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Austin V. Clifford
Indianapolis Bar

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SOME COMMENTS OF PROCEEDINGS UNDER SECTION 77B OF THE BANKRUPTCY ACT*

By AUSTIN V CLIFFORD

(A) THE SCOPE OF THE PAPER

When Judge Gause asked me to prepare this paper on Section 77B of the Bankruptcy Act, he said that he wanted it to be strictly a professional paper. I understood that to mean that, in view of the tremendous amount of current legal material on the subject, and the length of time allotted to this paper, it would be out of place for me to discuss the history, purpose, and constitutionality of the Act, or to give any detailed consideration as to the various steps which are undertaken in the course of a reorganization as a matter of routine, and that what really was desired was a discussion of some of the current decisions on interesting and debatable points of law arising in proceedings under 77B, with special reference to decisions which may have a local application.

At the outset, I want to plead guilty to over-simplification throughout the paper. It is obviously impossible to refer to all of the qualifications and exceptions which a statute, as broad in scope as Section 77B, must contain, in order to cover all cases. If those qualifications and exceptions were continually referred to, it would be impossible to follow the main trend of thought. The most that can be attempted now is to point out in rather broad outlines the way the law is developing in certain principal categories under Section 77B, as follows first, the method of invoking jurisdiction, second, questions that arise between the approval of the petition for reorganization and the approval of the plan, and third, the plan of reorganization and how it is proposed and approved.

*Address by Austin V Clifford, of the Indianapolis Bar, at the Mid-Winter Meeting of the Indiana State Bar Association, February 1, 1936.

(B) THE METHOD OF INVOKING JURISDICTION

Broadly speaking, Section 77B has greatly enlarged the scope of the Bankruptcy Act, for corporations may file under it which are not insolvent within the definition of that word given in Section 1 of the Bankruptcy Act. It is only necessary for the corporation filing under the Act to be insolvent in the old common law sense, that is, unable to pay its debts as they mature in the usual course of business (subsection (a)).¹ Many a corporation may have a substantial excess of assets over liabilities and a future of considerable promise, and still at certain periods be unable to meet its debts as they fall due in the usual course of business. Valuable equities in such corporations may often be saved by resort to Section 77B. It is interesting to note in this connection, however, that a corporation may voluntarily file under Section 77B, although it is insolvent in the bankruptcy definition of the word, that is, the aggregate of its assets at a fair valuation is less than the aggregate of its indebtedness. [Sec. 1, Sec. 77B, subsection (a)]. This means that a corporation which has no equity in its property still has such an interest in continued existence that it may seek the protection of the statute, even though the stockholders of that corporation may be entirely eliminated in the reorganization and an entirely new set of stockholders, consisting of creditors of the corporation prior to reorganization, become the owners of the corporation's property after the reorganization proceedings have been completed.¹ Thus, in *Re Central Funding Corp.*,² it was held that, after a decree had been entered dissolving the corporation, the bondholders might petition for a reorganization which consisted only, in essence, of an exchange of their bonds for participation certificates in a successor liquidating corporation. And in *Re 211 East Delaware Place Building Corp.*,³ a corporation dissolved for non-payment of franchise taxes was reorganized for the benefit of bondholders.

¹ In re Broadway-Exchange Corporation, C. C. H. Bankruptcy Service, Decisions Volume, Paragraph 3696.

² 75 Fed. (2d) 256, (2 C. C. A.)

³ 76 Fed. (2d) 834, (2 C. C. A.)

Involuntary petitions may be filed by three or more creditors holding provable claims in the aggregate, in excess of the value of securities of \$1,000. Likewise, three or more creditors possessing the same qualifications may contest the voluntary petition of the debtor. Stockholders holding 5% in number of all outstanding shares of stock of any class of the debtor corporation may contest the petition of creditors.

In this connection, a recent decision of the Circuit Court of Appeals of the 7th Circuit is of particular interest to attorneys in this state. All Indiana lawyers are familiar with the widespread practice in this state of financing real estate projects by means of preferred stock. Most of such corporations own the fee of certain real estate and do not have large amounts of creditors in proportion to the value of the real estate. However, during the depression, practically all of those corporations have defaulted in the payment of dividends on preferred stock and maturities of preferred stock. A particularly interesting question is whether corporations whose preferred stock is in default may be reorganized under Section 77B. In the *Piccadilly Realty Company* case,⁴ the corporation owned an apartment and store building having an assessed valuation of \$127,640, had cash on hands of approximately \$6,500, and accounts receivable in the amount of \$1,100. It owed approximately \$4,000 of taxes, \$1,756 of debts, \$6,600 for the services of the common stockholder, and the costs and expenses of administration which had accrued in state court receivership proceedings. The preferred stock having been in default since August 1, 1931, the preferred stockholders held a special meeting, purported to exercise the voting rights conferred upon them in event of default, and elected a new Board of Directors, who thereupon chose new officers and authorized the new officers to file proceedings for the reorganization of the company under Section 77B. This was done. The District Court approved the filing of the petition. On appeal, the Circuit Court of Appeals reversed the decision of the District Court. In its opinion, the Circuit Court of Appeals referred specially to

⁴ 78 Fed. (2d) 257.

subsection (b)10, which contains the words "The term 'claims' includes debts, securities, other than stock, liens, or other interests of whatever character" Relying upon the case of *Star Publishing Co. v. Ball*,⁵ the Court said that preferred stockholders, whatever their stipulated preferences might be, were nevertheless not creditors, but parties "to the business venture along with the common stockholders." Upon the authority of *Allied Magnet Wire Corp. v. Tuttle*,⁶ the Court held that the agreement to pay dividends on the preferred stock was not enforceable where there was no showing that profits were earned by the business of the corporation out of which the dividends could be paid. It is to be regretted that the court did not refer to the recent Appellate Court opinions in *Campbell v. Grant Trust & Savings Co.* and in *Cring v. Sheller Wood Rim Mfg. Co.*,⁷ which contain some contrary implications. The Piccadilly case was argued by able counsel and doubtless both Appellate Court cases were cited to the Circuit Court of Appeals. However, that court chose to base its decision strictly upon the wording of Section 77B, rather than on the general principles of corporation law. This case will undoubtedly settle the law for this jurisdiction that matured preferred stock, in default, cannot be a sufficient basis for saying that the corporation owes debts which it is unable to pay in the usual course of business, and means that most real estate corporations can only be reorganized in equity proceedings.

After a petition has been filed, the next step is that if the court is satisfied that the petition complies with this section and has been filed in good faith, it shall approve the petition. The court's order made in pursuance of this clause of the statute is equivalent to the adjudication of bankruptcy under the Bankruptcy Act itself, and establishes the exclusive jurisdiction of the bankruptcy court over all of the property, wherever located.⁸

⁵ 192 Ind. 158, 134 N. E. 285.

⁶ 199 Ind. 166, 154 N. E. 480, 156 N. E. 558.

⁷ 97 Ind. App. 169, 182 N. E. 267, 98 Ind. App. 310, 183 N. E. 674.

⁸ *Humphrey v. Bankers Mtge. Co.*, 79 Fed. (2d) 345, (10 C. C. A.), *In re Greyling Realty Corp.*, 74 Fed. (2d) 734, (2 C. C. A.).

Good faith in connection with the filing of a reorganization proceeding probably means that the petition is filed by properly authorized representatives of the debtor corporation or by bona fide and qualified creditors, that the jurisdictional requirements are present; that there is a genuine need for reorganization⁹ and that there is no intent by invoking the proceedings to delay action in a court which is already far along in the process of reorganizing or liquidating the debtor. In the *Grigsby-Grunow Company reorganization*,¹⁰ a petition was filed by three creditors after a sale by a trustee in bankruptcy in liquidating proceedings, but before the actual conveyance of the property by the trustee. The company had been either in equity receivership or bankruptcy for more than eleven months, and the District Judge who had jurisdiction of the case had urged that a reorganization be effected. Bondholders committees and creditors committees had sought to reorganize without success. Counsel for the petitioners under Section 77B refused to disclose what their plan of reorganization was, or who would act as financial sponsors of the plan, though they offered to reveal this in confidence to the Judge in chambers. The District Judge dismissed the petition as not brought in good faith, and the Circuit Court of Appeals affirmed that action.

There have been no decisions of the Supreme Court of the United States defining when a petition is filed in good faith. Four cases involving this point are pending before the Supreme Court upon petition for certiorari, all from the Seventh Circuit.¹¹

For corporations whose property is located in more than one state or Federal District and whose activities are of wide scope, Section 77B affords the tremendous advantage of nation-wide jurisdiction of property¹² No ancillary administrations, with their attendant expense and possible conflicts of jurisdiction are involved.¹³

⁹ *In re South Coast Co.*, 8 Fed. Supp. 43, (D. C. Del.).

¹⁰ 77 Fed. (2d) 200, (7 C. C. A.).

¹¹ U. S. Law Weekly, Dec. 31, 1935, p. 15, Jan. 14, 1936, p. 14.

¹² *In re Greyling Realty Corp.*, 74 Fed. (2d) 734, (2 C. C. A.).

¹³ See 23 *Georgetown Law Journal* 418.

Moreover, if the debtor corporation has a number of subsidiaries, the court may exercise the same jurisdiction to any subsidiary, its property, creditors and stockholders, as the court could exercise with respect to the principal debtor, if the subsidiary files a petition setting forth insolvency, inability to meet its debts as they mature, or simply a desire to effect a reorganization with or as a part of the plan of the principal debtor.

(C) QUESTIONS ARISING BETWEEN APPROVAL OF PETITION
AND THE APPROVAL OF THE REORGANIZATION PLAN

After approval of the petition, the court may, after a hearing upon notice to the debtor and to such others as the court may determine, temporarily continue the debtor in possession or appoint a trustee or trustees and cause the debtor or trustee to give such notice as the court deems proper to creditors and stockholders, and also cause publication thereof at least once a week for two successive weeks of a time for hearing to be held within thirty days from the date of the original order, at which hearing the court may permanently restore the debtor to possession or appoint a permanent trustee or trustees or additional or substitute trustees. Whether the debtor remains in possession or not, the court generally continues the operation of the debtor's business. A nice question arises in this situation as to what rank the obligations incurred by the debtor in possession, or by the temporary or permanent trustee may have with reference to claims of other creditors of the debtor. It would be reasonable to suppose that the courts would adopt the analogy to the debts created by an equity receiver while operating a business under the supervision of the court, and hold that the debts incurred subsequent to the entering of the order approving the filing of the debtor's petition would be paid prior to the general unsecured indebtedness of the debtor created theretofore. This result was reached by the Circuit Court of Appeals for the Second Circuit in the case of *In re Avorn Dress Co., Inc.*¹⁴

¹⁴ 78 Fed. (2d) 631.

All are familiar with the rule in receivership cases that persons dealing with a receiver must determine at their peril the scope of authority granted him by the court. In a subsequent controversy arising in the *Avorn Dress Company* case,¹⁵ the facts were that the debtor, in possession, had borrowed money to meet payrolls without authority from the court to do so, and had also pledged certain accounts receivable as security for the loan. The court applied the receivership rule to the situation, refused to recognize the validity of the pledge, and also refused to permit the lender to be subrogated to the priority of employees whose wages were thereby paid.

During this period, the debtor in possession or the trustee, may, under instructions from the court, reject executory contracts, including leases.¹⁶ Of course the rejection of an executory contract other than a lease gives the other contracting party a general claim against the estate of the debtor for the amount of the damages sustained.¹⁷ Likewise, the landlord, upon the rejection of his lease, is specifically given a claim for the damages which he may sustain not in excess of the rent, without acceleration, reserved by the lease for the three years next succeeding the date of the surrender of the premises to the landlord or the date of re-entry by the landlord, whichever first occurs, plus unpaid rent accrued up to the date of such surrender or re-entry (Subsection (b)10). No cases have been found in which determination of the amount of a landlord's damages under Section 77B has been discussed.¹⁸ It must, of course, be remembered that this provision, which seems somewhat hard on the landlord, really gives the landlord greater rights against a corporate tenant than he had under the Bankruptcy Act before Section 77B was enacted.¹⁹

¹⁵ 79 Fed. (2d) 337

¹⁶ In re 211 East Delaware etc. Corp., 76 Fed. (2d) 834, (2 C. C. A.), construing subsection (c)5, In re Cheney Bros., 12 Fed. Supp. 605, (D. C. Conn.).

¹⁷ Central Trust Co. v. Chicago Auditorium Ass'n, 240 U. S. 581, 60 L. Ed. 811.

¹⁸ Cf. under other provisions of the Bankruptcy Act — In re Outfitters etc. Co., 69 Fed. (2d) 90, (2 C. C. A.).

¹⁹ Manhattan Properties Corp v. Irving Trust Co., 291 U. S. 320, 78 L. Ed. 824.

Moreover, if the lease is really an asset of the debtor's estate, the debtor in possession or the trustee will have to adopt the lease in order to obtain the benefit of the use of the property

When considering the question of the custody and operation of the property during the period between the approval of the filing of the petition and approval of the reorganization plan, it is interesting to consider the status of property held by the debtor subject to conditional sales contracts and property of the debtor upon which the debtor has given chattel mortgages. A recent case decided by the Circuit Court of Appeals for the Second Circuit²⁰ has held that the machinery sold to a debtor in New York under conditional sales contracts which provided that the title to the machinery should remain in the seller until the machinery was paid for, was not "property" of the debtor within the provisions of Section 77B, and hence was not part of the subject matter of the reorganization proceedings. It further held that the seller, when default occurred in the conditional sales contract, could proceed immediately to repossess the property. This result was criticized in a note found in *35 Columbia Law Review* 1305. Of course, exactly the opposite rule has been reached in regard to the property of the debtor which has been pledged as security for a debt, or upon which a chattel mortgage has been given. Wide jurisdiction has been recognized in the bankruptcy court to restrain action by the pledgee or mortgagee to foreclose the pledge or mortgage lien and thereby destroy the debtor's equity in the property. The leading case on this subject arose under Section 77, the Railroad Reorganization Act, and went to the United States Supreme Court from the Circuit Court of Appeals for the Seventh Circuit.²¹ In that case, a petition for the reorganization of the Rock Island Railroad was pending under Section 77 of the Bankruptcy Act. The corporation had issued its notes secured by mortgage bonds issued by itself and its subsidiaries. The collateral notes being about to go in default and a sale

²⁰ *In re Lake Laundry*, 79 Fed. (2d) 326.

²¹ *Continental Illinois etc. Co. v. Chicago, Rock Island & Pacific Ry. Co.*, 294 U. S. 648, 79 L. Ed. 1110.

being threatened, the debtor filed a petition seeking an injunction against holders of the notes from selling any of the collateral. The holders of the collateral notes, some of them New York and St. Louis banks, objected to the jurisdiction of the court over their persons and over the pledged bonds, and challenged the summary jurisdiction of the court in the matter. The District Court issued an injunction, which action was affirmed by the Circuit Court of Appeals for the Seventh Circuit and by the Supreme Court of the United States. The Court thus upheld the jurisdiction under Section 77 of an equity of the debtor corporation in property in the possession of a third party under an adverse claim. The purpose of Section 77, the Railroad Reorganization Act, and Section 77B, the general corporate reorganization act, is essentially the same. In fact, a similar ruling has been made under Section 77B.²²

The power to stay foreclosure proceedings in mortgages upon real estate had been exercised under the Bankruptcy Act before the passage of Section 77B²³ and such jurisdiction has likewise been exercised under Section 77B, but, after efforts to reorganize continued over a reasonable time and proved unsuccessful, the court, having jurisdiction under Section 77B, has dismissed the petition and permitted the foreclosure to proceed.²⁴

During the period immediately following the entering of the decree approving the filing of the petition, the claims of all creditors of the debtor must be adjudicated, in order that their votes in connection with the reorganization plan may be given the proper weight. In order to speed up the proceedings, Section 77B requires the court to determine a reasonable time within which the claims and interests of creditors and stockholders may be filed and to order that no claim or interest not theretofore filed may participate in the reorganization plan. The court also has control over the manner in which such claims or interests may be filed or evidenced and must

²² *In re Prudence Bonds Corp.*, 77 Fed. (2d) 328, (2 C. C. A.).

²³ *Straton v. New*, 283 U. S. 318, 75 L. Ed. 1060.

²⁴ *In re 235 West 46th Street Co.*, 74 Fed. (2d) 700, (2 C. C. A.), *In re Coney Island Hotel Corp.*, 76 Fed. (2d) 126, (2 C. C. A.).

classify the various claims in some logical classification which will enable the court to ascertain the wishes of the various classes of claimants with respect to their particular interests. Thus, there may be several different classes of secured creditors. There may be creditors whose security consists of a mortgage upon the manufacturing plant of the debtor, other secured creditors whose collateral consists of warehouse receipts for some of the debtor's products, and still another class of secured creditors whose collateral consists in the pledge of notes or open accounts of the debtor. The security of one class of secured creditors may be adequate, that of another may not be. In such cases, subsection (b)10 specifically provides that the court 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.

During this same period, the officers of the debtor are usually engaged in formulating a reorganization plan in conjunction with committees representing creditors and stockholders, or independently, and the culminating steps in the proceeding under Section 77B turn upon the submission and approval of the reorganization plan.

(D) THE REORGANIZATION PLAN AND HOW IT IS PROPOSED AND APPROVED

The essential purpose of proceedings under 77B is the adoption of a reorganization plan. All of the jurisdiction and power granted to the court preliminary to the approval of such plan is for the purpose of enabling the court to clear away the corporate debris, such as unprofitable executory contracts and leases, and put the parties in interest in position to prepare and put into effect a satisfactory plan of reorganization.

The plan may, but need not be proposed at the time of the filing of the petition. The debtor may propose a plan without approval by any group of creditors or stockholders. Before any plan is proposed by others, it must be approved by creditors affected thereby who represent not less than 25% in amount of any class of creditors and not less than 10% in

amount of all claims. If the corporation is not insolvent, but is unable to meet its debts, the plan must be approved, before it is proposed, by stockholders representing not less than 10% of any class of stock outstanding, and not less than 5% of the total number of shares of all classes of stock outstanding. (Subsection (d))

Subsection (b) describes in considerable detail the requirements of a reorganization plan. It requires that the plan shall provide for payment in cash of all costs of administration and the allowances made by the court, or reimbursements ordered by the court under subsection (c) 9 for expenses incurred in connection with the proceedings and the plan by officers of the debtor, by parties in interest, or by depositories, committees, etc. It also requires the plan to include such provisions modifying the rights of any class of creditors as may be necessary, and permits the plan to modify or alter the rights of stockholders. Another mandatory provision is that the plan shall provide for the protection of any class of creditors or stockholders which, *as a class*, fails to accept the reorganization plan (a) by a sale of the property or equity in which the class is interested at not less than a fair upset price, or (b) by appraisal and payment in cash of the value of the interest of the class, or, at the election of the various members thereof, in securities allotted to such class under the plan, or (c) by any other method approved by the court. The reorganization plan must also specify what classes of creditors or stockholders are not affected thereby, and what claims, if any, are to be paid in full in cash. The plan itself may provide for the rejection of executory contracts and leases. Subsection (b)9 lists a large number of devices which the plan may include in order to carry the general purpose of the plan into operation.

It must not be supposed that the foregoing is an exhaustive analysis of the provisions with respect to the plan. As heretofore stated, the discussion has been over-simplified.

The plan, when proposed, must be submitted to the creditors and stockholders for acceptance. In order to be binding upon non-assenting parties, the plan must be accepted by

creditors holding two-thirds in amount of the allowed claims in each class affected by the plan, and on behalf of stockholders by those holding a majority of the stock of each class. (Subsection (e)1) Obviously, if the claims of certain creditors are not affected by the plan, either because, as secured creditors, they retain the full benefit of their security, or because, as small current items, they will be paid in full in cash, it *should not be*, and is not necessary to secure their approval to the plan. As to stockholders, if it is clear that their interests have been entirely lost, their approving votes need not be obtained. (Subsection (e)1)²⁵

An interesting situation arises where the debtor is a public utility. In such case, subsection (e)2 provides that the plan shall not be confirmed until it has been submitted to the commission or commissions created by the law of the state or states in which the debtor's property is located and an opportunity given to such commissions to suggest amendments or objections to the plan, and that the court shall consider such objections or amendments at a hearing at which the commission is entitled to be heard. Where the debtor is a public utility wholly intrastate in character, the same subsection provides that no plan of reorganization shall be approved, if the commission certifies that the public interest is affected by the plan, unless the commission shall fully approve the plan as to the public interest therein and the fairness thereof. If the commission does not act within thirty days after submission to it of the proposed plan, or within such additional period as the bankruptcy court may prescribe, the bankruptcy court shall consider that the public interest is not affected by the plan. These provisions, apparently simple, may raise many practical difficulties, although all of such difficulties should be capable of solution. The statute apparently contemplates the following sequence—first, approval of the plan by the creditors and stockholders interested in the debtor utility; second, an opportunity to the commission to be heard

²⁵ In re Continental Cigar Co., C. C. H. Bankruptcy Service, New Matters Division, Paragraph 3652; In re Witherbee Court Corp., C. C. H. Bankruptcy Service, New Matters Division, Paragraph 3727.

before the bankruptcy court on such objections or amendments as it believes should be made to the plan, and third, approval by the bankruptcy court. The language of subsection (e)2 and (f) is apparently quite clear as to this sequence. In the only utility reorganization which, so far as is known, has been completed in this District this simplicity proved to be theoretical, rather than actual. In that case, the reorganization of the Southern Indiana Telephone Company, the Public Service Commission took the position that it had two functions—first, a consideration of the public interest in the plan, and second, an approval under Section 89 and 91 of the Shively-Spencer Act,²⁶ of the securities to be issued by the reorganized corporation—and that it would not enter any order approving the securities to be issued in accordance with the plan, unless and until it was assured that the prospective issuer of the securities would be awarded the utility property involved in the reorganization. The Judge and the Special Master at first took the position that, under Section 77B, the burden was clearly upon the Commission to act before confirmation of the plan by the bankruptcy court. Eventually, the apparent impasse was solved in this manner. A notice, accompanied by a copy of the reorganization plan, was served upon the Commission, informing the Commission of the date on which the hearing on the fairness of the plan would be held before the Special Master, that date being more than thirty days from the date of the service of the notice. The Commission did not appear and object to the plan, and the Special Master thereupon filed his report approving the plan, stating that the provisions of subsection (e)2 had been complied with, but pointing out that the approval of the Commission for the issuance of the securities must be obtained before final confirmation. After the requisite number of days had elapsed, the Special Master's report was approved by the court *upon the condition* that the plan should not become operative until there should have been filed with the Clerk of the Court a certified copy of the order of the Public Service

²⁶ Acts 1933, General Assembly of Indiana, Chapter 190, Sections 7A and 8.

Commission approving the issuance of the securities contemplated by the plan. This conditional order was presented to the Public Service Commission which, in due time, issued its order approving the proposed securities. When the certified copy of this order, together with a report by the Trustee of the proceedings before the public Service Commission, was filed in the bankruptcy court, the bankruptcy court made a short order to the effect that the plan theretofore conditionally approved, was now unconditionally approved and put in operation.²⁷

It seems clear that in this sort of a situation, the Public Service Commission might cooperate by entering first its order approving the issuance of the securities contemplated by the plan, upon condition that the plan is finally approved by the Bankruptcy Court. Certainly, one tribunal or the other must be willing to mold its orders within the scope of its jurisdiction to permit the situation to be worked out.

It is interesting to speculate on what may happen if the Public Service Commission should feel that a proposed plan was inimical to the public interest. In such case, the Commission probably should certify such fact to the Special Master, with its objections to the plan. The Special Master would doubtless hear the evidence presented by the security holders, and by the Public Counsellor in support of the Commission's objections, and would certify the issue to the District Judge for decision. Here is a situation which may be fraught with great difficulty for the members of the Bar, if either the Commission or the Bankruptcy Court adopts an unreasonable and non-cooperative attitude toward the proposed reorganization.

After the plan has been proposed and accepted, it comes to the court for confirmation. (Subsection (f)) Strangely enough, there have not been, to date, any decisions carefully analyzing the factors which the court will consider controlling in determining the fairness of the plan. This is the more sur-

²⁷ See *In re Southern Indiana Telephone Co.*, In Bankruptcy No. 8085-B, in the District Court of the United States for the Southern District of Indiana, Indianapolis Division, especially Special Master's 5th Report, order for March 11, 1935, and order for April 16, 1935.

prising in view of the precedents built up on the equity side of the Federal Courts in connection with reorganizations therein. These precedents, starting with the cases of *Louisville Trust Co. v. Louisville Railway Co.* and *Northern Pacific Railway Co. v. Boyd*, and running down through *National Surety Co. v. Coriell* and *First National Bank v. Flershem*,²⁸ have analyzed the considerations affecting equity courts in the approval or rejection of reorganization plans. In general, the principles laid down in these cases would apply to reorganizations under 77B.²⁹ In the Coriell and Flershem cases, the Supreme Court of the United States went all the way in imposing upon the equity court the affirmative duty of seeing that the reorganization plan adopted was fair. In the Flershem case, the Supreme Court said

"The failure to secure an adequate price seems to have been due not to lack of opposing evidence, but to the mistaken belief that it was the duty of the court to aid in effectuating the plan of reorganization, since a very large majority of the debenture holders had assented to it. Moreover, the court stood in a position different from that which it occupies in ordinary litigation where issues are to be determined solely upon such evidence as the contending parties choose to introduce. In receivership proceedings, as was held in *National Surety Co. v. Coriell*, 289 U. S. 426, 436, 77 L. Ed. 1300, 1305, every important determination by the court calls for an informed, independent judgment; and special reasons exist for requiring adequate, trustworthy information where the jurisdiction rests wholly upon the consent of the defendant who joins in the prayers for relief. It would be unreasonable to impose upon a few dissenting creditors the heavy financial burden of making an adequate appraisal supported by the testimony of competent experts where, as here, the assets include extensive plants and equipment located in nine states." (78 L. Ed. at 478).

Does such an affirmative duty rest upon the court in passing upon the plans proposed under Section 77B? The indications are, to date, that the courts do not consider themselves under such a duty. The reason for this seems sound enough. The object of a reorganization is to promote the pecuniary interests of the parties concerned, not to evolve a legally perfect

²⁸ 174 U. S. 683, 43 L. Ed. 1130; 228 U. S. 482, 57 L. Ed. 931, 289 U. S. 426, 77 L. Ed. 1300; 290 U. S. 504, 78 L. Ed. 465.

²⁹ 35 Columbia Law Review 391, 549; 48 Harvard Law Review 39, 74.

plan. The creditors and stockholders have an opportunity to vote by classes as to whether they will accept the reorganization plan, and the required majorities are unlikely to accept a plan unfair to the class as a whole. If the required majorities have accepted the plan proposed, the court should not be too technical about its abstract fairness. A hint of this attitude appears in the decision of the Circuit Court of Appeals for the Second Circuit in the case of *In re New Rochelle Coal & Lumber Co.*³⁰ The opinion in that case says in part:

"It is argued that the appellee failed to make out its right to reorganization because it failed to offer some proof sustaining the fairness of the plan. The appellant offered no proof or objection to the plan. Counsel engaged in oral argument before the court. The outstanding fact, however, is that the proponents of the plan met all the requirements as to proof by showing the requisite number of creditors, stockholders, and bondholders who consented to the plan. * * *

Our attention is called to *National Surety Co. v Coriell*, 289 U. S. 426, 53 S. Ct. 678, 77 L. Ed. 1300, 88 A. L. R. 1231, where the court, in an equity receivership case, remanded to the District Court for further proceedings the matter of reorganization, and criticized the terms of the organization in equity receivership there provided for. A reorganization under Sec. 77B (11 USCA Sec. 207) is statutory, and *where there has been compliance with the terms prescribed in the statute, it is sufficient.*" (77 Fed. (2d) at 883, Italics ours.)

A similar point of view has been expressed by the English Court of Appeals under the Act of Parliament known as the Joint Stock Companies Arrangement Act. In the case of *In re English, Scottish and Australian Chartered Bank*,³¹ Lord Justice Lindley said

"If the creditors are acting on sufficient information and with time to consider what they are about, and are acting honestly, they are, I apprehend, much better judges of what is to their commercial advantage than the Court can be."

There are instances, however, where sufficient votes of all classes may be in favor of a reorganization plan and yet it

³⁰ 77 Fed. (2d) 881.

³¹ (1893) 3 Ch. 385, 409; cf. the discussion of the Circuit Court of Appeals of the Seventh Circuit in an equity reorganization case. *Jameson v. Guaranty Trust Co.*, 20 Fed. (2d) 803, cert. den. 275 U. S. 569.

must be denied for want of equity. Thus, where a plan calls for the release by the noteholders of the debtor corporation of their tort claims against the investment bankers for fraud in the sale of the notes to the public, the Circuit Court of Appeals for the Second Circuit refused to approve the plan because calling for the release of claims which were not against the debtor corporation and which, therefore, the court had no jurisdiction to alter.³²

In general, however, it may be safely assumed that in the absence of flagrant unfairness, or lack of jurisdiction, the courts will be strongly inclined to approve reorganization plans which have met with the approval of all classes of creditors and stockholders.

After approval of the plan, there remains the preparation, execution and delivery of the instruments of conveyance, contracts, or other documents necessary to vest title in a successor corporation, if that method is adopted in the plan, or the exchange of securities if the original corporation is to continue in existence in altered form. The exemption of such securities from the provisions of the Federal Securities Act of 1933 is beyond the scope of this paper.

(E) SUGGESTIONS AS TO POSSIBLE IMPROVEMENTS IN THE ACT

It is impossible to refrain from making two obvious suggestions for procedural improvement in Section 77B. Since most Federal Courts are much too busy to rule upon the many details connected with a corporate reorganization, the cases are referred to a Special Master, and subsection (c) 11 specifically authorizes the courts to appoint a Referee as Special Master. In such a case, the Special Master has only those powers given him under the equity rules. He must report to the court on the allowance of claims, on the rejection or adoption of executory contracts and leases, on the fairness of reorganization plans, etc. Often as many as seven or eight Special Master's reports will be found in a single re-

³²In *re* 1775 Broadway Corporation, 79 Fed. (2d) 108, (2 C. C. A.).

organization. Each of these reports must remain on file for a period of twenty days before it is ruled on by the District Judge. This results in delays which are often costly to the parties in interest. It is suggested that the Section be amended to give Special Masters appointed under it the same powers which a Referee in Bankruptcy possesses under Sections 38 and 39 of the Bankruptcy Act, with such limitations and additions as would be appropriate. The District Judge may very properly be given the exclusive power to pass upon the fairness of the plan, but certainly a Special Master with the powers of the Referee could save a great deal of time in passing upon all preliminary matters such as claims, making orders with respect to the rejection or adoption of leases, and the like.

The second suggestion is that the provisions of the Act prescribing the method by which an unsuccessful reorganization proceeding is changed promptly into a liquidation proceeding be made more specific. To state the matter mildly, there is some ambiguity when subsections (c) 8, (c) 1 and (k) are considered together. Whether it is necessary to have the creditors select a liquidating trustee, or whether the trustee who has been in charge of the property during reorganization proceedings can simply be continued as such by the court is a matter which certainly should be clarified.