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REORGANIZATION UNDER THE AMENDED BANKRUPTCY ACT

In an effort to lessen the severity of the depression, a new relationship between debtors and their creditors was evolved in the form of an amendment to the Bankruptcy Act, which established Chapter VIII, entitled "Provisions for the relief of Debtors." The need for this new form of relief became more and more apparent as the depression wore on and equities vanished. The losses and the stagnation of business were so terrific that many debtors who were substantial men, farmers and merchants and many business corporations, as well as railroads and municipalities, found their reserves and assets so frozen and diminished in value that they were unable to meet their debts as they matured. Creditors, whose securities were seemingly well secured when made, found that they were unable to liquidate their securities, except at a tremendous sacrifice.

A feeling became general among creditors that maybe the debtor was not entirely to blame after all, and that if he were given an opportunity to continue business in a normal way he could run the business and eventually liquidate it to a greater advantage for the creditors than could the creditors themselves. In many instances it was good business for the creditor to go along with the debtor, and in many instances also this program kept the debtor from having the stigma of bankruptcy attached to his name, and enabled the creditor to realize far more than he otherwise would have realized.

It was found, however, in most cases, that some of the creditors would withhold their cooperation with the thought that they would be granted an advantage by having their claims bought up, either by the creditors or by the debtor. In many instances it proved to be better to buy off these small minority holders rather than to have expensive litigation, with the probable attendance of liquidation. This, how-
ever, was not fair as far as the other creditors were concerned, and it became increasingly apparent that some legislation was needed which would make these minority creditors go along with the program agreed upon by the debtor and the majority creditors if the program was fair and feasible.

Up until that time there was no law which could compel a creditor to go along with the other creditors. Minority mortgage bondholders effectively and often unwittingly, to the detriment of themselves and all other bondholders, would hold up the completion of the foreclosure of the mortgage securing their bonds because of their failure to join with other bondholders in making a bid for the property. In those instances where the holders of a majority of the bonds, usually acting through a Bondholders' Protective Committee, were unable to raise a substantial amount of cash in order to pay the nonconsenting bondholders their share of the amount to be bid for the property, the foreclosure proceedings could not be completed. It was only, when substantially all of the bondholders cooperated with one another in making a bid for the property being foreclosed, or where the bondholders purchased or acquired, under a Plan, the title to the property and the junior liens, that it was possible to complete the foreclosure. It can readily be seen that the minority creditors or bondholders prevented all of the bondholders from getting the benefit of the security on which they presumably held a first mortgage.

Businesses which needed a breathing spell, in order to liquidate their assets in an orderly manner and to get their houses in order, found themselves unable to do so because of a relatively few creditors who were either taking pot-shots in the form of judgments and levies with their attendant expenses, or were threatening to do so to the detriment of the business which then found itself unable to secure any new capital, or even to secure loans.

Hardly a property which had been built during the boom days and which was financed by a large first mortgage bond
issue was free from default. In the case of many of these buildings, probably most of them, the cost of the building and the land was greatly in excess of the bond issue. With the depression came low rents, which made it impossible for the property owner to pay even taxes, and which resulted in the reduction of the market value of the property to such an extent that the first mortgage bond issue greatly exceeded the market value. Market values did not properly approximate the real values of the properties. The scarcity of purchasers generally enabled a few buyers to acquire properties at their own figure, far below the cost of the properties a few years before. To be forced to sell in such a market, was certain to result in a complete loss to the debtor and a substantial loss to the creditors.

The problems, therefore, resolved themselves down to a point where the debtor and his or its creditors could advantageously discuss the conditions in which they mutually found themselves and endeavor to work out a solution which would avoid the tremendous losses which would otherwise ensue. Legislation was needed to force the minority creditors to go along with the majority, and thereby prevent such minority creditors from obtaining an advantage over the other creditors.

In 1932 the Hastings Bill was introduced in the Senate by Senator Hastings of Delaware. It proposed to completely revise the bankruptcy procedure, and Section 75 of that Bill provided for corporate reorganizations. Because of the magnitude of the job of revising the entire Bankruptcy Act, it was decided to abandon this Bill, but to embody in separate bills certain of its proposals which were for the relief of debtors.

On March 3, 1933, Section 73, which carried with it Sections 74, 75, 76 and 77, were added to the Bankruptcy Act. Section 75 of the abandoned Hastings' Bill was rewritten and introduced by Representative McEwen in 1933. The McEwen Bill passed the House at the special session, but was
lost in the shuffle in the Senate, because of the rush of business at the end of the special session. It was, however, passed at the second session and became a law on June 7, 1934, known as Sections 77A and 77B. Its provisions resemble the provisions of Section 77, which provide for railroad reorganizations. It also was modeled after similar English and Canadian Statutes.

Municipalities were also unable, in many instances, to pay their debts as they matured, and there was need for a procedure which would force the minority creditors to go along with a plan approved by the majority of the creditors and the Court. To accomplish this end, Chapter IX was added which was entitled "Provisions for the Emergency Temporary Aid of Insolvent Public Debtors and to Preserve the Assets Thereof, and for Other Related Purposes." Under this Chapter, Sections 78, 79 and 80 were added to the Bankruptcy Act, by the Act of May 24, 1934. This Act, however, was declared unconstitutional by the United States Supreme Court in *Ashton v. Cameron County Water Improvement District No. One.*

At the last session of the Congress, Chapter X, creating an additional jurisdiction to provide for the composition of the indebtedness of certain municipal bodies, was enacted on August 17, 1937, which added Sections 81, 82, 83 and 84 to the Bankruptcy Act. Section 84 provides that the jurisdiction under Section 81 of Chapter X should be limited to proceedings initiated on or prior to June 30, 1940.

Section 73 grants to courts of bankruptcy, in addition to the jurisdiction exercised in voluntary and involuntary proceedings to adjudge persons bankrupt, original jurisdiction in proceedings for the relief of debtors, as provided in Sections 74, 75 and 77 of the Act.

Section 74 is for the relief of debtors who are individuals, and it provides in part that any person may file a petition or,
in an involuntary proceeding before adjudication, an answer, accompanied in either case, unless further time is granted, by Schedules, and stating in such petition or answer that he is insolvent or unable to meet his debts as they mature, and that he desires to make a composition with his creditors or to secure an extension of time to pay his debts.

Section 75 was designed to enable a farmer to effect a composition or an extension of time, which if accepted by a majority of the creditors in number and amount would be binding upon the other creditors. This relief, however, was not considered to be sufficient for the farmers for the reason that about all that could be accomplished was an extension of time because of the provisions of the Act to the effect that the lien of a secured creditor could not be reduced or impaired. Then, too, the secured indebtedness of the farmer was usually held by a relatively few creditors who were in a position to veto any attempt of a farmer to benefit under this Section.

In order to cure this defect, an amendment was enacted in 1934, adding Section 75(s) to Section 75, which amendment was known as the “Frazier-Lemke Act.” This amendment in effect only could be invoked after an attempt had been made to bring about a composition under Section 75, and if unsuccessful, the farmer could then petition to have his property appraised and could be given a period of time within which to purchase it at the appraised value and he could also continue in possession by paying a relatively small rental therefor. This Act was declared unconstitutional by the United States Supreme Court in *Louisville Joint Stock Land Bank v. Radford.*

In order to meet the objections raised by the Supreme Court, a new Sub-Section (s) was substituted for the invalid

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Frazier-Lemke Act by the 74th Congress on August 28, 1935. The constitutionality of the new Sub-Section (s) has not been passed upon.

Section 76 merely provides that the relief for individuals and farmers should extend the obligation of any person who is secondarily liable for or who has insured or guaranteed the debt or debts, or any part thereof. Section 77 provides for the reorganization of railroads engaged in interstate commerce. Section 77A grants to courts of bankruptcy original jurisdiction in proceedings for the relief of debtors, as provided in Section 77B of the Act.

Section 77B, as stated before, provides for the reorganization of any corporation which could become a bankrupt under Section 4 of the Act and any railroad or other transportation corporation, except a railroad corporation authorized to file a petition or answer under the provisions of Section 77 of the Act. Section 77B completed the provisions for the relief of private debtors. The new Chapters IX and X previously have been discussed.

At first Section 74 was very popular and its benefits were invoked by a large number of property owners, against whose property foreclosure proceedings had been instituted, with the hope that some relief might be granted. In the majority of instances, however, the debtors filing under Section 74, were without cash and were unable to meet the requirements of the Act, which provided that before a composition or extension could be confirmed, it was necessary to deposit, with the clerk of the court, cash to take care of all taxes and prior charges and administration expenses, as well as the attorneys' fees. A decision finding that it was improper to use the rents which had been collected during the proceedings to make such deposit, sounded the death-knell of a number of the proceedings. A further provision of this Section of the Act, which made it of little value to a lot of debtors, was the provision that no plan of composition or extension could be proposed which in any way disturbed the lien securing se-
cured claims. So it was impossible to reduce the principal amount of outstanding secured indebtedness and there was some question as to whether or not the interest which had accrued on the bonds could properly be reduced under the provisions of Section 74, inasmuch as the interest, as well as the principal, was secured by the property.

Two very interesting experiences which we had under Section 74 might be of interest. A client who owned a grain elevator and was engaged in the grain business awoke one day to find himself owing about $50,000, with assets of not more than $15,000. He readily acceded to the wishes of certain of his creditors and turned over all of his assets to a Creditors' Committee for the purpose of liquidation. The Creditors' Committee found, however, that it was unable to represent all of the creditors, and in order to effect a sale of the grain elevator it hit upon the supposed short cut of an involuntary bankruptcy proceeding against our client. As soon as the petition was filed, we immediately filed an answer under the provisions of Section 74 of the amended Bankruptcy Act, and within about two months thereafter we had the client back in the grain business, operating his elevator under a temporary lease, and within four or five months we had a plan of composition and extension approved by a majority in number and amount of his creditors. Under the plan the secured claims were to be paid off out of the rents arising out of the use of the elevator, and the unsecured claims were to be paid off over a period of five years time. To date the creditors have received more than they possibly could have received in the event the bankruptcy had been completed and they still hold the same security and position with reference to the assets which otherwise would have been sold. Our client has again gained the confidence of the people of his community and from recent reports is making good.

The other interesting experience under Section 74 did not result in a confirmed proposal for extension or composition, but did result in a distinct benefit to our client as will be
This client had signed a note for about $250,000, which was secured by stock of his Company which had a reputed value of about $750,000. The holder of the note also held obligations of the Company to the extent of approximately $250,000, in addition to the indebtedness against our client. The note payable by our client was due the day following the day he engaged us to represent him. He had been advised that if a breathing spell of a week or ten days could be had, a certain party would take over the loans and extend the time of payment. It also had been suggested to the client that under the circumstances it should be possible to get an injunction in the state court to restrain the holder of the note from selling the collateral. You know, of course, that it is elementary that you cannot secure an injunction merely because you do not want to pay an indebtedness on the particular day it is due, and because you want additional time to try to get together money to enable you to pay. We advised the gentleman that if he were willing to take a chance of being declared a bankrupt in the event he could not conclude a plan of composition and extension, we were confident that we could get a stay of sale for at least thirty days by the filing of a petition for composition and extension under Section 74 of the Bankruptcy Act. He readily consented and we immediately prepared the petition for composition and extension, an order approving the same, a petition for a restraining order to restrain the holder of the note from selling the collateral, and a restraining order. Within four hours after the client had called upon us and had first discussed the matter with us, we filed the petition and were fortunate enough to be able to have a judge pass upon it at once and enter an order approving the same and also to issue the restraining order. The next morning we served the holder of the note with a copy of the restraining order.

Strenuous efforts were made by the holder of the note to have the restraining order set aside, but each time the court granted us time in which to prepare our schedules and to endeavor to fashion a plan of composition or extension. Rath-
er than to be further delayed, the holder of the note offered $25,000 in cash, and agreed to assume certain guaranties and company indebtedness which our client owed, in consideration of the dismissal of the Section 74 proceedings and of an assignment of all interest which our client had in the collateral. This proved to be a very fine settlement because the parties who were endeavoring to get a refinancing loan found themselves unable to do so. Were it not for our ability to take advantage of Section 74 in the way we did, the collateral would have been bought in by the holder of the note at a price far below the amount of the indebtedness which would have burdened our client, not only with a total loss, but also with a large deficiency.

A number of clients who were the owners of real estate wanted us to commence proceedings under Section 74 in order to bring about a reorganization of their real estate. We pointed out to them the serious limitations of Section 74 as compared to Section 77B and advised them to have corporations formed and have their real estate conveyed to these corporations and then to have the corporations petition for corporate reorganization under Section 77B. It was then the feeling of a great number of lawyers that such a procedure would be ineffective in view of a decision of the United States Supreme Court to the effect that an individual could not form a corporation for the purpose of invoking the equity jurisdiction of the court for the appointment of a receiver. We maintained that it was the purpose of Congress to get properties and businesses of all kinds back in commerce and that the courts would be liberal in this viewpoint. In every proceeding of this kind that we commenced we always set forth in the petition a recital to the effect that the corporation had been formed for the purpose of invoking the provisions of Section 77B. Our judgment in this regard was later confirmed by the decision in the case of the In re Knickerbocker Hotel Company,\(^3\) which held that a corpora-

\(^3\) 81 Fed. (2d) 981 (C. C. A. 7th, 1936).
tion organized solely for the purpose of reorganizing under Section 77B, could become subject to the jurisdiction of the court for reorganization if there was a reasonable chance under the existing circumstances of a reorganization plan being confirmed.

Section 77B has made it possible to speedily reorganize a large number of properties which were frozen in foreclosure proceedings. Many foreclosure proceedings had gone to a decree, but because of the inability of the Bondholders' Committee to secure the deposit of substantially all of the outstanding bonds, or to acquire all of the junior interests and the title so as to avoid a redemption, it was impossible for the foreclosure proceedings to be completed. Foreclosure sales are supposedly for cash, and therefore, it is necessary to provide cash for that part of the bid allocable on the bonds which are not held by the successful bidder. Many of the properties had large amounts of unpaid taxes and had such impaired income that it was impossible to borrow sufficient funds to pay the taxes, to pay the costs of the foreclosure proceedings, and to pay the nondepositing bondholders their share of the bid price. Under Section 77B it is unnecessary to raise money for the purpose of paying the nondepositing bondholders for the reason that the nondepositing bondholders share on a parity with the other bondholders in any plan which is confirmed, nor to pay the accrued taxes or even to pay the reorganization expenses. Then too, there is no period of redemption and no sale of the property.

As soon as a property is reorganized under Section 77B, it can be made available immediately for commercial purposes and free from the jurisdiction of receivers or trustees. Corporations of all kinds found it possible to bring about a reorganization without materially affecting the operation of their business in the meantime, or of incurring large expenses, which formerly were incurred in equity receiverships.

Equity receiverships were in common use in reorganizing business corporations prior to the enactment of Section 77B.
A nonresident creditor who was friendly to the corporation would file a petition in the federal court asking for the appointment of a receiver and an order restraining all creditors from taking any action against the corporation. The corporation would come into court immediately and consent to the receivership. The court would fix an upset price and a sale would be held, at which the assets of the corporation would be acquired under a Plan of Reorganization. The court was without power to compel the minority to accept a Plan, and it, therefore, was necessary to allocate the pro rata part of the upset price applicable on the claims of the minority group. It was impossible for a federal court to appoint a receiver who could act outside of the district in which he was appointed. If the property of the corporation extended over a large area, as is true in the case of many types of organizations, it was necessary to appoint ancillary receivers in each district in which property of such corporations were located. Needless to say, this resulted in a tremendous expense and undue hardship. Under Section 77B the court in which the petition has been approved has exclusive jurisdiction of the debtor and its property wherever located, and, therefore, it is unnecessary to have ancillary receivers appointed for different jurisdictions.

Jurisdiction of the federal court under Section 77B is invoked either by an original petition filed by the corporation, which is referred to as the debtor, or by an involuntary original petition filed by three or more creditors holding unsecured claims against the debtor, or its property, in the aggregate amount of one thousand dollars ($1,000), or more, provided there is either a prior proceeding in bankruptcy or an equity receivership pending, or an act of bankruptcy committed by the corporation within four months prior to the date of the filing, or it may be invoked by an answer filed in an involuntary proceeding by the debtor before adjudication, or filed in any proceeding pending in bankruptcy. The petition or answer is then submitted to the court on such
notice as the court may require and a hearing is had to determine whether or not the petition or answer has been filed in good faith.

Good faith has been variously defined, but the inclusion of this term seems to have been made in order to give the court an opportunity to determine whether under all the circumstances there is a reasonable probability that a Plan of Reorganization will be accepted by the requisite number of creditors and stockholders and confirmed by the court, or whether the petition or answer has been filed merely to delay creditors.

The jurisdiction of the federal court is complete upon the entry of an order finding that the petition or answer has been filed in good faith, and the court thereupon either appoints a temporary trustee or permits the debtor to remain in possession of its property subject to the order of the court. At this time the court generally enjoins or stays the commencement or continuation of suits against the debtor until after the final decree, and under the Act, the judge requires the debtor, or the trustee, to give such notice, as the court may direct, to creditors and stockholders, and to publish a notice of a hearing to be held within thirty (30) days after the appointment of the temporary trustee or the order continuing the debtor in possession of its property. At this hearing the court may make permanent the appointment of the trustee, or may appoint a trustee, if none previously has been appointed, or may continue the debtor in possession, or place the debtor again in control of its property.

In the early days of this Amendment attorneys who represented the holders of only a few bonds would occasionally file involuntary petitions against corporations for reorganization under Section 77B. In the case of building corporations, which have been in foreclosure for a long period of time, it is difficult, if not impossible in most instances, to find a prior bankruptcy or equity receivership pending, or an act of bankruptcy committed by the corporation. However, in most of these instances, there was a receiver appointed by a court of
equity under the foreclosure proceedings, and the attorneys would, therefore, allege in their involuntary petitions that there was a prior equity receivership pending inasmuch as a receiver had been appointed in the foreclosure proceedings. They even went so far as to allege in the case of the Granada Hotel that a mortgagee in possession under the order of a court of equity in a foreclosure proceeding was equivalent to a prior equity receivership. However, in the case of Duparquet Huot & M. Co. v. Evans, the United States Supreme Court held that a receiver appointed in a foreclosure proceeding was not a prior equity receivership, and that a prior equity receivership meant a receivership of the company for the purpose of liquidation of the company, and in the case of Tuttle v. Harris, which involves the Granada Hotel, the Supreme Court said that a mortgagee in possession under the order of a court of equity in a foreclosure proceeding was not the equivalent of a prior equity receivership.

A question has been raised as to whether a corporation which had been dissolved by the state of incorporation more than two years prior to the date of the institution of either a voluntary or of an involuntary proceeding under Section 77B could properly be reorganized. In the case of the In re 211 East Delaware Place Building Corporation the Circuit Court of Appeals of the Seventh Circuit sustained the jurisdiction of the Court in the case where an involuntary proceeding was brought by creditors against the dissolved corporation. However, in the decision of the United States Supreme Court handed down on November 15, 1937, in the case of Chicago Title & Trust Company v. Forty-one Thirty-Six Wilcox Building Corporation, it was held that it was improper for a corporation organized in Illinois to institute proceedings for corporate reorganization more than two years after the corporation had been dissolved.

6 76 Fed. (2d) 834 (C. C. A. 7th, 1935).
7 59 S. Ct. 125 (1937), commented on herein, at p. 138.
We filed a bill to foreclose the lien of a first mortgage on an office building, which proceeding resulted in a decree being entered. However, no sale could be held under the decree because of the fact that the Bondholders' Committee did not have a sufficient number of bonds, and it was impossible to work out a reorganization with the corporation because of the fact that the corporation previously had been dissolved. While we were marking time, an involuntary petition was filed under the provisions of Section 77B. An attack was made on the jurisdiction of the court, but no decision was ever handed down because it was hoped that Congress would pass legislation, which was pending, to the effect that creditors might institute proceedings under Section 77B, provided a receiver had been appointed for 50% or more of the property of the corporation. This proposed legislation was not passed at the last session of the Congress, but it may be revived at the regular session which commenced in January, 1938. In the meantime, we have decided to endeavor to cure the lack of jurisdiction of the federal court, by having the decree of dissolution, which had been entered a number of years ago, vacated, and then by filing an application in the dissolution proceedings for the appointment of a receiver in equity under the provisions of Sub-Section (d) of Section 157.86 of the Illinois Business Corporation Act. If a receiver is appointed under the provisions of this Section, it is our opinion that there will then be a prior equity receivership pending, and, upon the filing either of a new involuntary petition or an amended petition reciting the appointment of an equity receiver in the State court, the jurisdiction of the federal court will not be subject further to question, and the property can then be reorganized.

At the time of the hearing for the appointment of a permanent trustee, the court generally fixes a time and prescribes the manner for the filing of claims. The Act provides that any claims not filed within the time fixed by the court, or such further time as the court might grant, shall be forever
barred. It is not necessary to wait the customary period prescribed by the old bankruptcy law, but such period of time can be of such duration as the court may direct.

Under the old bankruptcy practice, certain types of claims, particularly those arising in tort, were not dischargeable in bankruptcy. However, under the provisions of Section 77B, creditors are defined "for all purposes of this Section and of the reorganization plan, its acceptance and confirmation, all holders of claims of whatever character against the debtor or its property, including claims under executory contracts whether or not such contracts would otherwise constitute provable claims under this Act." The term "claims" is defined to include "debts, securities, other than stock, liens or other interest of whatever nature." Even government claims can be dealt with by the Plan, and a provision is made in the Act for the approval or nonapproval where monies are due the Federal Government.

We had occasion to extend the definition of creditors and claims to probably their broadest sense in proceedings which we instituted in Ohio, for the reorganization of a corporation which was the lessee under a ninety-nine year lease. It so happened that the title to the property was held by a trustee for the benefit of holders of units of beneficial interest. The trustee had also issued the ninety-nine year lease as lessor. The leasehold estate had been mortgaged by the lessee to the extent of several hundred thousand dollars. The company was unable to pay the ground rent and the accumulated taxes and the lessor was threatening to forfeit the lease, which, of course, would have wiped out the leasehold bondholders, as well as our clients who were the holders of the stock of the corporation. It was useless, therefore, to reorganize the corporation unless we could in some way reduce the requirements of the lease. In preparing the petition, we listed as creditors the holders of the units of beneficial interest on the theory that they were the ultimate beneficiaries of the rent and were claimants against the property interest of the lessee.
corporation. The court eventually held with us and sustained our contention that these certificate holders were creditors. We filed a Plan which materially changed the terms and provisions of the underlying lease, including the amount of rent payable and had reduced the distribution of interest applicable to the holders of units of beneficial interest from 5⅔% per annum to 3% per annum. After patient work, we were able to secure the consents of the holders of more than two-thirds of the outstanding units of beneficial interest, and this phase of the reorganization was assured. Under the Plan, the leasehold mortgage was eliminated and 90% of the outstanding stock was given to the leasehold mortgage bondholders and 10% of the stock to our clients. This reorganization has been confirmed and completed.

The court fixes a classification of the various claims which have been filed or expected to be filed, which classification is subject to change upon the objection of a creditor or a stockholder if the objections are sustained by the court. The Plan of Reorganization which is then filed deals with each of the various classes of claimants, and it is necessary before the Plan can be confirmed that the holders of two-thirds in amount of the claims of the various classes approve the Plan. The classes of stock are also classified, and in order that a Plan might be approved it is necessary that the holders of a majority of each class accept the Plan. Of course, only those claims and stock interests which have been filed and allowed need be considered in determining whether or not the requisite number of creditors or stockholders of each class have accepted the Plan. There is a provision in the Act to the effect that if creditors of certain of the classes to the extent of two-thirds or more of the total claims of creditors of that class do not accept the Plan, their claims or liens may be dealt with in one of several ways, the most important one of which seems to be by the appraisal of the property of the debtor and the payment either in cash to the extent of the value of their interests, or at their election in the securities
allotted to them under the Plan. When the Plan is confirmed the rights of all of the creditors and stockholders dealt with in the Plan are transmuted into the rights and benefits allocated under the terms of the Plan, although there is a provision in the Act to the effect that even after confirmation, but before final decree, the court can modify a Plan under certain conditions.

Of course, one of the most difficult tasks is adjusting the interest of the various parties in the Plan of Reorganization. Frequently, Bondholders' Committees have been over zealous in their efforts to get everything for their bondholders and have frequently forgotten that the proceedings were originally intended to be for the relief of debtors and not to relieve the debtors of their properties. In determining whether or not a Plan is fair and equitable and does not discriminate unfairly in favor of any class of creditors and stockholders, and is feasible, the court has been given great powers and discretion. Its decision is rarely upset by reviewing courts. The extent to which reviewing courts will sustain such findings as to the fairness of a Plan, is best illustrated by the decision of the United States Supreme Court in the case of Re 620 Church Street Building Corporation, which involved the reorganization of a hotel property. The Committee had negotiated for a long period of time with the owner and junior interests and was unable to reach a basis for a Plan of Reorganization. The Committee thereupon had an appraisal made of the property, which showed it to be worth less than the amount of the first mortgage indebtedness, and apparently under the circumstances the court found that the Plan, which granted no participation to the junior interests including the stockholders, was fair and equitable and confirmed it. An appeal was taken which confirmed the District court.

The Church case bid fair to wreck the constructive work of Section 77B and to rob it of its effectiveness as a relief for

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debtors. A debtor in a state like Illinois, where there is a long period of redemption, in many instances would fare far better in the foreclosure proceedings than it would if its property was subject to the jurisdiction of the federal court, and the Church case was followed. In a foreclosure proceedings not only the debtor but all of the junior lienors are given an opportunity to redeem from the foreclosure sale, while under Section 77B certain creditors can file a Plan eliminating all interests junior to them including the stockholders, and by appraising the property can usually establish that there is no equity and therefore that the Plan is fair and should be confirmed. Most all real estate corporations in the past have been definitely insolvent, not so much because of the unpaid principal amount, but because of the vast amount of interest and taxes which accumulated during the days of the depression.

I do not analyze the Church case to mean that it is necessary for a court to eliminate participation for junior interests, in the event the appraisal shows there is no security back of the junior interests, but merely to find that if the court after a comprehensive examination into all of the facts and circumstances surrounding the debtor and its property is of the opinion that a Plan eliminating the debtor and the junior interests is fair, that such judgment ordinarily will not be upset.

In the case of In re 333 North Michigan Avenue Building Corporation, in which a certiorari was denied after the Church case had been decided by the Supreme Court, the Circuit Court of Appeals clearly states that a participation can be given in a plan to junior interests and stockholders, even though a debtor may be insolvent. The Court said in part:

"It is further contended by appellant that the Court should have found as a fact that the debtors were either solvent or insolvent and that without an appraisal for that purpose it was impossible for the
Court to pass on the fairness or equitableness of the Plan. The law did not require the Court to formally find that the debtors were solvent or insolvent. The record discloses that the debtors were unable to meet their maturing debts. The fact was never controverted, and it constituted the basis of petitioner's right to a reorganization, upon the approval of a Plan which was fair, equitable, feasible, and not unfairly discriminatory. In satisfying itself that the Plan presented had those characteristics, the Court was required to exercise an informed, independent judgment, based upon reliable information as to the character of the property involved, its cost and productivity, the character and amount of the debtor's indebtedness, and the existing economic conditions. The record is voluminous and it contains much evidence in support of the Court's ruling in this respect. . . . Under these circumstances we cannot say that the Court abused its discretion in not requiring an appraisal, and we were convinced that such action of the Court was in no manner violative of the due process clause of the Federal Constitution.” (Italics are mine.)

In discussing the question as to whether or not the Plan was feasible, the Court continued:

“That, of necessity, must depend upon the earning power of the property and future economic conditions. . . . What the property is, and what it has produced, is well known. What it will do in the future is, of course, problematical. Under existing conditions no one can say with assurance that the Plan will succeed. The District Court thought that immediate liquidation would be disastrous to all interests, and that there was reasonable ground for believing that the Plan would succeed.” (Italics are mine.)

Particularly in those states where it is the established public policy of the state, as evidenced by redemption laws or moratorium laws, to give protection to the owner and the junior interests, it does not seem to be within the spirit or the intent of Section 77B of Chapter VIII of the Bankruptcy Law, which is entitled, “Provisions for the Relief of Debtors,” for the court to approve a plan as being fair and equitable which does not grant a participation for such junior interests and stockholders. If a participation is not given to such interests, no plan should be approved, and, if after a reasonable time no plan giving such participation is accepted, the proceedings should be dismissed and the creditors and the debtors relegated to their rights and remedies under the state laws. Clause 8 of subdivision (b) of the Act provides:
"If a Plan of Reorganization is not proposed or accepted within such reasonable period as the Judge may fix, or if proposed and accepted, is not confirmed, may after hearing, whether the proceedings be voluntary or involuntary, either extend such period or dismiss the proceedings under this Section, or . . . direct the estate to be liquidated. . . ."

Subdivision (f) provides in part:

"After hearing such objections as may be made to the Plan, the Judge shall confirm the Plan if satisfied, that

1. it is fair and equitable and does not discriminate unfairly in favor of any class of creditors or stockholders, and is feasible; . . ."

Inasmuch as redemption laws are not dependent on the solvency of the owner of the right of redemption but ordinarily are absolute, any Plan which does not give recognition to such redemption rights is hardly fair or equitable and would discriminate unfairly in favor of certain classes of creditors and therefore should not be confirmed irrespective of the insolvency of the debtor.

Arthur J. Hughes.

Chicago, Illinois.