Corporate Reorganization: Equity vs. Bankruptcy

Thomas Clifford Billig
CORPORATE REORGANIZATION:
EQUITY vs. BANKRUPTCY†

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President Hoover, on January 11th in a special message to Congress urged immediate passage of certain proposed amendments to the bankruptcy act which would give further relief to both individual and corporate debtors.¹ The immediate reason for this message was the introduction in Congress on December 29, 1932 of two measures² designed to alter somewhat several sections of the Hastings Bill,³ which, it will be recalled, was the

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¹The president's message is published in full in the United States Daily, January 12, 1933 at page 3.

²H. R. 13955 sponsored by Representative McKeown of Oklahoma and H. R. 13958 sponsored by Representative La Guardia of New York. Both measures were referred to the committee on the judiciary.

³The Hastings Bill is discussed in detail in Senate Document No. 65, entitled “Strengthening of Procedure in the Judicial System.” This Document consists of a brief message from President Hoover and a 200-page “Report of the Attorney General on Bankruptcy Law and Practice.” The Hastings Bill (S. 3866; H. R. 9968) was introduced in Congress on February 24, 1932, following an extensive nation-wide investigation conducted by the Department of Justice under the supervision of Solicitor-General Thacher and his special assistant, Lloyd K. Garrison, Esq., now dean of the University of Wisconsin Law School.

Section 76 of the Hastings Bill provided a plan for bringing the reorganization of a “moneyed business, or commercial corporation” under bankruptcy. Following extensive public hearings in Washington during the spring of 1932, subcommittees from the Senate and House Committees on the Judiciary revised section 76 and eventually sought to divorce it from other amendments to the bankruptcy act contained in the Hastings Bill. Eventually many of the provisions of section 76 found their way into section 75 of a Proposal of Relief of Debtors which is printed in full text
solicitor-general's bankruptcy measure introduced in both houses last February and still in committee.

One proposal which runs through these various bills would place within the jurisdiction of the bankruptcy court that incident which is peculiar to the corporate receivership in equity, namely, the "corporate reorganization." The original Hastings Bill limited the jurisdiction of bankruptcy to reorganizations involving the "moneyed, business, or commercial corporation." Subsequent measures have sought to include also within bankruptcy the reorganization of railroads, a type of business unit hitherto not susceptible to the Act of 1898. However, whether or not railroads

in the United States Daily, December 28, 1932 at page 4. In addition, Section 75 includes railroad reorganizations. The McKeown Bill (H. R. 13955) mentioned in note 2 supra includes the provisions of section 75 of the Proposal for Relief of Debtors but does not include railroads. The La Guardia Bill, also referred to in the same note, is concerned exclusively with the reorganization of railroads and "enables a railroad to propose a new set-up in the way of reorganization to the Interstate Commerce Commission and to have that body's consent and approval." United States Daily, December 30, 1932 at page 7. Both the McKeown and La Guardia bills are published in full in the United States Daily, January 13, 1933, at page 4. The McKeown and La Guardia bills finally were incorporated into a single measure called the Sumners Bill (H.R. 14359) which was reported favorably to the House on January 24, 1933 by the House Committee on the Judiciary. See United States Daily, January 25, 1933, at page 1.

The provisions of section 75 of the Proposal for Relief of Debtors (which, if passed, will become a new section (s. 75) of the Bankruptcy Act) are too lengthy to set forth in full. Certain important parts of the section, however, follow: Corporate Reorganizations.—(a) Any corporation, except as hereinafter provided, may file a petition, or, before adjudication in an involuntary proceeding, an answer, stating that the corporation is insolvent or unable to meet its debts as they mature and that it desires to effect a plan of reorganization. Any corporation which could become a bankrupt under section 4 of this act may file such a petition or answer, and any railroad corporation may file such a petition. 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 executive or operating office, or its principal assets. The petition or answer shall be accompanied by payment to the clerk of a filing fee of $100, which shall be in addition to the fees required by section 51 of this act.

Upon the filing of such a petition or answer the court shall enter an order either approving it as properly filed under this section, or dismissing it. If the petition or answer is so approved, an order of adjudication in bankruptcy shall not be entered and the court in which such order approving the petition or answer is entered shall during the pendency of the proceedings under this section have exclusive jurisdiction of the debtor and its property wherever located, for the purposes of this section. The corporation shall be referred to in the proceedings as a 'debtor.' . . .

"(b) A plan of reorganization (1) shall include a proposal to modify or alter the rights of creditors generally, or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise; (2) may include, in addition, provisions altering the rights of stockholders generally, or of any class of them; (3) shall pro-
are included, the plan advocates one of the most sweeping changes in the administration of insolvent estates ever contem-

porate reorganization provides adequate means for the execution of the plan, which may include the transfer of all or any part of the property of the debtor to another corporation or to other corporations, and the issuance of securities of either the debtor or any such corporation or corporations, for cash, or in exchange for existing securities, or in satisfaction of claims or rights, or for other appropriate purposes; and (4) may deal with all or any part of the property of the debtor...

"(c) Upon approving the petition or answer, the judge (1) may temporarily appoint a trustee or trustees of the debtor's estate, who shall have all the title and powers and duties of a trustee appointed pursuant to section 44 of this act;...

"(2) may, for cause shown, authorize the trustee or trustees to issue certificates for cash, for such lawful purposes, and upon such terms and conditions and with such security and such priority in payments over existing obligations, secured or unsecured, as may be lawful in the particular case;...

"(d) A plan of reorganization which has been approved by creditors of the debtor, being not less than 25 per centum in amount of any claim of creditors and not less than 10 per centum in amount of all the creditors of the debtor, whose claims or interests would be affected by the plan, may be proposed by the debtor or by any creditor at a hearing duly noticed for its consideration or for the consideration of any other plan of reorgan-

ization similarly proposed.

"(e) A plan of reorganization shall not be confirmed until it has been accepted in writing filed in the proceeding by or on behalf of creditors holding two-thirds in amount of the claims of each class whose claims or interests have been allowed and would be affected by the plan, and, unless the judge shall determine after a hearing that the debtor is insolvent, by or on behalf of stockholders of the debtor holding two-thirds of the stock of each class:

"Provided, however, That if adequate provision is made in the plan for the protection of the interests, claims and liens of any class of creditors in the manner provided in subdivision (f), clause (5) of this section, then the acceptance of the plan by such class of creditors shall not be requisite to the confirmation of the plan...

"(f) Upon such acceptance, and after hearing such objections as may be made to the plan, the judge shall confirm the plan if satisfied that (1) it is equitable;

"(2) all amounts to be paid by the debtor or by any corporation or corporations acquiring the debtor's assets, for services or expenses incident to the reorganization, have been fully disclosed and are reasonable, or are to be subject to the approval of the judge;

"(3) the offer of the plan and its acceptance are in good faith and have not been made or procured by any means or promises forbidden by this act;

"(4) the plan provides for the payment in cash of all costs of admin-

istration and other allowances made by the court;

"(5) the plan provides with respect to creditors not accepting the plan, and who do not become bound by the plan under the provisions of subdivision (g) of this section adequate protection for the realization by them of the value of their liens on or claim against the property of the debtor dealt with by the plan, either (a) by the sale of such property subject to such liens or claims, or (b) by a sale free of such liens or claims at not less than a fair upset price, and the transfer of such liens or claims to the proceeds of such sale, or (c) by appraisal and payment in cash of the value of such liens and claims, or, at the objecting creditors' elec-
plated in this country and, coming as it does originally from Solicitor-General Thacher himself, it surely is worthy of intensive study.

The British statute provides:

(1) Where a compromise or arrangement is proposed between a company and its creditors or any class of them, or between the company and its members or any class of them, the court may, on the application in a summary way of the company or of any creditor or member, order a meeting.

(2) If a majority in number representing three-fourths in value of the creditors or class of creditors, or members or class of members, agree to any compromise or arrangement, the compromise or arrangement, shall, if sanctioned by the court, be binding on all the creditors or the class of creditors, or on the members or class of members and on the company.

Mr. Rosenberg describes his plan thus (p. 536): "A brief statute, attaining such ends, could be formulated. It should vest in reorganization receivers such title as the bankruptcy act now confers on trustees, thus
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However, before there can be any intelligent discussion of the Thacher proposal and its successors and the desirability of incorporating one or more of them into the bankruptcy act, some consideration must be given to the proceeding which would be overthrown—the corporate reorganization as evolved by the court of equity, particularly by the federal court of equity, the birthplace of that administrative device. This consideration of the corporate reorganization in equity seems to call also for at least a brief look at the federal equity receivership generally as a means of administering the affairs of an insolvent or an embarrassed corporation. In other words, a scholarly consideration of the solicitor-general's proposal requires considerable background. This background will be presented as tersely as possible.

By way of introduction it may be stated that it is possible to classify insolvent estates into (1) those (regardless of the type of business unit employed) which require an immediate liquidation, and (2) those (ordinarily corporate in character) in which a reorganization of the business is contemplated, that is, where it is proposed to organize a new business unit for the express purpose of taking over the assets of its financially unfortunate predecessor upon whatever terms can be arranged with the old creditors and shareholders.

The first type of case will not be considered in this discussion. It will be mentioned merely in passing. While some difference of opinion prevails on the point, I take it to be at least partially con-

obviating the need of ancillary receiverships. It should provide a simple machinery for limited and speedy appeals, thus ending improper obstructive tactics, while giving honest minorities an effective day in court. It should do away with expensive foreclosures and with sales of doubtful validity, and give the court plenary supervision over the plan and the fees and expenses incident to its consummation. It should permit first liens to be allowed to those whose fresh money rescues the insolvent corporation, and, above all, it should enable a court of equity properly to fulfill one of its greatest functions by enforcing equality on all.

There have been conflicting viewpoints in the past. "This practice (consent receivership), as might have been expected, has led to some strange misconceptions regarding the nature of a 'receivership case.' It is all very well for a leading textbook (Alderson, Receivers 5) to speak of 'friendly receiverships' as an institution with us, but the vulgar error that the courts will allow a receivership for any other purpose than a winding up, should never be tolerated. There is no such thing as a nursing receivership. Long ago Lord Eldon pointed out, in the case of a partnership dispute, that a court of chancery had no right to appoint a receiver simply to enable the parties to adjust their affairs. No more has a court of chancery today the power to appoint a receiver merely to enable a corporation to tide over its difficulties, or to enable its creditors and bondholders to effect a plan of reorganization. If the record or the
ceded that the court of chancery has no peculiar concern with

conduct of the parties shows that the object was any other than liquidation, the court will refuse jurisdiction; if the liquidation is unduly delayed, the court will divest itself of jurisdiction so as to let in the other creditors according to their common law priorities." Glenn, Creditors' Rights, sec. 313.

"Apart from statutes, moreover, the law of receiverships has gone through a curious course of development with respect to corporations. The rule has been uniformly stated in the books and is still insisted upon that, in the absence of statutory authority, a court of equity has no power to appoint a receiver even of an insolvent corporation. It is said that such a court has no inherent power to wind up a corporation and that it cannot accomplish by indirection that which it cannot do directly. And it is perfectly true that the administration of the affairs of a corporation by a receiver and the distribution of its assets while not destroying its corporate existence do leave it a mere shell. Nevertheless exceptions to the rule have been evolved which are, in some aspects, as broad as the rule itself.

"One of these exceptions is in the case of creditors' bills. Courts of equity long ago lent their assistance to common law courts to enable particular judgment creditors to reach, through receivers, property beyond the reach of execution. These suits soon broadened in scope and were treated as equitable levies in favor of all judgment creditors entitled to seize the defendant's property—a substitute for separate proceedings. In these suits no distinctions were drawn between corporations and individuals and out of them the practice has grown up and become established of permitting creditors having judgments to apply to courts of equity to take possession of the assets of corporations and undertake through receivers their general administration. And now that which was formerly regarded as the essential thing—the judgment—is unnecessary unless the corporation object. Thus is illustrated anew the vainness of saying what courts of equity cannot do." Noyes, J. in Pennsylvania Steel Co. v. New York City Ry. Co., (C.C.A. 2nd Cir. 1912) 198 Fed. 721, 737.

"The case at bar presents a typical 'umbrella receivership;' by which is meant that a court of equity has extended its protection to a defendant which admitted that it was unable to discharge its obligations as they matured, but agreed that if well managed and granted a moratorium it had enough property to pay what it owed—and indeed do better than that. When such an application is made, the proper question (not I think always asked) is whether the 'hardship and impossibility of other relief justify the appointment.'

"I am sure that few suits of this kind were ever begun against corporations other than carriers where the suggestion of ultimate solvency or better was not somewhat hazardous. At all events, corporations whose solvency was thus averred in limine have so often turned out grossly insolvent that creditors' bills of this nature have by a process of evolution become an elaborate scheme of insolvent administration or corporate reorganization according to the turn of events after receivers appointed.

"Indeed, such bills have come to afford a species of locus poenitentiae for the study of possibilities by creditors, shareholders, directors, receivers and various self appointed committees sitting under the chancellor's 'umbrella' and watching the weather outside." Hough, J., dissenting in Manhattan Rubber Mfg. Co. v. Lucey Mfg. Co., (C.C.A. 2d Cir. 1925) 5 F. (2d) 39, 43.

"The statement of the Supreme Court in Harkin v. Brundage to the effect that receivers should not ordinarily be appointed at the suit of a simple contract creditor should warn any judge who found it necessary to appoint a receiver because of special circumstances to see that the business is liquidated as economically and speedily as possible, unless its
insolvent estates that require immediate liquidation.\textsuperscript{7} It is true that in certain parts of the country—southern Ohio for example—an extensive state equity machine has grown up which rivals the bankruptcy court as a forum for liquidating businesses that are insolvent beyond all hope of redemption. But, as I have pointed out in a recent study,\textsuperscript{8} I see no valid reason, save an historical one, for the existence in the same district of two courts—one federal and one state—which are both engaged in liquidating defunct businesses. In fact sometimes it may be possible to liquidate the estate without resorting to any court at all through the use of an assignment for the benefit of creditors. And the ultimate solution


"All this seems very academic, but these considerations are really intensely practical, and the practice of the courts in appointing receivers for corporations, which has grown almost literally by leaps and bounds, affords a good illustration of the thought intended to be expressed. If bills under which such receivers have been appointed were listed and analyzed, the growth and development of this branch of remedial law would be disclosed. It would doubtless be found that all of them from the beginning, at least 80 per cent, resulted in the making of a decree which was nothing more or less than the declaring of a moratorium against creditors, and of the proceedings in late years, 95 per cent of the bills had this more or less veiled end in view. It is difficult for a solicitor devoted to old established principles of chancery practice to understand how the courts can protect a corporation, which is in financial straits, against suits by its creditors, when it would not protect an individual under like circumstances, and yet so widespread and general a recognition and acceptance of the assertion of the power has been accorded its assertion, that in at least two notable instances in Pennsylvania it was even attempted to be extended, and, until halted by the Supreme Court, actually was extended to individual debtors. We do not need to search far for the reasons for this acquiescence. The end reached was a good end, and the remedy applied justified itself in practical results. The lawyer, who advised his clients who were interested in such a corporation that no such remedy could be had through a bill in equity, would have found himself supplanted by other counsel who promptly had the needed remedy applied through just such a bill." Dickinson, J. in Scattergood v. American Pipe & Construction Co., (D.C. Pa. 1917) 247 Fed. 712, 713, 714.

"The function of the equity receivership as your Committee conceives it, is to conserve the assets of a corporation really solvent but temporarily embarrassed financially until a plan of refinancing, rehabilitation, or reorganization can be evolved. The use of such receiverships in cases where liquidation is inevitable or the continuance of such receiverships after hopeless insolvency becomes apparent involves, we think, the usurpation of the powers intended by congress to be exercised by the bankruptcy court." Report of Special Committee on Equity Receiverships for 1926-1927, Association of the Bar of the City of New York, Year Book, 1927, 321.


\textsuperscript{8}Equity Receiverships in Franklin County, Ohio (1932).
of the problem of the immediate liquidation case well may be through the use of a general assignment around which proper legal safeguards have been thrown. At least such is the trend of some present day developments.\textsuperscript{9}

It is with the second type of insolvent estate that this paper will deal. Here, as in the former case, the business is operating at a loss. Financial difficulties due to general economic conditions, or to unsound business practices, or to a poorly arranged capital structure, or to any number of other causes have brought about a crisis in the corporate affairs. Perhaps, too, one or more voluntary reorganizations have been attempted without success. In other words, out of court remedies having failed, the business now requires the services of a legal umpire to pass upon the controversies of the sometimes warring groups of shareholders and security holders. The umpire is the chancellor. The type of proceeding employed is the receivership in equity, usually a federal receivership. The purpose of the proceeding is not the immediate liquidation of the corporate assets. Far from it. The purpose is to save the business, or more accurately, to create a new corporation which will take over the assets of the old one and (with the liabilities scaled down) carry on the former business, perhaps with new blood and generally with some new money.

This proceeding will now be examined under the following heads: (1) the manner of instituting the suit; (2) the place of instituting the suit, and (3) the problem of the dissenting minority creditors. Throughout this discussion emphasis will be laid on the flexibility of the equity receivership as an administrative device and the advantages which flow therefrom. The federal judge sitting in equity is hampered by no statutory rules save those of the judicial code.\textsuperscript{10} And the state statute covering receiv-

\textsuperscript{9}Section 74 of the Hastings Bill, supra note 3, provides:

"Assignments for the benefit of creditors: (a) If a person other than a municipal, railroad, insurance, or banking corporation shall make a general assignment for the benefit of his creditors to an authorized trustee, the debtor, or the trustee, if so authorized by the terms of the assignment, may, provided a petition in bankruptcy by or against the debtor has not already been filed, file the assignment with the clerk, and proof of notice having been mailed to the creditors of the assignment and of the first meeting. Upon approving such assignment the court shall enter an order appointing the assignee as trustee of the debtor's estate."

\textsuperscript{10}"A court of equity's modes of relief are not fixed and rigid. It can mold its remedies to meet the condition with which it has to deal. The jurisdiction of equity is the whole domain of conscience, limited only by legislative enactment." Manton, J. in Graselli Chemical Co. v. Actna Explosives Co., (C.C.A. 2nd Cir. 1918) 252 Fed. 456, 459.
ership (where the bill is brought in a state court) usually is a brief, fragmentary thing whose application requires frequent recourse by the chancellor to the "usages of equity." In a word we have here a legal proceeding possessing much of the elasticity of the out of court settlement, sometimes called a "friendly adjustment," a type of administration which has proved highly successful in certain kinds of immediate liquidation cases.

I. The Manner of Instituting the Suit

From its very inception the equity receivership is a fine example of how the law in practice may eventually change the law in the books. We read over and over again that a receivership is a remedy "ancillary in character" to some other remedy. A receiver, for example, may be appointed in conjunction with the foreclosure of a mortgage, or in connection with a partnership dissolution, or in aiding the satisfaction of a judgment. But never is the receivership the principal remedy, say the authorities.

Let us pursue somewhat further the receivership ancillary to satisfying a judgment. Of course—in the absence of statute—the complainant or plaintiff must be a creditor who has reduced his claim to judgment upon which execution has been returned unsatisfied. To this rule the federal courts have adhered most


The following quotation is typical: "Receivership is an incident merely to proceedings in equity involving the rights of parties, and is resorted to for the purpose of conserving the property and assets of the respondent pending adjudication of these rights. A receivership cannot be the primary object of litigation." Brewster, J. in Willson v. Waltham Watch Co., (D.C. Mass. 1923) 293 Fed. 811, 814.


"If the subject was a chose in action or other equitable asset, equity would not act except upon a showing that execution had been returned unsatisfied." Cardozo, C. J. in American Surety Co. v. Connor, (1929) 251 N. Y. 1, 166 N. E. 783.

Certain exceptions have been made to the strict rule of Cates v. Allen. "When the claim is admitted, or where it is shown that it would
strictly, regardless of whether the suit was brought by a creditor on his own behalf or in a representative capacity.\textsuperscript{15}

The difficulty of applying this rule of the game was that it slowed up the play, and so a plan was devised whereby the legal umpire would wink at certain infractions by one side provided that the other side did not object. After some encouragement had been given to the consent receivership, or "friendly receivership," by language used by the Supreme Court\textsuperscript{16} and by the holdings of inferior federal courts,\textsuperscript{17} the Supreme Court in 1908 gave final sanction to this practice in \textit{In re Metropolitan Railway Receivership}.\textsuperscript{18} Since that case a judgment creditor is no longer needed as party plaintiff. A simple contract creditor with a claim of $3,000 or more, residing in another state from that of the defendant, may precipitate the receivership as long as the defendant does not put in issue the fact that the plaintiff has no judgment.\textsuperscript{19}

be impractical to get judgment, or where the judgment, if obtained, would be useless, equity will usually take jurisdiction and grant the desired relief." Note, (1931) 17 Corn. L. Q. 141; Memphis, etc., R. R. v. Sage, (1888) 125 U. S. 361, 8 Sup. Ct. 887, 31 L. Ed. 694; Adler Goldman Commission Co. v. Williams, (D.C. Ark. 1914) 211 Fed. 530; Nunally v. Strauss, (1896) 94 Va. 255, 26 S. E. 85.

\textsuperscript{15}For the distinction between an ordinary judgment creditor's bill and a creditor's bill seeking an administration of the debtor's assets, see Memphis, etc., R. R. v. Sage, (1888) 125 U. S. 361, 8 Sup. Ct. 887, 31 L. Ed. 694, supra, note 14; George v. St. Louis Cable & W. Ry. Co., (C.C. Mo. 1890) 44 Fed. 117; Hanna, Cases on Creditors' Rights 48; Glenn, Creditors' Rights, secs. 16, 311.

\textsuperscript{16}Take the present case as an illustration: Suppose the corporation and other defendants had made no defence, and, without expressly consenting, had made no objection to the appointment of a receiver, and the subsequent distribution of the assets of the corporation among its creditors; it cannot be doubted that a final decree, providing for a settlement of the affairs of the corporation and a distribution among creditors could not have been challenged on the ground of a want of jurisdiction in the court, and that notwithstanding it appeared upon the face of the bill that the plaintiffs were simple contract creditors; because the administration of the assets of an insolvent corporation is within the functions of a court of equity, and the parties being before the court, it has power to proceed with such administration." Brewer, J., in Hollins v. Brierfield Coal and Iron Company, (1893) 150 U. S. 371, 380, 14 Sup. Ct. 127, 37 L. Ed. 1113.

\textsuperscript{17}As, for example, Brassey v. New York & N. E. R. Co., (C.C. Conn. 1884) 19 Fed. 663. Professor Garrard Glenn maintains that this was the earliest consent receivership, "so far as the reported cases go." See Glenn, Basis of Federal Receiverships, (1925) 25 Col. L. Rev. 434, 439, 440.

\textsuperscript{18}(1908) 208 U. S. 90, 28 Sup. Ct. 219, 52 L. Ed. 403.

\textsuperscript{19}The consent receivership is thoroughly considered in the following periodical literature: Glenn, Basis of Federal Receiverships, (1925) 25 Col. L. Rev. 434; Dodd, Equity Receiverships as Proceedings in Rem, (1928) 23 Ill. L. Rev. 105; Thacher, Some Tendencies of Modern Receiverships, (1915) 4 Cal. L. Rev. 32; Chamberlain, New Fashioned Receiverships, (1896) 10 Harv. L. Rev. 139; Notes (1930) 43 Harv. L. Rev. 1298; (1927) 41 Harv. L. Rev. 70; (1917) 17 Col. L. Rev. 714.
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The hundreds of consent receiverships that crowd the pages of the Federal Reporter and the thousands of others that never were reported testify to the importance of this judge-made "voluntary" receivership as a tool of the corporation bar, particularly in the commercial centers. The theory of the chancellor's aiding a judgment creditor who could find no leviable property by giving him the ancillary remedy of a receivership for his debtor seems almost forgotten by the corporation lawyers. In practice, the receivership of the debtor clearly is the principal remedy, and any creditor who fills the requirements of the judicial code and who can be induced to permit the use of his name serves well enough as party plaintiff.

Likewise the status of a debtor for whom a receiver may be appointed has undergone certain development. Take, for example, the financial condition of the debtor. Glenn in his excellent treatise, Creditors' Rights and Remedies, published in 1915, showed that the chancellor's peculiar jurisdiction over corporations rested on the limited fund upon which corporate creditors might rely. "So long as this fund is adequate for the payment of debts," he wrote, "there is no need to consider any special administrative powers of equity, because, by means of execution or judgment creditors' bill, each creditor can come into his own. But when those assets become insufficient to meet the liabilities, then the administrative jurisdiction of an equity court may be invoked by any creditor for the benefit of all."

From the standpoint of pure logic, then, equity might have adopted the assets-liability test of insolvency which is contained in the present bankruptcy act, and thus have furnished itself with what one federal judge has called "a rule of mathematics the terms of which are absolute." Instead, however, the chancery courts usually have stuck to the common law definition of insolvency which means inability to pay obligations as they accrue in the usual course of business. Obviously this test is very broad, and

20See Billig & Carey, Cases on Administration of Insolvent Estates 301-302, note 6.

21Section 308.


24Floyd Mathew Rett of the University of Michigan Law School thus summarizes his findings with respect to receivership proceeding in an article entitled, When Is A Corporation Insolvent, (1932) 30 Mich. L. Rev.
much always lies in the discretion of the chancellor. If certain other necessary elements are present, it usually is not difficult to show that the debtor is insolvent, and there are expressions in some of the cases which lead one to suspect that the solvency or insolvency of the defendant was quite immaterial. The end sought in those cases was frankly the protection of a federal injunction in order to hold off certain creditors from taking their "pound of flesh."

Let us consider another element in the status of the debtor for whom a receiver is sought. If the appointment is to stand unchallenged, just how much property must the defendant have in the district where suit is brought? In answering this question, the chancellor—as in the matter of the defendant's insolvency—has a considerable range of discretion. Where the defendant has no property whatever in the district, it has been held that the federal court has no jurisdiction to appoint a general receiver for the corporate property. But where even a small part of the corporate assets are within the district, certain federal judges are 1040, 1061: "Thus, while 'insolvency' is not the only factor in the appointment of a receiver of a corporation, it is by no means unimportant. Some courts consistently construe it as an inability to meet maturing obligations; others, as an utter insufficiency of assets; and still others apply both concepts according as the enterprise is active or defunct. It further appears that where a strict application of either concept produces harsh and untoward consequences, courts manage to extricate themselves from the difficulty by resorting to their inherent discretionary powers. It is also to be observed that the concept of insolvency is somewhat modified when applied to certain enterprises by reason of the interest of the public in their safe and efficient maintenance; and that the factor of public interest has the additional effect of influencing a court in the exercise of its discretion."


Compare the following quotations: (1) Van Fleet, V. C. in Edison v. Edison United Phonograph Co., (1894) 52 N. J. Eq. 620, 622, 623, 29 Atl. 195: "The case is destitute of the least proof tending to show insolvency. That, in cases of this kind, is the jurisdictional fact. The court can do nothing—neither issue an injunction nor appoint a receiver—until insolvency is first established. . . . It is too plain to require demonstration that this court has no power to appoint a receiver to wind up a corporation because it is feared or even expected that it will become insolvent some time in the future. Nothing short of present actual insolvency will warrant the appointment of a receiver for such a purpose;" (2) Manton, J. in In re Bankshares Corporation, (C.C.A. 2nd Cir. 1931) 50 F. (2d) 94, 95: "A receiver may be appointed for a solvent corporation under the New Jersey statute. . . ."

inclined to grant the prayer of the bill. This happened in the case of *Primos Chemical Co. v. Fulton Steel Corporation*.\(^27\) The Steel Corporation had been chartered in New York state. Its plant and principal office were in the northern district of New York. A bank account of $4,000, an office lease, and some office equipment were the sole assets in the southern district of New York where the bill was filed praying a general receivership for the defendant. The corporation consented to the suit and Judge Augustus N. Hand appointed three receivers. However, when the creditor thereafter attempted to obtain the appointment of ancillary receivers in the northern district of New York, the federal court there refused to entertain the ancillary bill.\(^28\) In other words the federal court for the northern district refused to play "second fiddle" to the federal court for the southern district. This decision was reached on the ground that the district court for the southern district of New York had no jurisdiction to appoint the primary receivers in the first instance. "A bank account or a lease of two or three rooms for subsidiary office purposes does not constitute a subject matter of a fixed character within the meaning of section 55 of the Judicial Code,"\(^29\) said the court. And, unless the case fell under the section of the judicial code, the court felt that the southern district had no jurisdiction in the first instance.

Despite this ruling, it is certainly true that federal courts in important receivership centers, such as New York City, frequently appoint general receivers, especially for foreign corporations, in consent cases where only a small proportion of the corporate assets (certainly the tangible assets) are within the territorial jurisdiction of the court. Many of these cases are unreported. Also in most of them the appointment of the primary receiver is never challenged. And the problem is further complicated by the fact that certain of these foreign defendants are holding companies. Take, for example, the unreported case of *J. Z. Horter Company v. Punta Alegre Sugar Company* in which receivers were appointed

\(^{27}\) (D.C. N.Y. 1918) 255 Fed. 427.

\(^{28}\) *Primos Chemical Co. v. Fulton Steel Corporation*, (D.C. N.Y. 1918) 254 Fed. 454.

\(^{29}\) Section 55 of the Judicial Code, 28 U. S. C. A., sec. 116, 2 Mason's Code, tit. 28, sec. 116, provides: Any suit of a local nature, at law or in equity, where the land or other subject-matter of a fixed character lies partly in one district and partly in another, within the same state, may be brought in the District Court of either district; and the court in which it is brought shall have jurisdiction to hear and decide it, and to cause mesne or final process to be issued and executed, as fully as if the said subject-matter were wholly within the district for which such court is constituted.
during the summer of 1930 by the United States district court for the southern district of New York. The plaintiff was a Cuban corporation. The defendant was a Delaware corporation which controlled vast sugar plantations and refineries in Cuba through the medium of subsidiary corporations. The actual assets owned by the defendant in New York City consisted of a lease on its principal office, its office equipment, and a bank account; also stock certificates and rights to stock certificates representing ownership of its various subsidiary companies. No hesitation was manifested by the court in appointing receivers for the sugar company, and next day ancillary receivers were named in the United States district court for the district of Delaware. The Punta Alegre case is not unusual. Rather, it is typical of the practice.

From the foregoing discussion, then, it is evident that not only may a simple contract creditor bring the bill, but both the financial condition of the debtor and the amount of property it owns in the particular district may be variable terms depending upon the particular case. Here, as generally throughout the entire equity receivership proceeding, the rules give way considerably to the discretion of the chancellor, and the flexibility of the process, in part at least, depends upon the flexibility of the mind of the court.

Although, as previously indicated, the chancellor has been very liberal in formulating and interpreting the rules governing the institution of the receivership suit, there is one step which the federal courts and at least some of the state courts have refused to take. All attempts to extend the general receivership of the insolvent corporation to cover the property of the insolvent individual have failed, even though the individual defendant appeared in court and consented to the appointment of the receiver. Here

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80In Equity, No. —.

81See Manning v. Middle States Oil Corporation, (1927) 15 Del. Ch. 321, 137 Atl. 79; Stone v. Jewett, Bigelow & Brooks Coal Co., (1924) 14 Del. Ch. 256, 125 Atl. 340. See also Farmers' Loan & Trust Co. v. Northern Pacific R. Co., (C.C. 1896) 72 Fed. 26. In that case the court said at page 30: "Proceedings to foreclose a mortgage placed by a railroad company upon its lines extending through more than one district should, to the end that the mortgaged property may be effectively administered, be commenced in the circuit court of the district in which the principal operating offices are situated, and in which there is some material part of the railroad embraced by the mortgage; ... such court should be the court of primary jurisdiction and of principal decree, and the administration of the property in the circuit courts of other districts should be ancillary thereto."

logic has been the controlling element in the result reached. The financial troubles of Josiah V. Thompson, the southwestern Pennsylvania and West Virginia coal baron, have filled the pages of many law books, but the efforts of his counsel to have his individual properties administered in equity rather than bankruptcy came to naught in both the circuit court of appeals for the fourth circuit and in the supreme court of Pennsylvania.\textsuperscript{33}

Generally speaking, however, the consent receivership has had rather smooth sailing in the federal courts. Occasionally it has been under fire. In 1928 the late Chief Justice Taft struck at it in a dictum in \textit{Harkin v. Brundage},\textsuperscript{34} but by 1931 the circuit court of appeals for the second circuit had explained in \textit{Kingsport Press, Inc. v. Brief English Systems, Inc.},\textsuperscript{35} what Mr. Justice Taft really meant. The friendly receivership meanwhile had flourished like the proverbial green bay tree. In 1923, five years prior to the Taft attack, Mr. Justice Brandeis in \textit{Pusey & Jones Co. v. Hanssen}\textsuperscript{36} refused to permit a receivership bill brought under the Delaware statute\textsuperscript{37} to lie in the federal court for the district of Delaware. His theory was that the Delaware statute—which permitted a simple contract creditor to have a receiver appointed for a


\textsuperscript{34}(1928) 276 U. S. 36, 52, 55, 48 Sup. Ct. 268, 72 L. Ed. 457. The chief justice observed: "We do not wish what we have said to be taken as a general approval of the appointment of a receiver under the prayer of a bill brought by a simple contract creditor simply because it is consented to at the time by the defendant corporation. The true rule in equity is that under usual circumstances a creditor's bill may not be brought except by a judgment creditor after a return of 'nulla bona' on execution. When a receiver has been thus irregularly appointed on such a bill without objection, and the administration has proceeded to such a point that it would be detrimental to all concerned to discharge the receiver, the receivership has been permitted to continue because not seasonably objected to. . . . As the Circuit Court of Appeals says, there should be no 'friendly' receiverships, because the receiver is an officer of the court and should be as free from 'friendliness' to a party as should the court itself."


\textsuperscript{35}(C.C.A. 2nd Cir. 1931) 54 F. (2d) 497.

\textsuperscript{36}(1923) 261 U. S. 491, 43 Sup. Ct. 454, 67 L. Ed. 763.

\textsuperscript{37}Delaware, Rev. Code, 1915, ch. 117, sec. 40.
Delaware corporation, even though the defendant did not consent—prescribed a rule of procedure rather than a rule of substantive law and, consequently, could not be used as the basis of a suit brought in a federal court. This holding reversed several prior federal court decisions and subsequently drew some adverse criticism from the Delaware court of chancery. But why, after all, should corporation lawyers be deeply concerned because they can no longer institute the receivership of a Delaware corporation in a Delaware federal court under the Delaware statute? The Delaware state courts, of course, are still open to them. And, as has been already mentioned, and as will be discussed further presently, the United States district court for the southern district of New York serves as an admirable forum for consent receiverships involving Delaware corporations.

In closing this first division of the discussion, perhaps this final word should be added. The jurisdiction in the federal equity receivership case, it is true, depends on the purely artificial concept of diversity of citizenship. It would be much more realistic to follow the practice of the early cases and to permit the financially embarrassed corporation to come into equity on some sort of a


39 Mackenzie Oil Co. v. Omar Oil & Gas Co., (1923) 14 Del. Ch. 36, 45, 120 Atl. 852.

40 Strengthening of Procedure in the Judicial System, supra note 3 at 90.

41 See Glenn, The Basis of Federal Receivership, (1925) 25 Col. L. Rev. 434, 440 et seq. Collins v. Central Bank, (1846) 1 Ga. 435 was one of the earliest American corporate receivership cases. A railroad which found itself in financial difficulties filed a bill for general liquidation. The supreme court of Georgia upheld the jurisdiction of the chancellor "in taking the matter in hand and directing a sale of the entire interest for the benefit of all concerned" on the ground (as Glenn points out) that the situation was analogous to that in which equity allows an executor or administrator to file just such a bill. However, it was soon held that a creditor objecting at the outset could defeat a bill for general liquidation filed by an insolvent debtor. Hugh. v. McRae, (C.C.S.C. 1869) Fed. Cas. No. 6840. For similar holdings in Georgia, see Steele Co. v. Laurens Co., (1896) 98 Ga. 329, 24 S. E. 755; Bartlett v. Taylor, (1918) 148 Ga. 854, 98 S. E. 491. For a receivership in a federal court where receivers were appointed on a bill filed by the debtor corporation, see Wabash, etc., Ry. v. Central Trust Co., (C.C. Mo. 1884) 22 Fed. 272; Wabash, etc., Ry. v. Central Trust Co., (C.C. Mo. 1886) 29 Fed. 618; Atkins v. Wabash Ry., (C.C. Ill. 1886) 29 Fed. 161; U. S. Trust Co. v. Wabash Western Ry. Co., (1893) 150 U. S. 287, 14 Sup. Ct. 86, 37 L. Ed. 1085. Much adverse comment by courts and writers followed the Wabash receivership. See Chamberlain, New Fashioned Receiverships, (1896) 10 Harv. L. Rev. 139 and authorities cited by Glenn, Basis of Federal Receiverships, (1925) 25 Col. L. Rev. 434, 443.
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voluntary receivership petition. Eventually some court may again find jurisprudential sanction for such a practice, although there are certain obstacles to be overcome. Meanwhile, however, we do have this most flexible and adaptable federal chancery scheme of administering an insolvent or an embarrassed corporation. Let us not abandon the judge-made law of the last half-century for a statutory reorganization plan until we are quite sure that there is no possibility of otherwise overcoming equity's worst difficulties.

II. THE PLACE OF INSTITUTING THE SUIT: ANCILLARY RECEIVERS

Granted then that the process of instituting a receivership in equity in the federal courts has become a relatively elastic process, let us consider for a moment the problem (already indicated) of where the suit may be brought. As no federal question is involved in most receiverships, the parties get into the federal court through diversity of citizenship. Section 51 of the Judicial Code provides that,

"no civil suit shall be brought in any district court against any person by any original process or proceeding in any other district than that whereof he is an inhabitant; but where the jurisdiction is founded only on the fact that the action is between citizens of different states, suit shall be brought only in the district of the residence of either the plaintiff or the defendant."

And, when we examine the cases, we find that the residence of a corporate defendant is the state of its incorporation. Logically, therefore, the receivership bill should be filed either in the district where the plaintiff resides or, more normally, in the federal court of the district which includes the state wherein the defendant was chartered.

But here again the theory has been wholly exploded by the practice. The United States district court for the southern dis-

43Italics, mine.
45"The plaintiff was a citizen of New York; the defendant a Delaware corporation; the federal jurisdiction (of the district court for New Jersey) rested wholly on diversity of citizenship; and neither party was a citizen of New Jersey. Thus, there was a sound objection to the venue. If that objection had been duly made, and insisted upon, an error of the lower court in overruling it could not justify charging the corporation now with payment of any charge on account of the receivership, . . ." Brandeis, J., in Burnrite Coal Co. v. Riggs, (1926) 274 U. S. 208, 211, 47 Sup. Ct. 578, 71 L. Ed. 1002.
trict of New York is the popular eastern forum for equity receivership cases. Yet, certainly not one defendant in ten, and possibly not one in fifty is a New York corporation. The explanation for this phenomenon is found in such holdings as \textit{Central Trust Company v. McGeorge}^{46} and \textit{Horn v. Pere Marquette Railway Co.}^{47} As the consent receivership is in fact a voluntary process usually engineered by counsel for the defendant, the defendant when sued in a district other than that of its incorporation simply winks at the defect in the venue, admits the allegations of the bill, and joins in the prayer. Consequently the bill ordinarily will be brought in the district where the defendant has its principal office and where it has enough property to meet this flexible requirement. As soon as the primary receiver has been appointed, counsel located in all the other districts where the defendant has property will be notified to file ancillary bills.\(^{48}\)

The courts of Delaware and New Jersey, two of the states most seriously affected, sometimes criticise the practice of having primary receivers appointed for their corporations by the federal courts of New York. Both of these states have statutes enabling a simple contract creditor to procure a receiver for a corporation on the grounds of insolvency alone,\(^{49}\) although it has been held in Delaware that the chancellor still has discretion in the matter of the appointment.\(^{50}\) Consequently the Delaware\(^{51}\) and New Jersey\(^{52}\) state courts dislike to see their power usurped by the federal courts outside and sometimes inside their territorial borders. Serious clashes of "jurisdiction" occasionally occur during which two or more "primary" receivers will appear, each claiming possession of the corporate assets.\(^{53}\)

\(^{46}\)(1894) 151 U. S. 129, 14 Sup. Ct. 286, 38 L. Ed. 98.
\(^{47}\)(C.C. Mich. 1907) 151 Fed. 626.
\(^{48}\)This process is described vividly in the opinion of Bourquin, J., in May Hosiery Mills v. F. & W. Grand 5-10-25 Cent Stores, Inc., (D.C. Mont. 1932) 59 F. (2d) 218.
\(^{49}\)See supra note 11.
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It is at this point that more attention should be paid to the practice of appointing ancillary receivers in districts other than that in which the primary receiver was named. A primary receiver, for example, may be appointed in the United States district court for the southern district of New York and ancillary receivers may be named by any number of other federal (or state) courts. This unwieldy and expensive process was made necessary by the ruling of the United States Supreme Court in the early case of Booth v. Clark which has been followed consistently in the federal courts. This decision held "that a chancery receiver has no authority to sue in the courts of a foreign jurisdiction to recover demands or property therein situated. The functions and authority of such receiver are confined to the jurisdiction in which he was appointed." Consequently, the possession which the federal equity receiver has over the corporate property of the defendant is limited to the property within the district of the federal court appointing him.

Inasmuch as under section 70(a) of the Bankruptcy Act the trustee in bankruptcy takes title to all the debtor's property wherever located (thus eliminating the need for ancillary receiverships), it is urged that placing the corporate reorganization under bankruptcy would solve the problem. However, before

54(1854) 17 How. (U.S.) 353, 15 L. Ed. 173.


57Supra note 22, sec. 110 (a).

58Strengthening of Procedure in the Judicial System, supra note 3, at page 90.
concluding that bankruptcy is the only remedy, let us notice another proposed solution.

In May, 1927 a Special Committee on Equity Receiverships appointed by the Association of the Bar of the City of New York made its annual report. One of the questions answered in the affirmative in that report was framed in the following language:59

"Is it desirable or practicable that the jurisdiction of the district court originally appointing equity receivers be extended to assets of the defendant company wherever located in the United States regardless of district, and, if so, subject to what limitations?"

In answering this question the committee began by considering section 56 of the Judicial Code. This section provides in part that

"where in any suit in which a receiver shall be appointed the land or other property of a fixed character, the subject of the suit, lies within different states in the same judicial circuit, the receiver so appointed shall .... immediately be vested with full jurisdiction and control over all the property, the subject of the suit, lying or being within such circuit ...."60

This section of course applies only to cases concerning land or fixed property which lies within different states in the same circuit. Furthermore, the property must be unitary in character and must extend into several states. Interstate railroads and pipe lines are included, but assets such as cash, mortgages, stocks, and bonds are excluded under the Supreme Court ruling in Lion Bonding Co. v. Karatz.61 However, in spite of its deficiencies, Section 56 is a step in the right direction. It came into existence in 1911 when the present judicial code was adopted, and its presence there can be explained by the fact that Congress desired to eliminate some of the embarrassments encountered in the great railroad receiverships of the 90's.

The New York lawyers—after a thorough investigation of law—felt that it was not beyond the powers of Congress to extend the application of section 56 in two respects: (1) to cover property not only in different districts in the same circuit but in different circuits as well, and (2) to cover property other than land and "other fixed property" of a unitary nature. Consequently they recommended62

59Report of Special Committee on Equity Receiverships, supra note 4 at page 304.
"that Section 56 should be so modified or supplemented as to vest in a single district court definite control of receiverships not only of unitary properties such as railroads or pipe lines extending through two or more circuits, but also of industrial corporations and of 'non-unitary' properties and that the power of disapproval vested by section 56 as it now stands in the circuit court of appeals of the circuit of primary jurisdiction, or by a circuit judge thereof, is a sufficient power of disapproval even when the application of the section is extended as above recommended."\(^3\)

Perhaps, instead of concluding that the only relief from the difficulties of the ancillary receivership lies in the direction of bankruptcy, we should first advocate the passage by Congress of legislation to extend the scope of section 56, such as that recommended by the New York lawyers.\(^4\)

### III. The Problem of the Dissenting Minority Creditor

The third and final problem to be considered in this paper obviously is the most difficult one. Upon its solution perhaps will depend the whole future of the federal receivership in equity as an administrative device. Stated briefly, the problem is this. Assume that a reorganization committee has worked out a reorganization plan which is manifestly fair to all classes of creditors and shareholders and which has the unqualified approval of both the court and perhaps three-fourths or more of the claims and interests to be affected. To what extent, if any under our existing law, can the objecting minority creditor—particularly the unsecured creditor—be compelled to come in under the plan?

The Hastings Bill\(^5\) and its successors, as previously indicated, would place the entire reorganization under bankruptcy through

\(^3\)Report of Special Committee on Equity Receiverships, supra note 4 at page 308.

\(^4\)Report of Special Committee on Equity Receiverships, supra note 4 at pages 312-313.

\(^5\)"A report of the Special Committee on Equity Receiverships of the Association of the Bar of the City of New York, for 1926-1927, recommends the amendment of sec. 56 of the Judicial Code . . . to vest in a single district court complete control of receiverships not only of railroads or pipe lines, but also of so-called 'non unitary' properties, wheresoever located, and not merely when located within the circuit. Were such an amendment adopted, it would probably answer the problem here discussed. A bill for this purpose was introduced in the last session of Congress by Senator Norris, together with other bills recommended by the committee (S. Nos. 3456, 3457, 3458, 3459). They did not, however, pass." Israels, Reorganization Sales: section 848 of the Judicial Code, (1932) 32 Col. L. Rev. 668, 678, note 30.

\(^6\)Supra note 3.
a voluntary petition filed by the corporation itself. After the trustee has been placed in charge of the corporate property, a plan of reorganization may be submitted, provided that it has been approved by not less than twenty-five per cent of any class of creditors and not less than ten per cent in amount of all the creditors of the debtor. Such a plan—if the court deem it equitable—may be confirmed, under certain conditions, provided it has been accepted in writing by "creditors holding two-thirds in amount of the claims of each class whose claims or interests have been allowed and would be affected by the plan, and, unless the judge shall determine after a hearing that the debtor is insolvent, by or on behalf of stockholders of the debtor holding two-thirds of the stock in each class."

"Upon such confirmation the provisions of the plan shall be binding upon (1) the corporation, (2) all stockholders thereof, (3) all creditors whose claims are payable in cash in full under the plan, (4) all creditors entitled to priority . . . whose claims are not payable in cash in full under the plan, provided two-thirds in amount of such creditors shall have accepted the plan in writing, (5) all other unsecured creditors, provided two-thirds in amount of the unsecured creditors shall have accepted the plan in writing filed in the proceeding, and (6) all secured creditors of each class of which two-thirds in amount have accepted the plan."

However, in the case of the dissenting secured creditor, provision is made for realization upon his lien through either sale of the security or by a payment (in cash or securities at his election) at an appraised value. And, following the confirmation, the property shall be transferred by the trustee to the new or reorganized corporation "free and clear of all claims of the debtor, its stockholders and creditors, except such as may consistently with the provisions of the plan be reserved in the order directing such transfer."

As far as the unsecured creditor is concerned, the proposed legislation would seem to do at least two things, assuming, of course, that the reorganization plan has the approval of the court and the requisite percentage of creditors (and perhaps stockholders) in each class. In the first place, the unsecured creditor who has done nothing during the progress of the reorganization or who has refused to come in under the plan can not thereafter proceed to prosecute his claim against the assets of the old corporation in the possession of the new corporation. And, in the

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66Section 75, supra note 4.
second place, under the proposed statute, it would seemingly not be necessary to offer cash, as an alternative to securities, to any save the secured creditors. In other words, two-thirds in amount of the unsecured claims could force upon the remainder a plan which might provide for securities instead of cash in satisfaction of their interests. At least such seems to be the import of the corporate reorganization section as revised to date.

However, before deciding finally that the incorporation of this section into the Bankruptcy Act is the only way to clip the wings of the unsecured creditor who would upset the reorganization, let us notice how far the federal equity powers have gone in the direction of reaching the same result. This will require some consideration of where the doctrine of the *Boyd Case* stands at the close of the second decade since its enunciation.

Prior to the Supreme Court's decision in 1913 of *Northern Pacific Railway v. Boyd* the full power of a single unsecured creditor to upset a reorganization was not fully realized, although as Mr. Robert T. Swaine points out in the Columbia *Law Review,* the result of the *Boyd Case* had been forecast some fourteen years previously in the *Monon Case.*

The *Boyd Case* has been stated and discussed in corporation law almost as often as has *Lawrence v. Fox* in the law of contracts. And, while no excursion into this field would be possible without it, a brief reference to its well known holding should suffice here. The Supreme Court, in a five to four decision, ruled that Boyd, an unsecured creditor of the old Northern Pacific Railroad (or more accurately one of its underlying companies),

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69 (1913) 228 U. S. 482, 33 Sup. Ct. 554, 57 L. Ed. 931.
60 Reorganization of Corporations: Certain Developments of the last Decade, (1927) 27 Col. L. Rev. 901, 903. This article, which was an address which Mr. Swaine delivered before the Association of the Bar of the City of New York on March 10, 1927, is also published in Some Legal Phases of Corporate Financing, Reorganization and Regulation 133.
70 (1899) 174 U. S. 674, 19 Sup. Ct. 827, 43 L. Ed. 1130; also in C. R. I. & P. R. Co. v. Howard, (1868) 7 Wall. (U.S.) 392, 19 L. Ed. 117.
71 See, for example, Swaine, Reorganization of Corporations: Certain Developments of the last Decade, (1927) 27 Col. L. Rev. 902; Cutcheon, An Examination of Devices Employed to Obviate the Embarrassments to Reorganizations Created by the Boyd Case published in Some Legal Phases of Corporate Financing, Reorganization and Regulation 35; Walker, Reorganization by Decree: Recent Noteworthy Instances, (1920) 6 Corn. L. Q. 154, 158.
72 (1859) 20 N. Y. 268.
who had not even filed his claim during the receivership of the railroad, might satisfy a judgment against his debtor out of the property purchased at the receiver's sale by the newly organized Northern Pacific Railway. The receiver's sale was held in July, 1896, and Boyd started his suit against the reorganized company slightly more than ten years thereafter. Under the reorganization plan, bondholders in the old company were given bonds in the new company, and stockholders in the old company were permitted to participate in the new company by paying an assessment of $10 per share for the preferred and $15 per share for the common stock. Unhappily for the reorganizers, the plan made no provision whatever for the participation of the unsecured creditors, and this omission was regarded by the majority of the court as a vital defect.

As the property of the Northern Pacific Railroad had brought only $61,000,000 (the upset price) at the receiver's sale, and as there were then outstanding against it about $157,000,000 in bonds, unpaid interest and receivers' certificates, and as the new company at once issued $190,000,000 in bonds and $155,000,000 in stock against the property purchased, the court explained its attitude in aiding Boyd, an unsecured creditor, by enunciating its now famous "fixed principle":

73 Northern Pacific Railroad v. Boyd, (1913) 228 U. S. 482, 507, 33 Sup. Ct. 554, 57 L. Ed. 931. A more detailed statement of the case follows: Boyd had been a general creditor of a small railway company, the Coeur D'Alene, which had been absorbed by the Northern Pacific Railroad. Boyd maintained that the Northern Pacific Railroad had cooperated in a diversion of assets of the Coeur D'Alene from creditors to stockholders and, therefore, the Northern Pacific Railroad had become legally responsible for the debts of the Coeur D'Alene, including his own. The Northern Pacific Railroad became financially embarrassed in 1892 and passed into a federal receivership. At that time it had outstanding about $157,000,000 in bonds, unpaid interest and receiver's certificates; also $155,000,000 in stock. During the course of the receivership the mortgages were foreclosed and the railroad property was sold for $61,000,000 to a reorganization committee representing the newly organized Northern Pacific Railway. The court confirmed the sale. The bondholders in the old company were given bonds in the new company, and the stockholders in the old company were permitted to participate in the new company by paying an assessment of $10 per share for the preferred and $15 per share for the common. As no provision had been made in the plan for unsecured creditors, Boyd first reduced his claim to judgment and then sought to enforce his judgment against the property of the Northern Pacific Railway. The Supreme Court, by a five to four decision, held that the transfer to the Railway was fraudulent in law as to Boyd and that his claim constituted a lien against the property subject, however, to the mortgage placed thereon.

There are numerous decisions in accord with the Boyd Case. See, for example, Wabash Ry. Co. v. Marshall, (1923) 224 Mich. 593, 195 N. W. 134 and comment (1924) 9 Corn. L. Q. 192; Mountain States Power Co.
"The invalidity of the sale flowed from the character of the reorganization agreement regardless of the value of the property, for in cases like this, the question must be decided according to a fixed principle, not leaving the rights of creditors to depend upon the balancing of evidence as to whether, on the day of sale the property was insufficient to pay prior encumbrances."  

In Kansas City Southern Ry. Co. v. Guardian Trust Co., the next reorganization case to come before the Supreme Court following the Boyd Case, Mr. Justice Holmes in the following statement seemed to cast doubt on the "fixed principle" enunciated by Mr. Justice Lamar: "As the claim of the trust company was put by the court of appeals upon the equitable right of creditors to be preferred to stockholders against the property of a debtor corporation, it is essential to inquire whether the appellant received any such property, that is whether it got by foreclosure more than enough to satisfy the mortgage, which was a paramount lien."

"But," observes Mr. Swaine in discussing the Kansas City Southern Case, "notwithstanding this language, the court looked not to see what the actual value of the property was, but whether the stockholders of the Belt Company got a valuable interest, when the creditors were excluded." And later Supreme Court decisions such as Kansas City Terminal Ry. Co. v. Central Union Trust Co., decided as recently as 1926, adhere to the "fixed principle" of the Boyd Case rather than to a formula which would take into account the selling price of the corporate property in relation to the amount of the secured debt.

These cases, therefore, establish the fact that the Supreme Court—at least as recently as 1926—still adhered to the doctrine of the Boyd Case. However, in the two decades that have elapsed since that decision, inferior federal judges sitting in equity have worked many times with corporation counsel in an effort to modify the harshness of that doctrine. The story of this development—which is the story of equity's growth in the corporate reorganization field—has been told in a scholarly manner in two lectures delivered in the spring of 1927 before the Association of the Bar of the City of New York by Robert T. v. A. L. Jordan Lumber Co., (C.C.A. 9th Cir. 1923) 292 Fed. 502, cert. den. (1924) 264 U. S. 582, 44 Sup. Ct. 332.


76Reorganization of Corporations: Certain Developments of the Last Decade, (1927) 27 Col. L. Rev. 901, 906.

Swaine, Esq., and Franklin W. M. Cutcheon, Esq. So exhaustively have these eminent corporation lawyers treated their subject that only brief reference to a few major points is necessary here.

The Boyd Case had emphasized the need for making a fair offer of an interest in the reorganized company to the unsecured creditors if the reorganization plan was to withstand possible subsequent attacks upon it. But did the decision mean that the federal court was to be empowered to pass upon the fairness of the plan? And, if so, precisely what is a fair offer to unsecured creditors? The inferior federal courts have approached the answer to these and kindred problems with a fine showing of intelligence and courage.

The first important railroad reorganization to come before the federal courts following the Boyd Case was that of the St. Louis & San Francisco Railroad Company. Judge Sanborn inserted a provision in the foreclosure decree (entered in March, 1916) stating that no sale to a reorganized company (admitting stockholders of the old company) would be confirmed unless "a fair and timely offer of participation in such corporation through stocks, bonds, or otherwise" had been made to all creditors who had filed their claims. Exclusive jurisdiction was reserved by the court to determine whether the plan did contain such a fair offer to general creditors. The corporate property was sold under the decree and purchased by a committee representing the reorganized Frisco Railroad. Prior to the sale unsecured creditors were offered participation, and this offer was kept open for nearly two years. The court confirmed the sale over the objection of certain unsecured creditors and "decreed that the purchaser should hold the property free from the claims of creditors of the old company."

78Reorganization of Corporations: Certain Developments of the Last Decade, (1927) 27 Col. L. Rev. 901.
79An Examination of Devices Employed to Obviate the Embarrassments to Reorganizations Created by the Boyd Case, published in Some Legal Phases of Corporate Financing, Reorganization and Regulation 35.
82Cutcheon, supra note 71 at page 49.
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Reorganizations subsequent to that of the Frisco Railroad have brought certain changes in procedure, but the underlying purpose—whatever the procedure employed—always has been the same—namely, to give certain groups of creditors an opportunity to be heard and to permit the court to declare the reorganization plan either fair or unfair within the none-too-specific requirements of the Boyd Case. Clearly, if the sale to the reorganization committee is to stand, it must be confirmed by the court. And, as has been pointed out, if the court deems the reorganization plan unfair to any of the interests affected, it will refuse to confirm the sale. Thus, by an indirect but nevertheless effective method, the chancellor exercises control over the reorganization plan.

The scope of this paper does not permit consideration in detail of the various formulae advanced for determining the fairness of a reorganization plan. One question, however, will be noticed in passing, and it is this. If the court is to approve the plan as fair, must it offer the unsecured creditors of the old corporation a cash payment of the value of their claims as determined by the court, as an alternative to shares or securities in the new corporation?

This question, which has aroused considerable speculation, grows out of the famous dictum of Mr. Justice Lamar in the Boyd Case. This dictum reads as follows:

"This conclusion [the judgment for Boyd] does not, as claimed, require the impossible and make it necessary to pay an unsecured creditor in cash as a condition of stockholders retaining an interest in the reorganized company. His interest can be preserved by the issuance, on equitable terms, of income bonds or preferred stock. If he declines a fair offer he is left to protect himself as any other creditor of a judgment debtor, and having refused to come

68See Cutcheon, supra note 71 at 60 et seq.; Swaine, supra note 69 at page 143 et seq; Walker, Reorganization by Decree: Recent Noteworthy Instances, (1921) 6 Corn. L. Q. 154.
64For a detailed consideration of this matter, see Swaine, supra note 66 at pages 148-166. This division of his lecture is entitled "The Test of Fairness." See also Buscheck, A Formula for the Judicial Reorganization of Public Service Corporations, (1932) 32 Col. L. Rev. 964. For a list of cases where the plan of reorganization was sustained under attack, see Tracy, Corporate Foreclosures, sec. 299, note 5.
into a just reorganization, could not thereafter be heard in a court of equity to attack it. If, however, no such tender was made and kept good he retains the right to subject the interest of the old stockholders in the property to the payment of his debt. If their interest is valueless, he gets nothing. If it be valuable, he merely subjects that which the law had originally and continuously made liable for the payment of corporate liabilities."

The Supreme Court mentioned the dictum in *Kansas City Terminal Ry. Co. v. Central Union Trust Co.* and seemed to say that it is not always necessary to offer cash to the unsecured creditor. Several inferior federal courts also have passed upon this question in cases which have arisen in various ways. The decisions are not in harmony, and no attempt will be made here to draw any generalizations from them. In the much discussed case of *Phipps v. Chicago, Rock Island & Pacific Railway* Judge Sanborn refused relief to a tort creditor who had reduced a $7,000 claim to judgment and who had steadily refused to come in under a reorganization plan, although he did file his claim in the receivership proceeding. The plan had been approved, and the railroad property in the receivership had been turned back to the old corporation without the formality of a judicial sale—a novel experiment in the field of equity jurisprudence. Phipps, the complaining creditor, had been offered $7,000 in six percent preferred stock of the Rock Island and a cash payment of the accrued interest on his claim. He declined this offer and sued the railroad. Judge Sanborn, sitting in the circuit court of appeals for the eighth circuit, affirmed an injunction restraining the suit. His authority for so ruling was the previously mentioned dictum of Mr. Justice Lamar in the *Boyd Case.* The Supreme Court granted a writ of certiorari, but the case was finally dismissed on stipulation of counsel.

In 1927 the same Circuit Court of Appeals for the eighth circuit decided *Temmer v. Denver Tramway Co.* The Tramway Company had passed through a receivership, and the property had been sold to the reorganized company under a mortgage foreclosure. Unsecured creditors were given dollar for dollar on

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89 (1913) 228 U. S. 482, 53 Sup. Ct. 554, 57 L. Ed. 931.
90 (1923) 261 U. S. 611, 43 Sup. Ct. 363, 67 L. Ed. 826.
91 (1923) 262 U. S. 762, 43 Sup. Ct. 701, 67 L. Ed. 1221.
92 (C.C.A. 8th Cir. 1927) 18 F. (2d) 226.
their claims in the preferred stock of the new company. They were not offered cash. Temmer appealed from the decree of the federal court for the district of Colorado which had fixed the manner and amount of his participation. The decree of the district court was affirmed, largely on the authority of Mr. Justice Lamar's famous dictum.

On the other hand, there are decisions such as that of Judge Learned Hand in *In re Prudential Outfitting Co.* This was a bankruptcy, but the problem was similar to that raised in the foregoing cases. The Prudential Company, a Delaware corporation, had been adjudicated a bankrupt and, contrary to the procedure in most bankruptcies, a reorganization of the debtor's business was arranged by a committee of creditors. A new corporation was organized which took over the stock in some twenty stores owned by the bankrupt, together with its good will and trade name. The expenses of administration were paid by the committee which bid in the property at the sale. The sale was confirmed by the referee. General creditors were paid 100 cents on the dollar in preferred stock of the new company under the plan which had the unanimous approval of a large number of creditors attending the creditors' meeting. However, despite the fact that the new corporation was operating the property and had already incurred liabilities of its own, the court ordered the sale set aside and the property resold at public auction. This order was made on the petition of a creditor who had not received a notice of the meeting at which other creditors approved the plan and who refused the preferred stock when it was tendered to him. "Bankruptcy does not change the character of the creditors' claims, which are measured by, and collectible in, money," said the court.

One of the most recent decisions to consider the question of cash payment is *Coriell v. Morris White, Inc.* decided in November, 1931 by the circuit court of appeals for the second circuit. The corporation involved was a leather goods company which was placed in a consent receivership on April 6, 1931. A reorganization plan was submitted which provided for the transfer of the corporate assets to a new corporation under the following terms.

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93 (D.C. N.Y. 1918) 250 Fed. 504.
94 (D.C. N.Y. 1918) 250 Fed. 504, 506.
95 (C.C.A. 2nd Cir. 1931) 54 F. (2d) 255. See Comment (1932) 41 Yale L. J. 577; Notes (1932) 45 Harv. L. Rev. 697; (1932) 18 Va. L. Rev. 784.
The new corporation was to assume $158,500 in overdue state and federal taxes. One thousand shares of no par common stock were to be issued to one White who had owned all the stock in the old corporation. Nine thousand shares of cumulative preferred stock (par value, $100) were to be issued to creditors as payment of eighty per cent of their claims. The remaining twenty per cent of the claims were to be met by four series of notes maturing from January 2, 1932 to July 2, 1933. There were no mortgage bonds outstanding. The assets were sold privately under the plan which was approved by the district court. Certain unsecured creditors holding about ten per cent of the total claims sought to set aside the sale on the ground that the plan made no offer of cash to the unsecured creditors and permitted White to obtain a controlling interest in the new corporation (his common stock was to elect three of the five directors) without any cash contribution.

The circuit court of appeals in this instance upheld the contention of the unsecured creditors that they could not be required to accept shares in lieu of cash. However, the Court did not order a public sale of the assets as did the district court in In re Prudential Outfitting Co. Instead it decreed that the creditor should be offered in cash their proportional shares of the amount the assets would bring if sold at public sale.

The Coriell Case has been carried to the Supreme Court of the United States, and a decision thereon should be forthcoming soon. A writ of certiorari was granted, and the case was argued on December 15, 1932.98

Let us assume now that the court has stamped the reorganization plan fair and has confirmed the sale. How far have the inferior federal courts gone under their general equity powers in preventing dissenting unsecured creditors from upsetting the reorganization "apple cart" by proceeding against the new corporation? It was with this question that the present division of this paper began, and it still is unanswered. Perhaps no unqualified answer is possible. However, in some instances the federal courts have not hesitated to use the power of injunction to restrain the dissatisfied creditor.

Following the Frisco reorganization, one McElvain, an unsecured creditor of the old company who had filed his claim in the

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receivership, who had not objected to the sale, and who had been tendered his share under the reorganization plan, commenced an action at law in a Missouri state court to recover his debt from the newly organized St. Louis & San Francisco Railway Co. The railroad thereupon brought a bill in the federal court for the eastern district of Missouri to enjoin the McElvain suit. The railroad's prayer was granted, and further prosecution of the creditor's suit was enjoined.97

The use of a federal injunction to restrain a creditor who refused to come in on the Rock Island reorganization already has been pointed out in *Phipps v. Chicago, Rock Island & Pacific Ry.*98 In that instance also the creditor had filed his claim. And a most interesting angle of the *Phipps Case* is the fact that the disgruntled creditor had not even been offered cash as an alternative to preferred stock in the new company.

In at least two other cases the court went even further. In *St. Louis—San Francisco Ry. v. Wall,*99 an unreported case also growing out of the Frisco reorganization, the court restrained a creditor who had not even filed a claim in the receivership. And in the leading decision of *Chicago, Rock Island & Pacific Ry. v. Lincoln Horse and Mule Commission Co.,*100 the circuit court of appeals for the eighth circuit reversed a district court judgment which had refused to allow an injunction to lie against a dissenting creditor who likewise had failed to file his claim in the Rock Island receivership and later attempted to come against the reorganized company.

In view of the condition of the authorities, any absolute statements concerning the legal position of the dissenting minority creditor in a corporate reorganization would be decidedly hazardous. Likewise, any predictions as to future holdings on the points raised in this paper may be equally hazardous. However, the following are suggested as the personal reactions of the writer:

1. Eventually the method of public sale, usually under a mortgage foreclosure, as a means of transferring the assets from the old corporation to the new corporation may well be abandoned.

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98 *(C.C.A. 8th Cir. 1922)* 284 Fed. 945, 28 A. L. R. 1184.
100 *(C.C.A. 8th Cir. 1922)* 284 Fed. 955.
It may require some such congressional legislation as that sug-
gested by section 76 of the Hastings Bill or by one of the later
bills to hasten this reform and thus give the court the direct con-
trol it should possess over the corporate reorganization plan.
However, should such legislation fail to pass, it may come about
eventually that the federal judges, acting under their ever ex-
panding general equity powers, may evolve a similar plan without
the aid of a statute.

2. The theory that it is always necessary to offer the unsecured
creditor his share in cash as an alternative to stock or securities
in the new corporation may also be on the way to the discard,
although an affirmance by the Supreme Court of the Circuit Court
of Appeals' holding in the Coriell Case will go a long way in the
direction of perpetuating this theory.

3. The power of a court of equity to enjoin a dissenting cred-
itor, if judiciously used, may well take the place, at least in part,
of a statutory enactment barring the creditor from further partici-
pation in the corporate assets.

In order to find precedents for these suggestions one need not
pass beyond the bounds of the very receivership law we have been
considering. As already emphasized, equity's control over the
affairs of the insolvent corporation has been an ever widening con-
trol. The vast range of that control is set forth in excellent sum-
mary fashion in the following paragraph from James M. Rosen-
berg's illuminating article in the Columbia Law Review entitled
"Reorganization—The Next Step:"

"If the court has such extensive powers over a corporate re-
organization before it, if its jurisdiction is the whole domain of
economic need limited only by express legislative enactment, if it
can, at the institution of a creditor at large, take hold of an insol-
vent defendant, administer its business and enjoin all interference,
if it can issue receiver's certificates having priority in all cases
over unsecured creditors, and in cases involving what is termed
'public interest' even over the secured creditors, if it can under
the so-called 'six months rule' require a prior payment of a general
indebtedness incurred in the mere operation of a public utility,
despite the existence of a previous mortgage and of the vested
rights of bondholders thereunder, if it exercises all these powers
without express statutory authority, it does not seem to be stretch-
ing equitable principles and jurisdiction beyond their reasonable

102 Rosenberg, Reorganization—The Next Step, (1922) 22 Col. L. Rev. 14, 22.
intention to give new money priority over secured creditors upon the consent of a majority, after complying with what may be called the essentials of due process, in giving notice and a 'day in court' to the dissenters, and by giving to secured creditors a lien on the property, junior only to the new money but maintaining a proper rank as to all other claims.”

Mr. Rosenberg, it will be noticed, has gone somewhat farther in his conception of the powers of the chancellor than has this paper, but his approach clearly is in the right direction. In fact, if one needs any further evidence than that of the receivership cases for the growing powers of equity, let him scan the whole realm of equity jurisprudence. His conclusion then may well be that of Judge Noyes in Pennsylvania Steel Co. v. New York City Railway Company\(^\text{103}\) when he said: “Thus is illustrated anew the vainness of saying what courts of equity cannot do.”

\(^{103}\) (C.C.A. 2nd Cir. 1912) 189 Fed. 721, 737.