights of creditors would be better protected by an adjudication under the involuntary petition, the right of the debtor to be adjudicated under its voluntary petition cannot be denied. . . . This is not a matter of priority in filing." See also In re South Coast Co. (D.C. Del. 1934) 8 F. Supp. 43, where a debtor's petition under Section 77-B was approved although a creditors' petition was pending.

89One of the reasons for the popularity of the consent receivership lay in the fact that it enabled the debtor to have a large measure of control over the proceedings. Just why these proceedings were not brought directly by the embarrassed corporation the present writer could never understand. Such procedure was adopted in Wabash, St. L. & P. Ry. Co. v. The Central Trust Co., (D.C. Ohio 1884) 22 Fed. 138. See Pacific R.R. Co. v. Humphreys, (1892) 145 U. S. 82, 12 Sup. Ct. 787, 36 L. Ed. 632 referring to the fact that the Wabash bill was so filed. This method of procedure was spoken of with apparent approval in Re Metropolitan Ry.
A question which will soon have to be worked out by the courts is the effect of proceedings under section 77-B on pending equity receiverships. At the start a difficulty arises. If “reorganization” is now “bankruptcy,” the federal act having covered the whole field, it would seem that state receivership proceedings could no longer be had. Likewise, in the case of federal equity receiverships, it might well be urged that the legal remedy—bankruptcy—is now adequate. If section 77-B is, as we think, merely procedural, these difficulties do not arise. The new procedure does not expressly oust the old, and in the case of such an act there is no reason to imply a change in the substantive law. Parts of section 77-B seem impliedly to recognize that the old methods are still available.

The act itself provides that, in the case of proceedings brought thereunder after a receiver has been appointed, the trustee, or the debtor corporation if no trustee has been appointed, shall become vested with the title to the debtor’s property when the petition or answer under the act is approved. Likewise, the bankruptcy court is given jurisdiction over the property of the debtor wherever located. The first of these provisions makes bankruptcy paramount over receivership proceedings in all cases.

Receivership, (1908) 208 U. S. 90, 28 Sup. Ct. 219, 52 L. Ed. 403. At any rate, the change made by the new Act in this respect, so as to allow the debtor itself to file a petition, is by way of convenient acknowledgment of the fact behind an admitted fiction.

This would be necessary, it could be argued, in order to have a uniform bankruptcy law within the Constitutional grant of power. U. S. const. art. I, sec. 8, cl. 4. Some support for this argument can be found in the language of Judge Inch in In re Prudence-Bonds Corporation (D.C. N.Y. 1934) (not yet officially reported), “It seems to me, if [Congress] intended to designate the Federal Court as the exclusive medium by which a reorganization may be accomplished provided, in good faith, a petition is filed.” See International Shoe Co. v. Pinkus, (1929) 278 U. S. 261, 49 Sup. Ct. 108, 73 L. Ed. 318, where the court said: "In respect of bankruptcy the intention of Congress is plain. The national purpose to establish uniformity necessarily excludes state regulation."
The second of these provisions does away with the necessity for ancillary proceedings by extending the territorial jurisdiction in such proceedings to that of the bankruptcy court. Both these provisions do not change reorganization law substantively; they merely extend the effective scope of the new act. A recent case applying these provisions has held that they give the court power to order the receivership court to turn over the debtor's property to the trustee or to the debtor:

"... it is apparent that the bankruptcy court has exclusive and paramount jurisdiction over the debtor and its property wherever located and that said court may order the property of the debtor in the custody of a receiver of any other court to be turned over to the court of bankruptcy...."

This seems clearly right in holding that the bankruptcy court may order the receivership court to give up the property.

Would the debtor or the trustee be vested with the property without such an order? In spite of the somewhat ambiguous wording of the act, it is submitted that this would not be so. Other provisions of section 77-B impliedly recognize that suits may continue against the debtor in spite of proceedings brought under the act. Thus the judge may enjoin or stay suits against the debtor. When the permissive language of this provision of

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86 Matter of Austin Hotel Co. (D.C. Ill. 1934) (not yet officially reported.) See In re South Coast Co. (D.C. Del. 1934) 8 F. Supp. 43, approving a petition under sec. 77-B though the debtor had been in receivership for over four years. See In re Surf Bldg. Corp. (D.C. Ill. 1934) (not yet officially reported) (discretion of bankruptcy court).
87 In this situation the act says that the trustee "shall be entitled forthwith to possession of and vested with title to such property." Sec. 77-B subdivision (1).
88 The judge "... in addition to the provisions of section 11 of this Act for the staying of pending suits against the debtor, may enjoin or stay the commencement or continuation of suits against the debtor until after final decree; and may, upon notice and for cause shown, enjoin or stay the commencement of any judicial proceeding to enforce any lien upon the estate until after final decree...." Sec. 77-B, subdivision (c), clause (10).

This section has been interpreted broadly to allow the court to restrain the enforcement of rights through other than court proceedings. In re White Truck & Transfer Co. (D.C. Cal. 1934) (not yet officially reported) re-
the act is compared with the more mandatory language of a similar provision in section 77 relating to reorganization of railroads engaged in interstate commerce and with the cases under the railroad reorganization section suggesting that suits may continue against the debtor, it becomes apparent that other judicial proceedings are not ipso facto prevented by proceedings under section 77-B. This certainly is the result we should arrive at from our procedural approach. New procedure should not oust the old except in so far as expressly provided.

Most important of all on the effect of proceedings under section 77-B on pending equity receiverships is the provision in the act authorizing the judge to classify creditors for the purpose of the plan and its acceptance, and allowing him to determine the unsecured part of a secured creditor's claim according to the provisions of section 57 (h) of the Bankruptcy Act. This is important for, apart from this provision, and another provision using this section 57(h) in a similar manner, this very important section of the Bankruptcy Act would not apply to proceedings under the new act. Section 57(h) provides for the valuing of the security held by a secured creditor according to the terms of the security agreement or, more specifically, "by agreement, arbitration, compromise or litigation, as the court may direct." We have seen that this provision in providing a means of valuing the unsecured part of a secured creditor's claim gives a valuation which may greatly assist the court in passing upon the fairness of a plan.

Prior to the new act, bankruptcy did not deprive secured creditors of the right to their security. While section 77-B allows strained lienholders from seizing the property of the debtor during the period of the reorganization. This decision merely adopts what has been the receivership practice and thus fills up an obvious gap in the Act.

Sec. 77, subdivision (1) differs from the corresponding section of sec. 77-B, subdivision (c), clause (10), and reads, in part, "such suits shall be further stayed. . . ." Italics ours.

Sec. 77-B, subdivision (c), clause (6).

Sec. 77-B, subdivision (b), latter part.

Sec. 77-B subdivision (k) provides that certain sections of the Bankruptcy Act, including sec. 57, subdivision (h), shall not apply, except as otherwise provided, to proceedings instituted under sec. 77-B, unless and until an order has been entered directing the trustee to liquidate the estate.

Wording taken from sec. 57, subdivision (h).

a majority of secured creditors to bind the minority of their class, there is some doubt if Congress could constitutionally, even through an exercise of the bankruptcy power, deprive a secured creditor of all rights in his security. Certainly, the older sections of the Bankruptcy Act did not deprive a secured creditor of such right. Where a secured creditor wished to prove the unsecured portion of his claim, the matter was somewhat different. He was then subjecting himself to the operation of the act, and the court could evaluate the secured portion of his claim by "agreement, compromise or litigation." In cases where there was a real fight on value, "litigation" was factually the only real method available. However, this litigation might take a number of forms. It could consist of proof before the referee, or it could consist of foreclosure and sale in the state courts or on the equity side of the federal courts. If this latter method was adopted, in order for the valuations thus found to be binding on the bankruptcy court, that court must have ordered the foreclosure to proceed, and the bankruptcy trustee must have been joined as a party thereto. Apparently, if these two requirements were observed, the values found were conclusive on the bankruptcy court. What method the court used to value the security depended largely upon the exercise of its sound discretion. Once the security was so valued, the secured creditor could keep the security (or the proceeds of a sale thereof) and prove the balance of his debt as an unsecured creditor. Where a sale was used to evaluate the security, this was always recognized as being essentially different from a sale of the bankrupt's general estate. Where the machinery of section 57 (h) is made available under the new Act, its prior history should be kept in mind.

106Sec. 77-B subdivision (e) clause (1).
107See In re Stowell, (D.C. N.Y. 1885) 24 Fed. 468, 469, where the court said in speaking of secured creditors as not being affected by a composition that their right was "... a vested right with which the Bankruptcy Court has no power otherwise to interfere...." The earlier bills upon which Sec. 77-B was patterned gave non-asserting secured creditors the right to the cash value of their claims in all cases. See Swaine, Corporate Reorganization under the Federal Bankruptcy Power, (1933) 19 Va. L. Rev. 317, 331.
108Sec. 57, subdivision (h).
110In re Soltmann, (C.C.A. 2nd Cir. 1918) 249 Fed. 455.
112In re Davison, (D.C. N.Y. 1910) 179 Fed. 750.
113Bankruptcy Act, sec. 57, subdivision (h).
114In re Rose, (D.C. Ky. 1911) 193 Fed. 815.
Litigation outside of the bankruptcy court has always been recognized as a convenient and appropriate means of evaluating security. Such litigation in the form of a foreclosure bill on the equity side of the federal court would be equally convenient in proceedings under section 77-B and, it is submitted, equally appropriate. Such a result could be arrived at by a not too narrow interpretation of the provisions incorporating section 57 (h) as part of the new reorganization machinery.

Whether such an interpretation as that here urged is wise or not depends upon an analysis of the alternative provisions in the Act. As noted before, a reorganization has two main aspects: first, the relationship inter se of the members of any class of creditors or stockholders and, secondly, the relationship between the various classes. In the case of secured creditors, their relationship inter se is taken care of by the provisions for alternative satisfaction of dissenters where less than two-thirds of a class assent to a given plan of reorganization. The valuation of the security herein involved in case the non-assenting secured creditors are to be thus satisfied is either a sale at a fair upset price or an appraisal of the non-assenting creditor's claim (and consequently of the security upon which it is based). How far the upset price and appraisal value here differ is a question which is open to debate and upon which it is too early to venture an opinion. The relationship of a particular class of creditors to other classes of creditors and to stockholders is taken care of by the plan of reorganization. The adoption of a plan is largely a matter of bargaining between the representatives of the respective classes. Before the plan becomes binding and the reorganization thus consummated, it must be submitted to and confirmed by the court.

In order to confirm a plan, the judge must find, in addition to the fact that the plan has been presented and approved according to the machinery provided in the Act, that "... it is fair and equitable and does not discriminate unfairly in favor of any class of creditors or stockholders." The method of litigation which will be used where the court is applying sec. 57, subdivision (h), as already noted, will vary with the discretion of the particular judge. Thus it is necessary to point out why foreclosure and sale will often be the most desirable method.

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116Sec. 77-B, subdivision (b), clause (5).

117Frank, Some Realistic Reflections on Some Aspects of Corporate Reorganization, (1933) 19 Va. L. Rev. 698, 708 notes these two alternatives and suggests the danger that the appraisal value will approach the upset price. It seems to the present writer that the converse is equally probable.

118Sec. 77-B, subdivision (f).
creditors or stockholders. and is feasible. . . 

We may assume that enlightened judicial scrutiny is necessary and that the purpose of this clause was to prevent the new act being used as a means of oppression. How is this enlightened judicial scrutiny to be had?

In certain cases, the claims of certain classes of creditors will have been evaluated by sale at a fair upset price or by appraisal in order to satisfy those creditors of which less than two-thirds assent to a given plan. In some cases, stockholders' interests may have been evaluated in a similar manner in order to satisfy stockholders of a class of which a majority has not assented to a given plan. In still other cases, it may have been determined that the corporate debtor was insolvent in the bankruptcy sense, and thus stockholders' assent may have been dispensed with. In all these situations various and probably different theories of valuation will have been used. When the court comes finally to pass upon the fairness of a proposed plan, it could ignore the fact findings already made. Such a course not only seems wasteful, but improbable. For example, if the court has found the debtor corporation to be insolvent and thus dispensed with stockholders' assent, it would probably not disapprove a plan as discriminating unfairly against stockholders if it gave them little or no interest in the reorganized company. Similar reasoning might well be applied by the court in passing upon the fairness of the treatment

119 Sec. 77-B, subdivision (f).

120 Certainly the recent receivership cases show the court trying to prevent receivership-reorganizations being used as a means of oppression. National Surety Co. v. Coriell, (1933) 289 U. S. 426, 53 Sup. Ct. 687, 77 L. Ed. 1300; First Nat'l Bk. of Cinn. v. Flershem, (1934) 290 U. S. 504, 54 Sup. Ct. 298, 78 L. Ed. 388.

121 How vague is the valuation for determining a "fair value" of the assets in making such determinations may be seen from McGill v. Commercial Credit Company, (D.C. Md. 1917) 243 Fed. 637, 647, where the court said: "The effort is to find out not what a real buyer and a real seller, under the conditions actually surrounding them, do, but what a purely imaginary buyer will pay a make-believe seller, under circumstances which do not exist. You are forced to wonder what would have happened if everything had been different from what it was. It is not easy to guess what will take place in Wonderland, as other people than Lewis Carroll's heroine have found out."

122 Value is a variable concept. See Bonbright and Pickett, Valuation to Determine Solvency Under the Bankruptcy Act, (1929) 29 Col. L. Rev. 582.

123 In confirming a plan, the judge must find in addition to the other requirements that it "does not discriminate unfairly in favor of any class of creditors or stockholders." Sec. 77-B, subdivision (f). This probably adds little, as it is hard to see how a plan that so discriminated could be "fair and equitable." Sec. 77-B, subdivision (f).
given to various classes of creditors. On the whole, facts already
found cannot be ignored. Where there has been little or any of
this prior fact-finding, upon what will a court base its judgment in
determining the fairness of the plan? The totality of assets and
the assets behind each secured claim can, of course, be appraised.
This is probably the method that will be followed where the claims
of creditors are largely secured or largely unsecured so that the
question of valuing the unsecured part of a secured creditor's
claim is not of great moment. In the in-between case, where the
secured creditor is substantially secured and also occupies a sub-
stantial position as an unsecured creditor, the fair\textsuperscript{124} and convenient
method for calculating the value of the security and thus arriving
at a value for the unsecured part of the claim is to apply section
57 (h). In applying this section, "litigation" in the sense of a full
adversary proceeding whether before the referee in bankruptcy or
on the equity side of the federal court would seem the fairest
method to adopt where the rights of a secured creditor to realize on
his security are involved. Where the claims are largely secured,
this is of less importance as the unsecured portion of any particular
claim will be worth little. Likewise, where there is but little se-
curity held by any creditor, it is not a matter of great moment
what valuation the plan places upon the security. The act allows
a flexible machinery to be adopted. Where the question of the
valuation of security is important for classifying creditors for the
purpose of the plan, section 77-B wisely recognizes that a secured
creditor should be required to take his security (i.e., as finally
represented by its proceeds in the reorganized company) not at
some hypothetically high value but at a valuation somewhat ap-
proaching that of the market place.

We can indicate here only the general type of situation in which
section 57 (h) may be used and point out that, when it is used,
"litigation" by way of foreclosure in the bankruptcy court or else-
where, probably on the equity side of the federal court, either in
or apart from a receivership cause, is one way of classifying and
thus evaluating claims. How far this method will be used depends
upon a balancing of conveniences, section 77-B being, as we have
seen, procedural. Decisions on this point and on the kindred ques-

\textsuperscript{124}This would be fair because the value of a secured creditor's security,
whatever it may be, is thus assured to him. As already noted the Bank-
rup tcy Act and probably the new amendments do not alter greatly the
relations between a debtor and his secured creditors.
tion of how far existing receivership machinery will be used as a means of evaluating secured claims can be judged by our formula. Their efficacy will vary directly with their favoring majority rule and speeding the adoption of a plan, and inversely with the possibility of holdups they will present and their tendency to cause delay.

Other problems under section 77-B may be similarly worked out. For the reorganization lawyer of tomorrow, the law will remain difficult, but perhaps the reorganization process will offer fewer opportunities for holdups or delay. This will certainly be so if the new act is interpreted liberally with a view to expediting corporate reorganizations.