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CORPORATE REORGANIZATIONS UNDER CHAPTER X OF THE NATIONAL BANKRUPTCY ACT

By GEORGE COCHRAN DOUB*

The Bankruptcy Act of 1938, known as the Chandler Act, has made drastic changes in the procedure for the reorganization of industrial corporations. The section of the Bankruptcy Act dealing with corporate reorganizations—77B—under which numerous corporations have been reorganized since 1934, has been superseded by Chapter X of the Chandler Act with the result that a comprehensive revision of the text and structure of 77B has been effected.

The provisions of Chapter X represent principally the joint work of the National Bankruptcy Conference and the SEC. The wording of the Act is largely the work of the drafting committee of the National Bankruptcy Conference and the procedural changes stem from a study and investigation of reorganization practices made by the SEC. Representatives of the SEC testified before the Senate and

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* Of the Baltimore City Bar; A.B., 1924, Johns Hopkins University; LL.B., 1926, University of Maryland School of Law.


2 Bankruptcy Act, Sec. 106 (3), Sec. 4. The Act is inapplicable to municipal, insurance and banking corporations, building and loan associations and railroad corporations subject to Sec. 77.

3 Bankruptcy Act, Sec. 77B, 11 U. S. C. A., Sec. 207 (1934).

4 The Chandler Act makes no change in the provisions of Sec. 77 entitled "Reorganization of Railroads Engaged in Interstate Commerce". Chapter XI of the Chandler Act is a revision of former Sec. 12 relating to Compositions and of former Sec. 74 relating to Extensions and Compositions. Chapter XI deals with the unsecured debts of corporate debtors as well as of individuals. A corporate debtor will avail itself of its provisions in order to effect a rearrangement or extension of unsecured creditors' claims, including note issues and debenture issues.

House Committees as to the deficiencies of 77B and the theory of the corporate reorganization provisions of the Chandler Bill. The general purposes of Chapter X, as declared by Congress, were:

"To prescribe . . . a carefully prepared plan for corporate reorganizations, retaining the desirable permanent provisions of the new legislation and eliminating cumbersome, overlapping and inconsistent provisions."

The Chandler Act became effective on September 22, 1938. The provisions of Chapter X are made applicable in their entirety to reorganization proceedings in which a petition under 77B was approved on or after June 22, 1938. If the petition under 77B was approved prior to June 22, 1938, the provisions of Chapter X are applied to the proceedings to the extent that the judge deems practicable.

The tax exemption sections, providing that no taxable income or profit shall, in respect to the adjustment or cancellation of the indebtedness of a debtor, be deemed to have been realized by the debtor in the absence of bad faith, are made retroactive to all plans confirmed under 77B either before or after the effective date of the Act.

Assuming that A. A. Berle, Jr. was correct in stating that a legitimate criticism of the Administration is that it "has indulged in shotgun imposition of regulation without adequate definition of standard"; the same criticism may

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* Originally introduced in the House as H. R. 6439, 75th Cong., 1st Sess. (1937); subsequently amended and reintroduced as H. R. 8046, 75th Cong., 1st Sess. (1937). Commissioner William O. Douglas, Commissioner Jerome N. Frank and Mr. Martin Riger, Associate Attorney, appeared on behalf of the SEC at the hearings before the House Committee and the Senate subcommittee. See Houston, Corporate Reorganizations under the Chandler Act (1938) 38 Columbia L. Rev. 1199, 1201-1204 for a description of the development of Chapter X.

7 H. R. 1400 containing an explanation of H. R. 8046 known as the Chandler Bill; concurred in by S. R. 1916.

8 Bankruptcy Act, Sec. 7 of the Amendatory Act.


10 Bankruptcy Act, Sec. 276 c (2). In re Old Algiers, 100 N. Y. L. J. 1131 (D. C. S. D. N. Y. 1938).

11 Bankruptcy Act, Secs. 268 and 270.

12 Bankruptcy Act, Sec. 276 c (3).

13 Memorandum of A. A. Berle, Jr. to the Temporary Economic Committee (1938).
not be taken to the definitions of Chapter X. Without reference to the character of the amendments, the form, definitions and exact phraseology of Chapter X are definite improvements over 77B. Conflicts of 77B have been eliminated and obscurities and ambiguities clarified. Related but scattered provisions have been assembled and overlapping provisions integrated. The exact and meticulous definition and statement of Chapter X mark a high level of legislative draftsmanship and represent an orderly and inclusive presentation of the law of corporate reorganizations.

JURISDICTION

Although the general jurisdiction of the court is the same as under 77B, certain notable changes have been made. A voluntary petition may be filed by the debtor or an involuntary petition may be filed by three or more creditors holding liquidated claims aggregating $5,000 or more, although it is not necessary that the value of the security be deducted from the amount of the claims in determining the jurisdictional amount. Where the securities outstanding under the indenture are liquidated as to amount and not contingent as to liability, an indenture trustee may file an involuntary petition in conformity with the policy of attempting to make the indenture trustee an active participant in the proceeding.

Under 77B it was doubtful whether creditors having claims against the debtor's property, but not against the debtor, could file an involuntary petition. The Chandler Act eliminates all ambiguities on this point by explicitly authorizing an involuntary petition to be filed by holders of claims against the debtor "or its property".

Under the Chandler Act neither the corporation, creditors nor indenture trustee may file a petition if another petition by or against the corporation is pending. Al-

14 Bankruptcy Act, Sec. 126.
15 Bankruptcy Act, Sec. 126. It is unlikely that a trustee under the prevailing forms of indentures, which confer no power on the trustee to file a petition, will assume the responsibility of doing so.
17 Bankruptcy Act, Sec. 128. 77B (a) precluded the filing of a creditors' petition if the debtor had filed a petition or answer.
though this innovation has been given little attention the change is an important one. Under 77B it frequently occurred that, after an involuntary petition or petitions had been filed on behalf of creditors but prior to approval, a voluntary petition by the debtor would be filed in the same or in another jurisdiction. The debtor acted in order to select the forum, minimize the position of the petitioning creditors and improve the status of the debtor in the reorganization proceedings. In such cases it was the practice for the voluntary petition of the debtor to be given the right of way and to be approved. In this connection, approval of an involuntary petition frequently could not be had without the delay incident to a hearing on the controversial issue of "good faith", while ordinarily a debtor's petition could be speedily acted upon. Considerable legal authority developed supporting the priority thus given the debtor's petition.18 The theory of these decisions has been that priority of the approval of the petition—which has the same consequence and effect as an order of adjudication—and not priority in the filing of the petitions determines the right of one court to retain jurisdiction as against another in which a petition has also been filed. The effect of the practice has been that under 77B the debtor has been able to select the forum and, although involuntary petitions have been occasionally filed, reorganization proceedings have rarely been had upon them.

By reason of this change an involuntary petition of creditors or of an indenture trustee becomes of considerable practical significance because, when filed in good faith in a proper case, it will determine the forum and result in the debtor losing such tangible and intangible benefits

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as have been associated with the control formerly attaching to a debtor's petition. Clearly, the debtor should not forego its right to determine the reorganization forum in favor of the choice of an irresponsible creditors' petition, but Chapter X contemplates that the "good faith" requirements of a creditors' petition afford adequate protection against that danger. Although this jurisdictional change obviates a confusing multiplicity of petitions, it may have the undesirable consequence of encouraging a race between the debtor and its creditors to initiate the proceedings.

A corporation which has been dissolved under state law may not file a voluntary petition for reorganization under Chapter X. No material change has been made in the definition of a corporation subject to the provisions of the Bankruptcy Act and there appears to be no provision in Chapter X to preclude application of the doctrine of Chicago Title & Trust Co. v. 4136 Wilcox Building Co. In that case, under a statute in Illinois a decree had been entered dissolving the corporation for failure to pay franchise taxes and to file an annual report. The Supreme Court decided that the corporation was a creature of state law which in this case had specifically withdrawn its corporate capacity to prosecute any suit or to initiate any legal proceeding; hence a voluntary petition could not be filed, the court pointing out that the purpose of the pending 77B proceeding was a reorganization and continuance of the corporation which, if successful, would constitute an effective attempt to thwart the state law. The decision had the effect of reversing the contrary rule followed in a number of lower court cases.

The court has exclusive jurisdiction over the debtor and its property, wherever located. Jurisdiction is obtained upon the filing of the petition and not upon its approval as under 77B. Pending action upon the petition the judge may stay prior bankruptcy, foreclosure or receivership

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20 Old Fort Improvement Co. v. Lea, 89 F. (2d) 286 (C. C. A. 4th 1937); In re 211 East Delaware Place Building Co., 76 F. (2d) 834 (C. C. A. 7th 1935); Capital Endowment Co. v. Kroeger, 86 F. (2d) 976 (C. C. A. 6th 1936).
proceedings or the commencement or continuation of any suit against the debtor.\textsuperscript{21} It will be necessary for the court to act promptly on a petition because the filing of a petition under Chapter X may have the practical effect of precluding the debtor from continuing its business since no person with knowledge may deal safely with the debtor thereafter.\textsuperscript{22}

**Venue**

Under 77B a petition could be filed in the court (a) where the debtor had its principal place of business, (b) where the debtor had its principal assets during the preceding six months or where the greater portion thereof was located, or (c) where the debtor was incorporated. The Chandler Act has eliminated the jurisdiction of the court of the state of incorporation.\textsuperscript{23}

In the original drafts of the bill prepared in 1929 by the William J. Donovan Committee to revise the Bankruptcy Act, the reorganization sections omitted the state of incorporation as an alternative jurisdiction. Not until the bill containing 77B was in conference, after having been passed by both the House and Senate, was the state of incorporation added. Senator Hastings of Delaware was one of the conference managers in the Senate and responsibility for the addition has been attributed largely to his influence.

This change of the Chandler Act was designed to eliminate the inconvenient necessity for creditors to appear in a remote domiciliary jurisdiction in which the corporation might have no principal place of business and no substantial assets. The change is also said to have been designed to curb the practice of a debtor or of creditors shopping for a "friendly" jurisdiction.\textsuperscript{24}

\textsuperscript{21} See In re Associated Gas & Elec. Co., 11 F. Supp. 339 (N. D. N. Y. 1935), where a temporary stay was granted prior to approval of the petition under 77B; In re Hotel Martin Co. of Utica, 83 F. (2d) 231 (C. C. A. 2d 1936); In re Hygrade Cake Baking Co., 21 F. Supp. 314 (E. D. N. Y. 1937); In re Fox Metropolitan Play Houses, 74 F. (2d) 722, 723 (C. C. A. 2d 1935), where the court stated the debtor's property was not in the custody of the court until the approval of the petition under 77B.

\textsuperscript{22} Gerdes, Corporate Reorganizations: Changes Effected by Chapter X of the Bankruptcy Act, (1938) 52 Harv. L. Rev. 1, 16.

\textsuperscript{23} Bankruptcy Act, Sec. 128.

\textsuperscript{24} Jacob I. Weinstein, The Bankruptcy Law of 1938, 204.
It has been suggested that, where the assets of a corporation are scattered in several jurisdictions or where the debtor is only a holding company with assets consisting of securities, the jurisdiction of the domicile should have been continued. In both situations, however, there is no difficulty in discovering the principal place of business of the corporation and there is no logical reason why the courts of that jurisdiction should not be deemed a proper forum. Since the principal assets of a holding company are frequently found to be pledged under an indenture, its principal assets may thus be located at the trustee's domicile which consequently may become the reorganization forum.  

Since a corporation may file a straight bankruptcy petition in its domicile upon insolvency, the suggestion has been made that, in order to secure the benefit of the domiciliary jurisdiction, a debtor might proceed first in bankruptcy and then file a petition under Chapter X for reorganization in the pending bankruptcy proceeding.

If a corporation be a subsidiary, an original petition by or against it may be filed not only in the forum in which it has its principal assets or place of business, but also in the forum where the petition of the parent corporation has been approved. Accordingly, it is possible for a subsidiary to file an original petition in a jurisdiction in which it has no assets and no place of business and, nevertheless, have its reorganization conducted there independently of the reorganization of the parent company.

The judge may transfer a proceeding to a court of bankruptcy in any other district regardless of the location of the principal assets or the principal place of business if the interests of the parties will be best served by such transfer. This provision disposes of the former restriction that transfer to another court could be made only to

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25 In re Central States Edison Company, Bankruptcy Docket No. 60512 (D. C. S. D. N. Y., Coxe, D. J. 1934) (not reported). The assets of a Delaware holding company with its principal place of business in Illinois consisted of securities of subsidiaries operating in Southern and Western states. The securities were pledged under an indenture of trust with a New York trustee. New York thus became the reorganization forum.

26 Bankruptcy Act, Sec. 118.

27 Bankruptcy Act, Sec. 129.
a jurisdiction where an original petition could have been filed. Now the sole determining factor is the interests of the parties. It will be noted that in the event a sufficient reason exists for the proceeding to be conducted in the jurisdiction of the domicile of the debtor, a transfer to that forum may be effected. This provision will most frequently be invoked to permit an original proceeding by or against a subsidiary to be transferred to the jurisdiction where the parent is being reorganized.

**The Petition**

Chapter X requires additional information to be stated in the petition. A voluntary petition must set forth, as heretofore, that the corporation is insolvent or unable to meet its debts as they mature, the applicable jurisdictional facts, the nature of the business, the assets and liabilities of the company, and the desire that a plan be effected. In addition, the petition must state the nature of all pending proceedings affecting the property of the corporation, the status of any plan of reorganization affecting the property pending in connection with or without any judicial proceeding and reasons why adequate relief can not be obtained under Chapter XI of the Act.

In addition to the allegations required in a voluntary petition, a creditors' or indenture trustee's petition must state (1) that the corporation was adjudged a bankrupt in a pending bankruptcy proceeding, or (2) that a receiver or trustee has been appointed for, or has taken charge of, the property in a pending equity proceeding; or (3) that an indenture trustee or mortgagee is, by reason of a default, in possession of the property of the cor-

28 77B (a); In re Midland United Company, 8 F. Supp. 92 (D. C. Del. 1934).
29 Bankruptcy Act, Sec. 130. The new requirements appear to be based upon the Rules of the United States District Court for the Southern District of New York, i.e., Rule 77B-2.
30 Bankruptcy Act, Sec. 131.
31 The mere filing of a bankruptcy petition is not sufficient.
32 Clauses 1 and 2 clarified subdivision (a) of 77B, which merely referred to "a prior proceeding in bankruptcy or equity receivership" by making it clear that a petition in bankruptcy or a petition for the appointment of a receiver is not enough. This expressed what was apparently contemplated but was not made plain before.
poration; or (4) that a proceeding to foreclose a mortgage or to enforce a lien against the property of the corporation is pending; or (5) that the corporation has committed an act of bankruptcy within four months of the filing of the petition.

As heretofore, a petition is required to be filed in "good faith". A petition may not be deemed to be filed in good faith if (1) the petitioning creditors acquired their claims for the purpose of filing the petition; or (2) adequate relief would be obtainable by a debtor's petition under Chapter XI; or (3) it is unreasonable to expect that a plan

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33 This provision was added by reason of a decision of the Supreme Court that an equity receivership incident to a foreclosure proceeding is not an "equity receivership" proceeding within the meaning of subdivision (a) of 77B. In Duparquet Huot and Moneuse Co. v. Evans, 297 U. S. 216, 80 L. ed. 591 (1936), there was a receivership for the collection of rents in a suit for the foreclosure of a mortgage. A decision of the Circuit Court of Appeals for the 2nd Circuit (78 F. (2d) 678) holding a 77B creditors' petition was properly dismissed, was affirmed. In Tuttle v. Harris, 297 U. S. 225, 80 L. ed. 654 (1936) a decision to the contrary of the Circuit Court of Appeals for the 7th Circuit (78 F. (2d) 409) was reversed. The Supreme Court based its conclusion in these cases upon the ground that "an equity receivership" had a well recognized meaning whereby the assets of the corporation were committed to the custody of the court until the time should arrive when they could be returned to the rehabilitated debtor or, if that were impossible, divided among its creditors. In that case the end was reorganization or liquidation. A receivership in connection with a foreclosure suit on the contrary was limited and special, rents being impounded exclusively for the benefit of a particular mortgagee to be applied upon the mortgage indebtedness in the event of a deficiency. In that case, therefore, there was neither a winding up nor an attempt to reorganize. It was indicated that the appointment of a receiver in connection with the foreclosure proceedings could not be deemed an act of bankruptcy within the rule that such an act is deemed to have occurred if, "while insolvent a receiver or trustee has been appointed or put in charge of the property." The court expressed a qualified opinion that such a receiver must be, a general one to gratify this definition of an act of bankruptcy.

34 This clause is new. The mere institution of a foreclosure proceeding suffices.

35 This clause is unchanged.

36 In re Philadelphia Rapid Transit Co., 8 F. Supp. 51 (D. C. E. D. Pa. 1934) where it was found petitioners had acquired their bonds for the purpose of filing the petition. "The petition is not in truth a real creditors' petition and in this sense is not in good faith". To the same effect: In re Hudson Coal Co., 22 F. Supp. 765 (M. D. Pa. 1938). See: In re North Kenmore Building Co., 81 F. (2d) 656 (C. C. A. 7th 1936) where a corporation was organized expressly for the purpose of filing a petition under 77B. Held, the petition was not filed in good faith. See, however, In re Loeb Apartments, 89 F. (2d) 461 (C. C. A. 7th 1937), where the court indicated that, although the debtor had incorporated for the purpose of the 77B proceeding, the former lack of corporate existence was not a bar on the ground of bad faith.

can be effected; or (4) it appears that in a prior proceeding in any court, the interests of creditors and stockholders would be best subserved thereby. This new provision embodies several of the tests of "good faith" which have been developed by the courts in construing 77B. However, a broader construction of the phrase "good faith" is permissible since "good faith" is not limited to the enumerated tests.

A petition may be approved notwithstanding the pendency of a prior mortgage foreclosure, equity or other proceeding in which a receiver or trustee has been appointed. The trustee, upon qualification, or the debtor, if continued in possession, is expressly vested with the right to possession of property of the debtor held by a trustee under a trust deed or by a mortgagee under a mortgage.

As under 77B, the court approves the petition if satisfied that it has been filed in good faith or dismisses it if not so satisfied. An answer controverting the material

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38 Petitions under 77B held not filed in good faith on the ground that a plan was not feasible: Provident Mut. Life Ins. Co. v. University Evangelical Lutheran Church, 90 F. (2d) 992 (C. C. A. 9th 1937); Manati Sugar Co. v. Mack, 75 F. (2d) 284 (C. C. A. 7th 1935); In re Electric Public Service Co., 9 F. Supp. 128 (D. C. Del. 1934); In re Williamsport Wire Rope Co., 10 F. Supp. 481 (M. D. Pa. 1935). It has been held that the filing of a plan with an involuntary petition is not necessary in order for the creditors to show that a plan can be effected. In re Surf Building Co., 11 F. Supp. 295 (D. C. Ill. 1934). See In re Lehrenkrauss, 10 F. Supp. 14 (D. C. N. Y. 1935), where a plan was filed by petitioning creditors prior to approval of petition. Held, it was not the duty of the court in passing on the petition to consider whether the plan was feasible.


Bankruptcy Act, Sec. 256.

40 Bankruptcy Act, Secs. 141, 142. In re Matter of Francis E. Willard, National Temperance Hospital, 82 F. (2d) 801 (C. C. A. 7th 1936). Held, that the district court was without power to enter an order in a 77B proceeding directing an indenture trustee, which had taken possession of the property of the debtor in a foreclosure proceeding and had been operating the property for the benefit of bondholders to relinquish possession to the 77B trustee. The decision was based upon the Illinois rule that a mortgagee, after a condition broken, is the owner of a legal estate and as such entitled to possession of the mortgaged premises. See also: Reighard v. Higgins Enterprises, 90 F. (2d) 569 (C. C. A. 3d 1937); Continental Bank & Trust Co. v. Nineteenth & Walnut Street Corp., 79 F. (2d) 284 (C. C. A. 3d 1935). It is not certain whether this section is applicable to personal property which is ordinarily held by the pledgee as collateral prior to a default.

Bankruptcy Act, Secs. 141, 142.
allegations of a petition may be filed by any creditor, indenture trustee or stockholder.\(^4\)

**Appointment of Trustee**

Where the liquidated and non-contingent indebtedness of a debtor is $250,000 or over, the judge shall, upon the approval of the petition, appoint one or more disinterested trustees. If the indebtedness is less than $250,000, the judge may continue the debtor in possession. Where a trustee is appointed, the judge may for operating purposes appoint as an additional trustee a person who is a director, officer or employee of the debtor.\(^4\)

A person shall not be deemed disinterested if (1) he is a creditor or stockholder of the debtor; or (2) he was an underwriter of any of the debtor's securities; or (3) he was within two years before the filing of the petition, a director, officer, employee or attorney of the debtor or any such underwriter; or (4) he has an interest materially adverse to the interests of any class of creditors or stockholders by reason of any other relationship to the debtor or such underwriter, directly or indirectly.\(^4\)

Serious criticism has been leveled at the mandatory requirement that a trustee be appointed in all cases where the liquidated indebtedness of a debtor is in the aggregate amount of $250,000 or more. It is argued that in some instances the appointment of a trustee is wholly unnecessary; that he serves no useful purpose; that his appointment saddles the estate with substantial and unnecessary expense; that the break-up and liquidation of small companies will result; that the good will and business of these small debtors will be destroyed. Therefore, the argument concludes, the discretionary power of 77B should have been retained.\(^4\)

\(^4\) 77B (a) permitted three or more creditors having provable claims amounting in the aggregate in excess of their security, if any, to $1,000 or stockholders holding 5% in number of shares of any class to appear and controvert the facts alleged in the petition.

\(^4\) Bankruptcy Act, Sec. 156.

\(^4\) Bankruptcy Act, Sec. 158.

\(^4\) The provision of 77B enabling the continuance of the debtor in possession was believed to permit the proceedings to be conducted with a minimum of expense and of interruption to the debtor's business. In re Utilities Power & Light Corp., 90 F. (2d) 798 (C. C. A. 7th 1937); Gerdes,
A survey by the SEC of 77B proceedings conducted during the year 1936 indicated that in a majority of cases the debtor was continued in possession. The legal incidents of continuing the debtor in possession are significant. Upon the approval of a petition, although the debtor remains in possession, the property of the debtor is placed in custodia legis. A debtor in possession holds the estate as agent of the court. His position has been said to be analogous to that of a receiver in equity, and he is given the powers of a trustee in bankruptcy during pendency of reorganization proceedings.

This practice of continuing the debtor in possession in effect represented a restoration of the "friendly" receivership which prevailed as the principal means of achieving a reorganization prior to 77B. The consequences of leaving the debtor in possession may be deemed to approximate those ensuing from the appointment of an officer or agent of the debtor as trustee or receiver. It will be recalled that in Harkin v. Brundage, the Supreme Court of the United States, in an opinion by Chief Justice Taft, con-
demned the widespread practice of appointing "friendly" receivers. The Court said:

"As the Court of Appeals says, there should be no 'friendly' receivership because the receiver is an officer of the court and should be as free from 'friendliness' to a party as should the court itself."

In *National Surety Co. v. Coriell,*59 in an opinion by Mr. Justice Brandeis, the Supreme Court said:

"Every important determination by the court in receivership proceedings calls for an informed independent judgment."

While the Supreme Court had taken steps to require the appointment of independent receivers in equity reorganizations, 77B has been employed to perpetuate in essence the outlawed practice of the continuance of a partisan debtor in possession. It must be recognized that reorganization proceedings are only incidentally law suits, that primarily they represent a problem in corporate finance. The conduct of the proceedings is of necessity largely administrative. To determine whether a plan is fair and feasible, there is required an informed independent judgment based upon inquiry, investigation, examination and analysis of the cause of the bankruptcy, the worth of the assets, the character of the management, past earnings, probable future earnings and what should constitute a sound financial structure. Under 77B there was rarely an independent opinion or a disinterested source of information available to the judge. When he acted upon a plan he did so largely upon the basis of an impression formed from the testimony of officers of the debtor and from statements made, during the course of one or more hearings, by counsel whose clients were deemed to have a first call upon their loyalty.

Where the debtor was continued in possession, the judge did not have the benefit of the advice of even a "friendly" receiver for the anomaly occurred of a receivership without a receiver and of a theoretically prostrate corporation elevated to a position of unwarranted power and responsi-
bility. The suppliant debtor, seeking the respite offered by a bankruptcy court and permitted to suspend all legal and equitable remedies of secured and unsecured creditors, was nevertheless vested with the powers of an equity receiver and of a trustee in bankruptcy. The difficult position of the court under 77B was well described by a commissioner of the Securities & Exchange Commission when he said:

"Now consider the task which confronts the judge when he undertakes, under Section 77B, to determine the fairness and equity, and feasibility, of a proposed plan of reorganization. For guidance on the host of questions—financial, business, economic and legal—which present themselves, he must depend upon a biased debtor, a trustee who all too frequently is partisan, if a trustee has been appointed at all, and upon the committees for bondholders and stockholders. Occasionally the isolated creditor or stockholder may be represented, in good faith or for the sake of a nuisance value, if one can be created. One of two things will generally happen. The judge must set out on a search for the truth as it may be present in a welter of partisan charges, often bald misinformation, and exaggerated claims. His search and determination are reduced to the level of a guess as to the credibility of highly distorted and conflicting allegations. Or, as may happen more frequently, he finds a "united front" before him, with all seeming differences composed. If anything, this is even less effective as a test of the truth. Rarely will the judge be apprised adequately of the considerations which have made for compromise, or their effect upon the interests of investors."

It has been pointed out that the Supreme Court of the United States was the inspiration for these provisions of Chapter X separating the trustee from the debtor, stockholders and underwriters. Their underlying purpose is to insure that the judge has before him detailed and authentic information in considering a reorganization plan. In National Surety Co. v. Coriell, the Supreme Court re-

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58 Address of Jerome N. Frank before the American Bar Association, Cleveland, Ohio, July 25, 1938.
54 Supra, note 52.
versed a decree approving the plan on the ground that the judge did not have before him sufficiently definite and accurate information to form a reliable opinion as to the fairness of the plan and moreover did not have the benefit of advice from its receiver. The Court remarked:

"The District Court had before it, in support of the plan, only information inadequate and conflicting ex parte assertions unsupported by testimony. It undertook to pass upon the wisdom and fairness of the plan of reorganization, and the rights of non-assenting creditors. For the proper disposition of these questions definite, detailed and authentic information was essential. Such information was wholly lacking."

"The receiver submitted no facts and made no recommendations."

"The proceeding was not an adversary one and jurisdiction rested wholly upon the consent of the defendant corporation. The court did not have the advice of its receiver."

In First National Bank v. Flershem, the Supreme Court, in an opinion by Mr. Justice Brandeis, again emphasized the necessity for an informed independent judgment by reason of the special nature of reorganization proceedings. There the lower court had approved a plan in a consent receivership of the National Radiator Corporation, whose officers felt that a reorganization was necessary although the Supreme Court found that insolvency was neither present nor imminent and an interest default was purely voluntary. The Court said:

"The District Court did not make an appraisal by independent experts. In fixing the upset price and in confirming the sale, it relied practically upon the evidence given and introduced by officers of the corporation and the members of the reorganization committee."

"In justifying the action taken, the Court of Appeals called attention to the fact that the non-assenting creditors had not introduced any evidence to prove

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their contention that the sale should not be confirmed. In view of the undisputed facts stated above, the introduction of such evidence was not indispensable. 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 Company v. Coriell*, 289 U. S. 426, 436; 77 Law Ed. 1800, every 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 is submitted that the criticism directed at the mandatory requirement of the appointment of a trustee where the liquidated indebtedness of a debtor aggregates $250,000 is not persuasive. Under Chapter X the court and security holders will have the benefit of an impartial source upon which they may rely for information and for that "informed independent judgment" which the Supreme Court of the United States has declared to be essential in reorganization proceedings. The discharge of the duties relative to formulation of a plan and investigation of the management of the debtor would seem to make the requirement of an independent and disinterested trustee inevitable.\(^6\) Insofar as the charge of excessive expense is concerned, the control exercised by the court over allowances should prove adequate protection against the imposition of an undue financial burden upon the estate.

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\(^6\) In advocating the mandatory appointment of a trustee, the primary objective of the SEC was to take the conduct of the debtor's business out of the hands of the management which had proven unsuccessful and to facilitate the discovery and pursuit of corporate assets which might exist in the form of claims against directors, officers and persons affiliated with them. SEC Report on Protective and Reorganization Committees (May 10, 1937 Pt. I, pp. 137-160, Pt. II, pp. 11-164, 186-200. The Commission demonstrates the ineffectiveness of the security holder's conventional legal weapon, the minority stockholder's suit. SEC Report, Pt. I, pp. 684, 870.
The requirement that the trustee be disinterested will not materially affect the practice formerly prevailing in certain districts in cases where trustees were appointed. Under Article X where it is deemed desirable, a director, officer or employee of the debtor may be appointed as an additional trustee for operating purposes, but he may not exercise any of the other duties of the disinterested trustee. It is further provided that an attorney appointed for a trustee shall be disinterested. However, an attorney not disinterested within the meaning of the Act may, with the approval of the judge, be employed for the performance of specific services; but he may not represent the trustee in conducting the proceedings.

The disqualification of counsel for the debtor to act as counsel for the trustee is a logical one in view of the new duties imposed upon the trustee. Whether the same disqualification extends to counsel for creditors is not entirely clear. The definition of the word "disinterested" does not explicitly refer to a creditor relationship. If such a disqualification be held to exist, it will be based upon the catch-all provision that a person is not disinterested if "it appears that he has, by reason of any other direct or indirect relationship to, connection with, or interest in the debtor or such underwriter, or for any reason an interest materially adverse to the interests of any class of creditors or stockholders."

The Chandler Act provides that, "if the judge shall so direct", the trustee shall investigate the affairs, conduct, property, liabilities and financial condition of the debtor, the operation of its business and the advisability of its continuance; shall report thereon to the judge; may examine the directors and officers and any other witnesses concerning the foregoing matters; shall report to the judge any fraud, misconduct, mismanagement or any irregu-

[57] It has been customary in the districts of Maryland and Delaware for the court to appoint as trustee either a person who has no relationship to the parties or an officer of the debtor and a disinterested person.
[58] Bankruptcy Act, Sec. 156. See: In re Hotel Martin Co. of Utica, 83 F. (2d) 233 (C. C. A. 2d 1936).
[59] Bankruptcy Act, Sec. 157.
[60] Bankruptcy Act, Sec. 156 (4).
larity and the facts with respect to any cause of action available to the estate; may with the approval of the judge employ such persons as may be needed to assist him in his duties; and shall submit a brief statement of his investigations to creditors, stockholders, indenture trustees, Securities & Exchange Commission and such other persons as the judge may designate.\textsuperscript{61}

Prior to a late amendment in 1938, the Chandler Bill\textsuperscript{62} provided that the trustee should "forthwith under the control of the judge" make the investigation and report described above. In its then mandatory form, this provision was criticized on the ground that in many cases such an investigation is unnecessary, arbitrarily increases reorganization expenses and delays the reorganization. In its present form it is difficult to believe that this provision is subject to valid criticism. Resort to a court of bankruptcy has always been deemed a matter of gravity and of public interest. Why should less inquiry be had into the causes underlying the plight of a debtor, which seeks affirmative relief from creditors in order to preserve an alleged equity, than in the case of a bankrupt which proposes liquidation of its assets and their distribution in full to creditors? But even if the provisions of Chapter X were designed merely to afford a facile process for the readjustiment or extension of corporate securities, the court and creditors are surely entitled to make inquiry as to the character of the management and as to the reason the corporation requires the drastic remedy of a court of bankruptcy. It would be difficult for the court and security holders to appraise the worth of the management in connection with any plan and determine intelligently whether it should be continued without reliable information as to the history of the company.

The trustee need no longer reside or have an office in the district in which he is appointed. Corporations may serve as trustees if authorized so to do by their charters or

\textsuperscript{61} Bankruptcy Act, Sec. 167. Where the judge does not direct an investigation, the duty of the trustee to submit to security holders a statement of the financial condition of the debtor is not clear.

\textsuperscript{62} H. R. 8046.
The trustee is appointed upon the approval of the petition and no provision is made for "temporary" and "permanent" trustees.

The Plan

Where a trustee has been appointed the judge shall fix a time within which the trustee shall prepare and file a plan, or report his reasons why a plan cannot be effected, and shall hold a subsequent hearing for the consideration of any objections, amendments or plans which may be proposed by the debtor or by any creditor or stockholder. The trustee shall give notice to creditors and stockholders that they may submit to him plans or suggestions for the formulation of a plan within a designated time.

The disinterested trustee is thus charged with the responsibility of negotiating and formulating a plan. He becomes the clearing house for proposals of plans whether by the debtor, creditors or stockholders. It is intended that he will participate in and supervise negotiations among the various interests, and, although at the subsequent hearing before the court other plans or proposals may be submitted, the primary responsibility for submitting a plan to the court rests with him. Neither the debtor nor creditors may assume the initiative of proposing a plan until the hearing before the court on the plan formulated by the trustee. The debtor is thus restrained from exercising the dominant role frequently assumed under 77B.

It is believed that the theory of a disinterested person vested with the responsibility for formulation of a plan should contribute to the evolution of a proper plan. A more desirable solution might have been to require the appointment of a special master to act in the quasi-judicial capacity of settling basin for incipient plans, and to im-

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64 Bankruptcy Act, Sec. 168.
65 Bankruptcy Act, Sec. 167.
pose different types of functions upon different officials. It is evident that few persons are sufficiently versatile to qualify as trustee in a reorganization when the position requires a hybrid specialist who is at the same time an effective executive, relentless investigator and financial expert. The answer must be that in practice a substantial amount of the work of the trustee will be done by counsel to the trustee and under Chapter X, as in past corporate reorganizations, whether through mortgage foreclosure, judicial sale, equity receivership or 77B, lawyers will continue to play an essential part.

The provisions regarding the requirements of a plan are more exacting than the comparable provisions of 77B. The plan must include equitable provisions compatible with creditor and stockholder interests and consistent with public policy with respect to the manner of selecting persons who are to be directors, officers or voting trustees, if any, and their respective successors, upon the consummation of the plan. The plan must require in the charter of the debtor or of any corporation organized for the purpose of carrying out the plan (a) provisions prohibiting the issuance of non-voting stock and maintaining among the several classes of securities a fair and equitable distribution of voting power, including adequate provisions for the election of directors representing preferred stock in the event of default in the payment of dividends, and (b)

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67 Where the debtor is continued in possession this separation of function is recognized. Bankruptcy Act, Sec. 168. See: Utilities Power & Light Corp., 90 F. (2d) 798 (C. C. A. 7th 1937) where the debtor under 77B was continued in possession but the court appointed an investigator to examine into charges of improper conduct on the part of the management. See also: Gerdes, Corporate Reorganizations (1937) 71 U. S. L. Rev. 443, 452-53. Under 77B a special master has been frequently appointed in the District of Maryland to advise the judge as to the fairness and feasibility of a plan. In re American States Public Service Co., Bankruptcy Docket No. 7851 (U. S. D. C. Md. 1934) not reported on this point; In re North Avenue Market, Inc., Bankruptcy Docket No. 8887 (U. S. D. C. Md. 1936) not reported; In re Anchor Post Fence Co., 14 F. Supp. 801 (U. S. D. C. Md. 1936); In re Hugo Stinnes, Bankruptcy Docket No. 8875 (U. S. D. C. Md. 1936) not reported; In re Hugo Stinnes Industries, Inc., Bankruptcy Docket No. 8876 (U. S. D. C. Md. 1936) not reported. See: In re United States Dairy Products Corporation, Bankruptcy Docket No. 7855 (U. S. D. C. Md. 1934) not reported, where the trustees and their counsel were largely responsible for the development of the reorganization plan although the plan was filed in the name of the debtor.

68 Bankruptcy Act, Sec. 216 (11).
fair and equitable provisions with respect to the terms, rights and privileges of the several classes of securities, including provisions relating to the issuance, acquisition, purchase, retirement or redemption of any such securities and the declaration or payment of any dividends thereon.69

**Report of SEC**

After the hearing and before the approval of any plan, the judge may, in cases in which the scheduled indebtedness does not exceed $3,000,000, and shall, in cases in which the scheduled indebtedness exceeds $3,000,000, refer to the SEC for examination and report the plan or plans deemed by him worthy of consideration. Such report shall be advisory only.70 No plan may be approved until the SEC has had a reasonable opportunity to file its report.71 Upon the approval of the plan, the trustee or debtor in possession shall transmit to all creditors and stockholders who are affected by the plan (1) the plan so approved, together with a summary approved by the judge, (2) the opinion of the judge approving the plan, or a summary approved by the judge, (3) the report of the SEC or a summary prepared by the SEC, and (4) "such other matters as the judge may deem necessary or desirable for the information of creditors and stockholders".72 The SEC shall, if requested by the judge, and may, upon its own motion if approved by the judge, file an appearance in a proceeding under Chapter X, and shall thereupon be deemed a party in interest with the right to be heard on all matters arising in the proceeding, but the Commission does not have a right of appeal.73

This provision, designed to give the court and security holders the benefit of the advice and recommendations of an experienced commission of experts, represents the most drastic reform of the Chandler Act, by the injection of the administrative tribunal into the proceedings of the judiciary. Without attempting to consider the desirability

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69 Bankruptcy Act, Sec. 216 (12).
70 Bankruptcy Act, Sec. 172.
71 Bankruptcy Act, Sec. 173.
72 Bankruptcy Act, Sec. 175.
73 Bankruptcy Act, Sec. 208. The Commission is not expressly precluded, however, from being heard on an appeal taken by another party.
of the governmental tendency represented by this innovation, it is apparent that in the final analysis its success will depend upon how expeditiously, fairly and impartially the SEC meets the responsibility imposed upon it by Chapter X. From a theoretical standpoint, it is desirable that the federal courts and security holders be granted the benefit of expert disinterested advice with reference to the difficult problems involved in a readjustment of conflicting equities. However, there appears to be some fear that under the guise of an advisory opinion the SEC may attempt to exercise substantial control over the adoption of a plan of reorganization. If the SEC yields its necessary technique of impartial approach to the temptation of aggressively championing the rights of particular classes of security holders, it will not be difficult to predict that operation under these provisions of Chapter X will prove unsatisfactory. If the SEC becomes an advocate instead of a technical advisor, content to offer its advice for what it may be worth, the reorganization proceedings cannot avoid the serious threat of disorganization.

There are undoubted disadvantages under the revised procedure of Chapter X. Delays seem inevitable. The report of the SEC may be of such significance and may so influence the reorganization proceedings that the parties will wish to appear and be heard before the SEC. The proponent of a plan referred to the SEC may feel bound to present his case to avoid an adverse report. Informal discussions between the trustee and representatives of security holders will be followed by a hearing before the judge; and the hearing before the judge, who has the power to approve a plan, may be followed by an informal hearing before the

74 Commissioner Samuel O. Clark, Jr., has become director of the recently organized Reorganization Division of the SEC. Regional offices have been located in New York, Boston, Chicago, Atlanta, Ft. Worth, Denver, Seattle and San Francisco to facilitate the performance of the additional work of the Commission.

78 See: Statement of Hon. John C. Knox, Senior United States District Judge for the Southern District of New York, as to the advantages of the appearance of the SEC in the reorganization proceedings. [Hearings on H. R. 6439 (reintroduced and reported as H. R. 8046) before House Committee on Judiciary, 75th Cong., 1st Sess. (1937) 365-366.]
SEC which is without power to approve a plan. The result is divided responsibility and a succession of delays. In this connection, Chapter X failed to fix a definite period within which the SEC could be required to act when its advice was requested.  

77B was designed to afford an expeditious corporate reorganization procedure which would permit reorganizers to deal effectively with dissenters. The provisions of Chapter X are calculated to produce the fairest possible reorganization plan by the creation of a more elaborate system of checks and balances. Under the new complicated and untried procedure the emphasis is upon the beneficial result to be attained rather than upon the speedy accomplishment of the reorganization.

**Approval of Plan**

Under the revised procedure of the Chandler Act the judge approves the plan as fair, equitable and feasible before it may be submitted to creditors and stockholders. Without the consent of the court no person may solicit any acceptance of a plan or any authority to accept a plan whether by proxy, deposit or power of attorney until after the judge has entered an order approving it, and the plan has been transmitted for acceptance. Any acceptance or authority procured by solicitation before such approval and transmittal without the consent of the court is deemed invalid.

The development of the law of corporate reorganizations indicates a continuing trend towards the extension of the judicial power to enable the court to act upon a plan before it has reached an advanced stage. It will be recalled that at the time *Northern Pacific RR Co. v. Boyd* was decided no legal machinery had been developed for the determination of the validity of a reorganization plan prior to its completion. This decision resulted in an earnest ef-

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76 Bankruptcy Act, Sec. 173 does provide that the judge may fix a reasonable time for the filing of the report of the SEC.
77 Bankruptcy Act, Sec. 174.
78 Bankruptcy Act, Sec. 176. The Act does not forbid the solicitation of dissents to a plan prior to approval by the judge.
79 228 U. S. 482 (1912).
fort by lawyers and others interested in corporate reorganizations to devise a means whereby a specific plan of reorganization could be approved by a court of appropriate jurisdiction in advance of its consummation. Subsequent decisions prior to 77B established that the fairness of a plan might be determined upon application for confirmation of a sale pursuant to the plan, but it was recognized that there was no general right in security holders to compel such a determination in anticipation of the foreclosure decree. Unless the adoption of 77B in 1934 the court had no jurisdiction to pass on the fairness of a reorganization plan except as an incident to the confirmation of a judicial sale and in legal theory the entire proceeding was directed to liquidation. 77B provided for the confirmation of a plan after it had been duly accepted in writing by creditors holding the requisite amount of claims, but there was no express provision for the approval of the plan by the judge prior to acceptance on behalf of creditors and, when required, of stockholders.

60 Robert T. Swaine, Reorganization of Corporations: Certain Developments of Last Decade (1927) 27 Columbia Law Journal, 901, 910. In Guaranty Trust Co. v. Chicago M. & St. Paul RR. Co., 15 F. (2d) 434 (D. C. N. D. Ill. 1926), where a decree for sale of railroad property in a mortgage foreclosure proceeding provided for a hearing of stockholders and bondholders of a railroad of a adequacy and fairness of the plan before confirmation of sale, it was held that the junior bondholders were not entitled in advance of the sale to an anticipatory ruling as to the adequacy of any bid or the fairness of a reorganization plan.

The general practice was for the determination of the fairness of the plan to be made upon the confirmation of the sale. St. Louis-San Francisco Ry. v. MacElvain, 253 Fed. 123, 126 (E. D. Mo. 1918). Westinghouse Elec. & Mfg. Co. v. Brooklyn Rapid Transit Co., (U. S. D. C. S. D. N. Y., Cons. Cause Eq. No. E15-347, 1923) not reported; American Brake Shoe & Foundry Co. v. N. Y. Rys. (U. S. D. C. S. D. N. Y., Cons. Cause Eq. No. E-17-80, 1924) not reported. Occasionally a determination of the fairness of the plan was secured in advance of the foreclosure decree or the sale, although there was a serious question whether the decision was moot and not binding. Habirshaw Elec. Cable Co. v. Habirshaw Elec. Cable Co., 296 Fed. 875, 879 (C. C. A. 2d 1924). Eastern States Public Service Co. v. Atlantic Public Utilities, 156 Atl. 214 (Del. 1931). The machinery for determining the fairness of the plan was usually set up in the foreclosure decree which would provide that the court would hear complaints as to the fairness of offers to various classes of security holders and the court reserved the power to modify the foreclosure decree if such offers had not been made. Guaranty Trust Co. v. Chicago. M. & St. Paul Ry., supra; Guaranty Trust Co. v. Mo. Pac. R. (U. S. D. C. Mo., E. Div., Cons. Cause, Eq. No. 4540, 1916) not reported. The judicial determination of the fairness of the plan in connection with the confirmation of the sale was binding on all creditors. St. Louis-San Francisco Ry. v. Wall (U. S. D. C. E. D. Mo., Cons. Cause, Eq. No. 4557, 1918) not reported.

81 Sec. 77B (E) (1).
Approval of the plan prior to its acceptance constitutes an important step in the revised procedure for the formulation, consideration and acceptance of a plan. This procedure is similar to that provided for under Section 77 except that under Section 77 the plan is approved by the Interstate Commerce Commission instead of the judge. The change is said to have been patterned after an informal practice which has grown up under 77B in certain districts. Creditors and stockholders are protected from solicitation before there is full information, investigation and scrutiny of the plan. High pressure tactics of investment bankers, protective committees and the like on behalf of any plan that may be proposed, regardless of its merit, are ended. The judge is enabled to consider plans objectively without being harassed by pressure groups purporting to represent predominant holdings of securities and without being consciously or unconsciously influenced in determining the fairness of the plan by the purported backing security holders may have given it. He is no longer presented with a fait accompli and faced with the unenvi-

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82 Under 77B a plan was sometimes approved informally by the judge before it had been submitted to, or accepted by the required majorities of security holders. In the District of Maryland, the District of Delaware, and the Eastern District of Pennsylvania it has not been the practice for the judge to approve a plan either tentatively or informally under these conditions although frequently the important features of the plan have been discussed fully with the judge in advance of the hearing on the confirmation of the plan. In re Hopkins Lake Drive Apartments Corp., Bankruptcy Docket No. 7960 (U. S. D. C. Md. 1935), not reported, Judge Chesnut at a preliminary hearing disclaimed any authority to approve a plan, but he specified a formula which had the effect of limiting and defining any plan proposed but at the same time was extremely helpful to the parties. At that time two plans had been submitted to creditors, one proposed by the debtor and the other by a large number of bondholders. In Downtown Investment Co. v. Boston Metropolitan Building, Inc., 51 F. (2d) 314, 321 (C. C. A. 1st 1936), the court disapproved of the judge passing upon the fairness of the plan before it had been assented to by creditors on the ground that it might be deemed an attempt by the judge to influence security holders in favor of a plan. See: Alley and Ellsworth, Tentative Approval—Its Use, Abuse and Remedy (1937) 4 Corp. Reorg. 11.

83 In Downtown Investment Co. v. Boston Metropolitan Building, Inc., supra, note 82, the court stated that in determining the fairness of the plan the judge should be greatly influenced by the fact that it had been accepted by a high percentage of the parties affected. In practice great weight has been given by the judge to the support given a plan in determining whether it is fair and equitable. See: In re A. C. Hotel Co., 93 Fed. (2d) 841 (C. C. A. 7th 1937); In re Day and Meyer, Murray & Young, 83 F. (2d) 657, 659 (C. C. A. 2d 1938); In re Barclay Park Corp., 80 F. (2d) 595 (C. C. A. 2d 1937); In re Wilbur-Suchard Chocolate Co., 33 Am. B. R. (N. S.) 291 (E. D. Pa. 1937).
able choice of either confirming the plan and permitting the prompt completion of the proceedings or frustrating the apparent wishes of informed or uninformed security holders with the delays attendant upon any other action. On the other hand, it is clearly desirable that the parties in interest know at the outset whether a plan will be able to secure court approval before the time, energy and money involved in its submission to security holders are expended.

CREDITORS AND STOCKHOLDERS

Throughout Chapter X there is wide recognition of the right of the debtor, any creditor, indenture trustee or any stockholder to be heard on all matters. Thus, material allegations of a petition may be controverted by any creditor, indenture trustee or stockholder. A plan may be proposed by the debtor, any creditor, any stockholder or an indenture trustee. The debtor, the indenture trustees and any creditor and stockholder have the right to be heard on all matters.

After the approval of the petition, the judge prescribes the manner in which, and fixes the time within which, the

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84 See: In re American Department Stores Corporation, Bankruptcy Docket No. 1058 (D. C. Del. 1936) not reported, where a special master reported adversely on a plan, but between the time of his report and the hearing thereon the debentures of the persons opposing the plan were "bought out". Judge Neilds overruled the report of the special master and approved the plan referring to the fact that there was no opposition. Previously Judge Neilds had refused to confirm an earlier plan (16 F. Supp. 977). It is of interest that, in In re Allegany Corporation, 75 Fed. (2d) 947 (C. C. A. 4th 1935) the judge was presented with a plan which had already been accepted by the required majorities of security holders before the 77B petition was filed and, indeed, before 77B had been enacted.

85 Bankruptcy Act, Secs. 206, 207, 209. Under 77B (c) a creditor or stockholder had the right to be heard on the permanent appointment of trustees, on the confirmation of a plan and, upon filing a petition for leave to intervene, on such other questions as the judge should permit.

86 Bankruptcy Act, Sec. 144. 77B (a) required three or more creditors having provable claims amounting in the aggregate in excess of their security, if any, to $1,000, or stockholders holding 5% in number of shares of any class to be permitted to appear and controvert the facts alleged in the petition.

87 Bankruptcy Act, Secs. 169, 170. Under 77B (d) a plan could be proposed by any creditor or by any stockholder provided that the plan had been approved by creditors affected whose claims were not less than 25% in amount of the class and not less than 10% in amount of all claims against the debtor, or if the debtor was insolvent by stockholders affected by the plan provided their stock was not less than 10% of the class of stock outstanding and not less than 5% of the total number of shares of all stock outstanding.

88 Bankruptcy Act, Sec. 206.
proofs of claim of creditors and of the interests of stockholders may be filed and allowed. Objections to the allowance of any such claims or interests are summarily determined by the court. For the purposes of the plan and its acceptance the judge fixes the division of the creditors and stockholders into classes according to the nature of their respective claims and stock. For the purposes of such classification the judge shall, if necessary, upon application fix a hearing upon notice to determine summarily the value of the security and classify as unsecured the amount in excess of such value. The voting on a plan by creditors and stockholders is essentially the same as under 77B.

An indenture trustee may file claims for all holders of securities issued pursuant to the indenture who have not filed claims, provided, however, that in computing the majority necessary for the acceptance of the plan only claims filed by the holders and allowed may be included.

In case an executory contract is rejected pursuant to the provisions of the plan or under the authority of the court any person injured thereby shall for the purposes of the plan and its acceptance be deemed a creditor. The three year limitation of rent upon the claim of a landlord for injury resulting from the rejection of an unexpired lease found in 77B (b) is preserved.

An attorney for creditors or stockholders shall not be heard unless he has first filed with the court a statement setting forth the names and addresses of such creditors or stockholders, the nature and amounts of their claims or stock and the time of their acquisition, except as to claims or stock alleged to have been acquired more than one year prior to the filing of a petition. The judge is granted con-

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98 Bankruptcy Act, Sec. 196.
99 Bankruptcy Act, Sec. 197. This provision simplifies Section 77B (c) (6).
100 This is in accordance with the holding In re Allied Owners Corp., 74 F. (2d) 201 (C. C. A. 2d 1934).
101 Bankruptcy Act, Sec. 198.
trol over protective committees and other representatives of creditors and stockholders. To enable the judge to exercise his control effectively, relevant information is required to be furnished to the Court concerning the employment and interests of such representatives and the interests of the persons represented. As under 77B, the judge may disregard the provisions of any authorization, force an accounting, restrain the exercise of any power found to be unfair or inconsistent with public policy and may limit any claims or stock acquired by attorneys, agents, indenture trustees or committees in contemplation of or in the course of the proceeding to the consideration paid therefor.

CONFIRMATION OF PLAN

The conditions under which the judge shall confirm a plan are derived generally from 77B. Acceptances must be filed by the holders of two-thirds in amount of the claims filed and allowed of each class of securities affected. Claims filed by an indenture trustee, but not by the holders of the claims, will not be considered in computing the necessary acceptances. The judge must be satisfied that the plan is fair, equitable and feasible; that the proposal of the plan and its acceptance are in good faith and have not been procured by means forbidden by the act; that all payments made or promised for services and expenses in connection with the proceeding have been fully disclosed and are reasonable; that the plan provides for any class of creditors, affected by the plan but not accepting the plan by two-thirds majority in amount, adequate protection for the realization of the value of their claims against the property dealt with by the plan, and that the plan provides for any class of stockholders, affected by the plan but not accepting the plan by a majority of the stock, adequate protection for the realization of the value of their equity, if any, in the property of the debtor, provided that such pro-

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95 Bankruptcy Act, Secs. 210, 211 and 212.
96 Bankruptcy Act, Sec. 212.
97 Section 77B (f), (g) and (h).
98 Bankruptcy Act, Sec. 221.
tection is not required if the judge determines that the debtor is insolvent.99

A new provision consists in the requirement that the judge shall be satisfied of the full disclosure of the identity, qualifications and affiliations of the persons who are to be directors, officers or voting trustees upon the consummation of the plan and that their appointment to, or continuance in, such offices is “equitable, compatible with the interests of the creditors and stockholders and consistent with public policy”.100 This provision was designed to require an accounting as to the competency and integrity of the management and the elimination of any objectionable elements from the management which is recognized as ordinarily self-perpetuating. If the acceptance or failure to accept a plan by the holder of a claim or stock is not in good faith, after hearing the judge may direct that such claim or stock be disqualified for the purpose of ascertaining the required majority for the acceptance of the plan.101

LISTS OF SECURITY HOLDERS

The Chandler Act provides that any person, other than the debtor or trustee, having possession or control of a list of security holders of the debtor or information as to their names, addresses or the securities held by any of them may be required by the court to produce such lists, or a correct copy of them, or to permit their inspection. The court may, upon cause shown, impound such lists or copies and prescribe the terms upon which they may be made available to the trustee, indenture trustee or any creditor or stockholder. The court may refuse to permit an inspection by a creditor or stockholder who acquired his

99 Bankruptcy Act, Sec. 216.
100 Bankruptcy Act, Sec. 221. There is no indication in the Act as to the “public policy” to be applied. In confirming a plan under 77B the District Courts have in certain cases given consideration to the character of the management of the new company. In re Anchor Post Fence Co., 14 F. Supp. 801, 804 (D. C. Md. 1936); In re Parker-Young Co., 15 F. Supp. 965, 971 (D. C. N. H. 1936).
101 The application in practice of this provision will be extremely difficult. See: Texas Oils Securities Corp. v. Waco Development Co., 87 F. (2d) 395 (C. C. A. 5th 1937) where it was held that under 77B the judge had no power to disfranchise a creditor who, in contemplation of the reorganization proceeding, acquired over one-third of the notes of the debtor in order to have a veto upon reorganization plans.
claim or stock within three months of the filing of the petition.¹⁰²

These provisions recognize the importance of lists of security holders in a reorganization proceeding and broaden the power of the court to obtain such lists, to impound them and to open them for inspection upon terms that it may define. These sections appear to have been inspired by experimental devices developed in the receivership proceedings of S. W. Straus & Co., Inc. by Justice Charles A. Lockwood of New York.¹⁰³ Prior to its receivership, S. W. Straus & Co., Inc. had a virtual monopoly on lists of names and addresses of persons to whom it had sold bonds which enabled it to control the reorganizations of a great number of defaulted bond issues.¹⁰⁴ In an effort to insure that the lists were used for the benefit of all investors rather than for the benefit of a dominant group, Judge Lockwood developed a practice of denying access when it was not believed a proper use would be made of them. He indicated that he would permit an applicant to obtain access to a list upon showing (a) that he had a meritorious plan to submit to bondholders, or (b) that his objections to a proposed plan were reasonable, or (c) that he desired to communicate some matter of importance or advantage to bondholders.¹⁰⁵ In brief, in his treatment of the list problem, Justice Lockwood required lists of security holders to be closely held and permitted their use only on the showing of a meritorious purpose.

ALLOWANCES

General authority is conferred upon the judge to allow reasonable compensation to all parties in interest, includ-

¹⁰² Bankruptcy Act, Secs. 165, 166.
¹⁰³ Supreme Court of the State of New York (King's County).
CORPORATE REORGANIZATIONS

In fixing allowances for creditors and stockholders and their attorneys, "the judge shall give consideration only to the services which contributed to the plan confirmed or to the refusal of confirmation of a plan, or which were beneficial in the administration of the estate, and to the proper costs and expenses incidental there-
to."

Chapter X establishes the right of individual creditors and stockholders and their attorneys to allowances for bona fide and useful services.

Protective committees, representatives of security holders and others may be compensated for services beneficial to the estate although a plan is not approved or confirmed.

Although the provisions of Chapter X relating to allowances have been referred to as the "Christmas tree" provisions and have been frequently attacked, it is submitted that the real protection of an estate from excessive allowances rests not on a legal disqualification for compensation but on the proper exercise of the control of the judge.

No compensation or reimbursement may be allowed to any committee or attorney or other person acting in a representative or fiduciary capacity who at any time, after

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107 Bankruptcy Act, Sec. 243.
109 Compensation has been frequently refused for services rendered in unsuccessful opposition to a plan that was confirmed. See: In re Clark & Willow Streets Corp., 22 F. Supp. 666 (E. D. N. Y. 1938). Allowances have been generally made for services in opposing successfully a plan with the result another plan was adopted. In re Consolidated Motor Parts, 85 F. (2d) 579 (C. C. A. 2d 1936); In re Irving Austin Bldg. Corp., 22 F. Supp. 583 (N. D. Ill. 1937). Under 77B an allowance has been denied for services rendered on behalf of minority creditors in successfully opposing on appeal a plan which had been confirmed by the district court. In re Nine North Church St., 89 F. (2d) 13 (C. C. A. 2d 1937), cert. denied Glass & Lynch v. Nine North Church St., 302 U. S. 700, 82 L. ed. 22 (1937).
110 Senate hearings, p. 91.
assuming to act in such capacity, has purchased or sold claims or stock without the consent or approval of the judge.\textsuperscript{111}

CONCLUSION

In the past, the adoption of a reorganization plan has rarely, if ever, been based on purely theoretical considerations of "fairness." The problem of reorganization has been fundamentally a struggle between conflicting interests. The final solution has been largely the result of the competition involved in private bargaining efforts of the various parties whose interests have been at stake. Prior to 77B, the matter was deemed one of private contract attended by minimum judicial control, the power of the court being limited to a veto power to declare a plan inequitable because failing to provide for a relatively fair offer to the different classes of security holders. Under 77B the underlying principle of the competitive process was continued within the procedural channels of that act. Although there were conspicuous exceptions, the limitations of 77B were such that the tendency of the judge was not to frustrate the purported wishes of a substantial number in amount of security holders but rather to acquiesce in the result of the private bargain conducted outside of court.\textsuperscript{112}

The derivation of a reorganization through the operation of this bargaining process is so deeply imbedded in our thinking that it has been generally assumed without serious inquiry to be a sound, proper and indispensable system.

\textsuperscript{111} Bankruptcy Act, Sec. 249. This provision was anticipated by the action of the court on allowances in In re Paramount Publix Corp., 12 F. Supp. 823, 831, 832 (S. D. N. Y. 1935, Coxe D. J.) and In re Republic Gas Corporation, C. C. H. Bankr. Serv., par. 4104 (S. D. N. Y. 1936).

\textsuperscript{112} The theory that the working out of the plan under 77B is a matter of private negotiation and that the court should review the result of the negotiation, but should not participate therein, has been adopted by many Federal judges. In Downtown Investment Co. v. Boston Metropolitan Building, Inc., 81 F. (2d) 314, 321 (C. C. A. 1st 1936) the court not only disapproved of any attempt by the judge to influence security holders in favor of a plan, but stated that the judge should be greatly influenced on the question of the fairness of the plan by the fact that it had been accepted by the statutory majorities of the groups concerned. The court disapproved of the judge expressing an opinion upon the fairness of the plan before it had been assented to by creditors. In support of the \textit{laissez faire} theory see: Lindley, L. J., In re English, Scottish and Australian Chartered Bank (1893), 3 Ch. 385, 409. Compare remarks of Vaughan Williams, J., at p. 396 in the same case. See note 83, supra.
The underlying principle of Chapter X is that the bargaining process does not necessarily produce a reorganization plan which can stand such close scrutiny, judged by ordinary standards of fairness, as to require the non-asserting minority to be bound by its provisions. The self-interest of groups of security holders who are active participants in the proceedings is so great that it is impossible to expect them to press the assertion of proposals unconditioned by that interest. It is inevitable that a well organized, effectively represented class of security holders influence the character of a plan to an extent out of proportion to the influence of an inadequately organized or ineffectively represented class. For the bargaining process to operate successfully, each class of security holders is required to be well organized and to be actively and effectively represented. The process presupposes independence of action among the groups representing different classes of securities with conflicting interests. It presupposes that the assent of security holders to a plan represents a free and intelligent expression of opinion and that in the final analysis the problem is one of private contract.

These ideal conditions rarely exist. The owners of the equity in the property frequently have bought into the outstanding bonds either for investment or in anticipation of the reorganization proceedings, and a committee often has a divided allegiance with its ability to act solely in the interest of bondholders impaired. The SEC reported a widespread practice for committees to be formed by the corporation's investment bankers, by the management of the corporation or by the management and bankers in combination. Frequently the security holders are not presented with a choice of plans but with a single plan coupled with the untrue suggestion that the alternative is liquidation. If the creditors are not effectively organized, the debtor tends to occupy a dominant position with the not infrequent result that secured and unsecured creditors are induced to make sacrifices out of proportion to those of stockholders. An equity in the property is not preserved as contemplated by 77B and Chapter X; it is created.
The initiation of a plan by the trustee, the requirement of court approval prior to the submission of the plan to creditors, the advisory report of the SEC and the greater control conferred upon the judge drastically condition the traditional bargaining process. As a result, a plan may be formulated and considered free from the former pressures of vocal parties in interest. The reorganization is treated less as a matter of private bargain and more as an abstract problem in the adjustment of conflicting equities, and the solution is found less in struggle and more in critical and impartial analysis. On the other hand, there is nothing in Chapter X to preclude the debtor, creditors and other parties in interest from aggressively supporting or opposing a plan formulated by the trustee or approved by the court. The competitive process is limited, but it is not eliminated.