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THE PROTECTION OF MINORITY BONDHOLDERS IN FORECLOSURES AND RECEIVERSHIPS*

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FOR THE development of the law of corporate reorganization, the cumulative disasters of 1929 to 1932 were rich in promise. Not only would many large railroads and industrial enterprises be forced to reorganize, but default in countless real estate bond issues would present many of the same problems and turn what had always been an esoteric legal specialty, understood and practiced by only a few lawyers in the metropolitan centers, into a fully developed and generally understood branch of the law. Reorganizations did come by the hundred; thousands of members of the bar developed an avid interest in the subject; but the promise has not yet been fulfilled. One is forced to admit that even on elementary questions there is almost as much uncertainty today as there was before the depression.

The most fundamental problem of reorganization law has been that of the relation between groups of creditors within a given class, the problem as to the type of protection, if any, to which minorities are entitled. There has been little detailed analysis of this problem as it arose in cases of reorganization in equity.¹ Such an analysis is worth attempting in spite of the fact that probably a large majority of current reorganizations are brought about through proceedings under Section 77B of the Bankruptcy Act.²

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¹ Perhaps the ablest treatment of the subject is Weiner, *Conflicting Functions of the Upset Price in a Corporate Reorganization*, 27 Col. L. Rev. 132 (1927). For a general statement, see also *Warner Bros. Pictures v. Lawton-Byrne-Bruner Ins. A. Co.*, 79 F. (2d) 804, 810 (C.C.A. 8th 1935); Dodd, *Reorganization through Bankruptcy: a Remedy for What?* 48 Harv. L. Rev. 1100 (1935).

² 48 Stat. 912 (1934), 11 U.S.C.A. § 207 (1934).

Some reorganizations are still effected through foreclosure or receivership proceedings and in such cases the fundamental problem with which this article deals continues to trouble the courts. And although Section 77B contains elaborate provisions as to the rights of minority creditors, some of these provisions are intelligible only in the light of the history of reorganization in equity.³

I. THE POSITION OF THE MINORITY BONDHOLDER⁴

The problem of "reorganization," as the term is here used,⁵ arises when a corporation or individual with a number of creditors is unable to meet his obligations, but when there is some likelihood that with relief from the pressure of maturing debts his business can profitably be operated. Often there are many classes of creditors and shareholders, but for the purposes of this article we are concerned primarily with the senior class of creditors, frequently first mortgage bondholders,⁶ and for convenience these senior creditors will usually be referred to as "bondholders."⁷ If the bondholders should force an actual liquidation of the debtor's assets by sale, the proceeds probably would be insufficient to satisfy even the claims of this class. A majority of the bondholders, therefore, is usually induced to unite to avoid or minimize loss by acquiring the assets of the debtor and continuing the business.⁸ This cooperative action is usually brought about through a "committee." In the case of bonds, debentures or other publicly marketed securities, the committee is frequently organized by or under the leadership of the investment bankers who originally distributed the securities. The holders are solicited to deposit their bonds under an agree-

³ See, for example, the provisions of subsection (b) (4) and (5) with respect to an "upset price"; Frank, *Some Realistic Reflections on Some Aspects of Corporate Reorganization*, 19 Va. L. Rev. 698, 707 (1933).

⁴ At the risk of boring readers familiar with reorganization practice, the steps in a typical reorganization are outlined in this section in very elementary terms.

⁵ The term is often used in a broader sense so as to include readjustment of the rights of creditors and shareholders by voluntary agreement without court proceedings or readjustment of rights of shareholders by charter amendment, merger, etc.

⁶ If no mortgages or other liens or priorities are involved, the senior class will of course consist of the general creditors.

⁷ To simplify the problem further it will also be assumed, except where otherwise stated, that all of the debtor's property is subject to the mortgage securing the bonds. In the case of such a mortgage, the legal security interest is vested in a trustee, often a bank or trust company, for the benefit of the bondholders. See 2 Bogert, *Trusts and Trustees* § 246 (1935).

⁸ If the debtor has other classes of creditors or one or more classes of shareholders, this acquisition is often brought about through the cooperation of the various classes.

ment vesting in the committee broad powers to act for the depositors in effecting a reorganization.⁹

A plan of reorganization is presented to the bondholders either at the time of the original solicitation of deposits or at a later date. The plan usually provides for the acquisition of the debtor's property by a new corporation¹⁰ to be formed by the committee and the issuance by the new corporation of new stock or stock and bonds to the holders of the old bonds who shall have assented to the plan.¹¹ Bondholders who deposit after the promulgation of the plan thereby indicate their assent to the plan, and the deposit agreement usually provides that prior depositors who do not withdraw their bonds within a specified period will be deemed to have assented to the plan.¹²

This acquisition of the debtor's property for the benefit of the assenting bondholders is usually brought about through a suit for foreclosure by judicial sale, if a mortgage is involved, or a suit instituted by a general creditor's bill looking toward a receiver's sale, or both.¹³ Thus reorganization is effected through the same types of legal proceedings which would be used if it were proposed to have the assets sold to outsiders and cash proceeds applied upon the claims of creditors. While the foreclosure or receivership suit is proceeding toward a decree of sale, the committee is completing the reorganization plan and pressing its solicitation of de-

⁹ For a criticism of such deposit agreements, see Lowenthal, *The Stock Exchange and Protective Committee Securities*, 33 Col. L. Rev. 1293 (1933). See also *A Functional Study of the Operation of Bondholders' Protective Committees in Realty Reorganizations*, 35 Col. L. Rev. 905 (1935).

The classic exposition of reorganization procedure is Cravath, *The Reorganization of Corporations*, in Stetson *et al.*, *Some Legal Phases of Corporate Financing, Reorganization and Regulation* 153 (1917).

¹⁰ In the reorganization of many real estate bond issues a "liquidation trust" has been used instead of a corporation.

¹¹ If the plan represents a cooperative effort on the part of holders of several classes of securities or interests, it will provide, of course, for distribution of securities of various kinds or in varying proportions among the respective classes.

¹² Deposit agreements frequently permit the committee to require a contribution toward their compensation and expenses as a condition precedent to withdrawal. Such a charge, of course, operates as a strong inducement to leave securities on deposit.

¹³ In comparatively rare cases ordinary bankruptcy proceedings were utilized for this purpose prior to the enactment of § 77B of the Bankruptcy Act. See Douglas and Frank, *Landlords' Claims in Reorganizations*, 42 Yale L. J. 1003 (1933).

On the general subject of the typical corporate receivership, see Glenn, *Liquidation*, c. XIV (1935).

posits.¹⁴ When sufficient deposits have been secured to enable the committee to bid for the property on behalf of the depositors, the foreclosure or receiver's sale is held and usually the committee is the only bidder. The sale to the committee is then confirmed by court order. Expenses of the sale and other charges in connection with the foreclosure or receivership proceeding are of course paid from the proceeds of the sale and the balance is available for distribution among all the bondholders. If the committee paid its full bid in cash, it is apparent that a major portion of this cash would immediately be returned to it in connection with the distribution. This circuitry of payment is obviously unnecessary, and to avoid it the committee is required to pay only part of its bid in cash—an amount sufficient to pay the expenses of the sale and other prior charges and the portion of the balance of the bid which is distributable to non-assenting bondholders. The remainder of the bid is paid by presenting the deposited bonds and having stamped upon them a notation that they are satisfied to the extent of the amount which would have been distributable to their holders had the entire bid been paid in cash. After the sale has thus been consummated, the committee causes the property to be transferred to the new corporation in return for the securities which are distributed pursuant to the plan.

It has been said that the committee is usually the only bidder at the sale. This results from the fact that it is rarely worth while for an outsider to enter the bidding. The committee, with its power to use the deposited bonds in payment of a major portion of its bid, will usually prefer, if necessary, to carry the bidding beyond any price which would attract a cash purchaser. And minority bondholder groups will seldom be in any substantially better position than an outsider. It usually results, therefore, that the committee has no opposition at the auction and is thus under no compulsion to bid its maximum price. In the case of a railroad or an industrial concern or large hotel, the character and size of the property are further factors contributing to the committee's monopoly; but it is important to note that even apart from these factors, even in the case of relatively small real estate properties, because of the committee's bidding advantage, competition develops only in very rare cases.¹⁵ In the *Chicago*

¹⁴ In some cases, the formulation of the plan and the solicitation of deposits is commenced and even almost completed prior to the institution of any legal proceedings. See, for example, *First Nat'l Bank v. Flershem*, 290 U.S. 504 (1934).

¹⁵ An outside bidder will almost never be willing to bid as much as the aggregate claims of the creditors.

In a few cases other bidders have appeared under circumstances suggesting that they represented minority bondholders or junior interests and were bidding to force the committee up

& *Milwaukee Electric* case,¹⁶ the committee was said to be in a "masterful situation . . . controlling the sale." But while there has been early and general recognition of the committee's dominant position,¹⁷ there has been little agreement as to the resulting legal responsibilities, if any, to be imposed upon the committee.

Even down to the present time many reorganization lawyers have urged that this monopoly of the bidding has no special legal consequences—that a sale to the committee is to be treated just the same as a sale to an outsider—that a minority bondholder in a reorganization case may raise no objections except those which might be raised by a creditor disappointed with the results of any execution or foreclosure sale. These objections are few in number. The postulate underlying the general law applicable to such sales is that the common interests of debtor and creditors in having the debtor's property go as far as possible in satisfying his debts are best promoted by assuring an open public sale and protecting the rights of purchasers. And if such a sale fails to attract bidders who are willing to pay a satisfactory price, the creditor's power to bid at the sale furnishes the only added protection to which he is usually thought entitled.

Various defects in the sale itself will entitle a creditor (as well as the debtor) to have the sale set aside. The defect may arise from inadequate notice or from circumstances, conduct or agreements having the effect of keeping bidders away—of "chilling the sale."¹⁸ In most cases some such defect in the sale must be shown before a creditor may defeat the rights of the purchaser. It is usually said that inadequacy of price alone affords no ground for objection, although occasionally a gross or "shocking" inade-

rather than with any desire to secure the property. See *Investment Registry v. Chicago & M. E. R. Co.*, 206 Fed. 488 (D.C. Ill. 1913); *Equitable Trust Co. v. U.S. Oil & Ref. Co.*, 35 F. (2d) 508 (D.C. Wyo. 1928), modified, *Werner, Harris & Buck v. Equitable Trust Co.*, 35 F. (2d) 513 (C.C.A. 10th 1929).

¹⁶ *Investment Registry v. Chicago & M. E. R. Co.*, 212 Fed. 594, 610 (C.C.A. 7th 1913).

¹⁷ See *Walker v. Whelen*, 4 Phila. 389 (1861); *Duncan v. Mobile & O. R. Co.*, 8 Fed. Cas. 25, Fed. Cas. no. 4139, 3 Woods 597 (S.D. Ala. 1879); *Cushman v. Bonfield*, 139 Ill. 219, 238, 28 N.E. 937, 942 (1891).

In *Ketchum v. Duncan*, 96 U.S. 659, 672 (1877), it was urged by a minority bondholder that because of this situation the majority should be required to pay their entire bid in cash. This position is obviously without merit and was repudiated by the Supreme Court. A rule such as that urged would not afford substantial protection to the minority and would merely harass the majority by requiring them to borrow a large amount for the short period between the time of the payment of their bid and the distribution of the net proceeds.

¹⁸ For example, in *Martin v. Crews*, 279 Ill. App. 37 (1935), a resale was ordered at the request of the receiver of a creditor who had been prevented from bidding because of his inability to secure timely authorization. See note, *Agreements Not to Bid at Judicial Sales*, 67 U.S. L. Rev. 433 (1933).

quacy is said to be evidence of some defect in the sale, or is recognized as ground for ordering a resale.¹⁹ In considering inadequacy of price, one must, of course, distinguish cases where the objection is raised by the debtor. Especially during recent years, some courts have frequently given the debtor protection against the consequences of a sale at an inadequate price. Such cases will be considered later,²⁰ but it has only been in rare instances of extreme inadequacy that a creditor has been able to block confirmation of a sale where there was no irregularity or unfairness in the sale itself.

If objections by minority bondholders in reorganization cases are similarly limited, as often contended by committee counsel, the interests of the minority are clearly in jeopardy. Unless restrained by additional rules of law, the majority committee, with its inevitable monopoly of the bidding, might on the one hand deny the minority participation in the reorganization plan or offer only an unfair plan, and on the other hand make a low bid which would give to the minority a cash distribution substantially less than the fair value of their interest in the property.

In a few reorganization cases, of course, minority bondholders have been able to have the sales set aside by the application of rules governing judicial sales generally, such as those with respect to notice or misconduct on the part of the officer conducting the sale,²¹ but usually the formalities are scrupulously observed. Occasionally, also, the rule against chilling of the bidding is urged with effect by a minority bondholder. Thus in the *Chicago & Milwaukee Electric* case²² a syndicate interested in acquiring the property had begun to buy up bonds, apparently with a view to their use in bidding at the foreclosure sale. Another group of bondholders bought out the syndicate and it was held that this purchase constituted an im-

¹⁹ *Ballantyne v. Smith*, 205 U.S. 285 (1907). Cf. *Wright v. Branch*, 27 Del. 484, 90 Atl. 41 (1914); *Northrop v. Cooper*, 23 Kan. 432 (1880); *Smith v. S.S. City of Columbia*, 11 Haw. 709 (1899). Decisions involving objections by creditors in cases not involving reorganization are relatively rare. See also 3 Jones, *Mortgages* §§ 2140, 2141 (8th ed. 1928); 2 Wiltsie, *Mortgage Foreclosure* § 752 (4th ed. 1927).

²⁰ See section IV, p. 544 *infra*.

²¹ *Jackson v. Luedling*, 21 Wall. (U.S.) 616 (1874). Cf. *Anthony v. Campbell*, 112 Fed. 212 (C.C.A. 8th 1901). See also *Bovay v. Townsend*, 78 F. (2d) 343 (C.C.A. 8th 1935), where the offering of two bridges as a unit was held to constitute chilling the sale.

²² *Investment Registry v. Chicago & M. E. R. Co.*, 206 Fed. 488 (D.C. Ill. 1913), *aff'd* 212 Fed. 594 (C.C.A. 7th 1913).

For an unsuccessful attempt to invoke the "chilling" doctrine, see *Bethlehem Steel Co. v. International Combustion Eng. Corp.*, 66 F. (2d) 409, 412 (C.C.A. 2d 1933).

proper elimination of a prospective bidder and justified ordering a resale.²³ It was conceded in this and other cases, however, that while any combination of bondholders to purchase at the sale may involve an elimination of possible bidders, such agreements are legitimate between persons who did not acquire their bonds for the purpose of becoming bidders at the sale.²⁴ In many cases, in fact, without such combination no satisfactory bid could be obtained.

In a sense, of course, as already noted, the sale is almost always "chilled" in a reorganization case: the superior bidding power of the committee usually has the effect of removing from the field any other bidders who might be interested. But even if this aspect of the situation should be regarded as legally constituting a "chilling of the sale," it is obvious that the usual consequence of such chilling, the ordering of a resale, furnishes no solution of the problem of the minority bondholder. What "chilling" exists is inevitable and unless the reorganization process is to be completely blocked, a valid sale must be possible in spite of such "chilling." Furthermore, a low bid by the committee does not justify an inference of any irregularity in the sale.²⁵ The low bid results from the committee's conceded and inevitable monopoly of the bidding. And even if relief might be given in a case of "gross" or "shocking" inadequacy of price, there would remain many cases where the traditional rules applicable to ordinary judicial sales would leave the minority bondholder virtually unprotected.

These rules are thus entirely inadequate in reorganization cases. As already stated, the denial of relief to creditors in cases of other types is justified in view of the power of the creditors to protect themselves by bidding. Since the minority bondholder lacks this power in any practical sense, the basis for the usual rule is lacking. Special rules are necessary for the protection of minority bondholders—rules which are based upon the realities of the reorganization problem. But what kind of protection should be given? Should the court attempt to protect by control over the

²³ It is not clear what help ordering a resale would offer with respect to this type of chilling of the bidding. The court made no attempt to set aside the purchase of the syndicate's bonds. Unfairness in the reorganization plan furnished an additional ground for the decision of the circuit court of appeals.

²⁴ *Central Trust & Savings Co. v. Chester County Elec. Co.*, 9 Del. Ch. 123, 77 Atl. 771 (1910). See 67 U. S. L. Rev. 433 (1933). Cf. *Warner Bros. Pictures v. Lawton-Byrne-Bruner Ins. A. Co.*, 79 F. (2d) 804, 815 (C.C.A. 8th 1935), involving a contention by a minority first mortgage bondholder that recognition of second mortgage bondholders in the plan constituted chilling of the bidding.

²⁵ But see *Straus v. Anderson*, 283 Ill. App. 342, 348 (1936), where the court referred to the inadequacy of the bid as "sufficient to excite suspicion."

price bid, and, if so, what should the standard be? Or should the court consider the reorganization plan, and, if so, should such consideration be given only in connection with the amount of the bid, or independently? Or should protection be given with respect to both the price and the plan? Or should traditional reorganization practice be entirely overthrown in favor of purchase for the benefit of all bondholders by the trustee under the mortgage?

II. JURISDICTION OVER REORGANIZATION PLANS

Until comparatively recently committee counsel have frequently urged that the reorganization plan is no concern of the court, that minority bondholders have no cause to complain if the plan is unfair, that the only protection available to them is under the rules outlined in the preceding section or perhaps by insistence upon an "adequate bid." It is surprising that this fundamental question of jurisdiction over the reorganization plan should still be open in any jurisdiction where reorganization cases have been numerous. Yet two divisions of the Illinois Appellate Court for the Chicago district have recently taken opposing views,²⁶ and at the present writing the state supreme court is still holding under advisement a case squarely presenting the issue.²⁷

It may easily be demonstrated that unless the courts consider objections to the fairness of a reorganization plan obvious injustice may be done to either the minority or the majority. In the first place, if the court has no such power, fairness to the minority requires that the court insist upon a bid which will give the dissenter the full value of his interest, a bid equal to the full, fair, going-concern value of the property. If he is not to be given a legal right to participation in the plan, any less protection as to the bid would clearly be inequitable in view of the strategic position of the majority. And if the minority bondholder is not to have a hearing on his objections to the plan, the result is almost as harsh. True, the approval of the plan by a majority of the bondholders of the same class may be a strong indication of the fairness of the plan; but the personnel and affiliations of bondholders' committees and methods sometimes used to secure assents²⁸ justify skepticism as to the force of the argument based upon the majority acceptance of the plan. Unless the plan is to have some inde-

²⁶ First Nat'l Bank v. Bryn Mawr Beach Bldg. Corp., 283 Ill. App. 267 (1936); Straus v. Anderson, 283 Ill. App. 342 (1936).

²⁷ First Nat'l Bank v. Bryn Mawr Beach Bldg. Corp., 283 Ill. App. 267 (1936).

²⁸ See, for example, Commissioner Eastman in Chicago, M., & St. P. Reorganization, 131 I.C.C. 673, 701-14 (1928); Lowenthal, *The Investor Pays*, cc. 25-8 (1933). See also note 12 *supra*.

pendent scrutiny when challenged as unfair, the minority bondholder has no fair alternative unless the majority are forced to make a bid affording to him the full value of his interest.

But reorganization could seldom be effected if so high a bid were required. If such were known to be the law, the advantage of being a dissenter would be so obvious that it would be impossible to secure sufficient assents to the plan to make the purchase financially possible. Too great a portion of the purchase price would have to be paid in cash. Most holders of defaulted bonds would be happy to liquidate their holdings on these terms; the majority assent to a plan only because cash is not available except at a sacrifice. The conclusion is inescapable: Since control over the sale price cannot afford adequate protection to the dissenter without making reorganization impossible, courts must consider the plan of reorganization and, if it is found to be fair, confirm a sale at less than the full, going-concern value. We shall consider later what should be done if the plan is unfair; that is, whether a high bid should be required or whether the court should refuse confirmation of a sale to the majority at any price.²⁹

As already suggested, the early position of counsel for committees was usually to deny jurisdiction of the court over the reorganization plan. Their tactics, however, in cases involving several classes of creditors were changed by the decision in *Northern Pacific Ry. Co. v. Boyd*,³⁰ in which the new company resulting from the reorganization was held liable to an unsecured creditor because the plan was found unfair to that class. In cases involving more than one class of creditors, committee counsel have adopted the expedient of presenting the plan to the court in the hope of blocking such attacks. In simpler cases, however, they have often continued in the attempt to immunize their plans from judicial scrutiny. In his book published in 1929, Mr. Tracy stated their position as follows:

Where the reorganization is by one class of security holders only, there being no question involved as to the distribution of securities among different classes of persons interested, for example, where a first mortgage bondholders' committee buys in the property with bonds and reorganizes it, there is no reason for submission to the court of any reorganization plan. The non-participating bondholder must protect himself by objecting to the sale price of the property as inadequate, in which complaint, . . . he is rarely successful.³¹

²⁹ No attempt is made in this paper to deal with the problems arising where the plan has not been approved by a majority of the class to which the objector belongs. Many such cases are referred to in Moore and Levi, *Federal Intervention: I. The Right to Intervene and Reorganization*, 45 *Yale L. J.* 565, 595 ff. (1936).

³⁰ 228 U.S. 482 (1913).

³¹ Tracy, *Corporate Foreclosures, Receiverships and Reorganizations* § 297 (1929). For a similar statement, see 3 Jones, *Bonds and Bond Securities* § 1518 (4th ed. 1935).

It should have been clear, however, even in 1929, that reorganization plans might be unfair even if they involved no distribution of securities among several classes. Even the simplest plan might be unfair, for example, in providing for exorbitant fees for the committee or its counsel,³² or excessive commissions for underwriters of securities to be sold for working capital.³³ Or, conceivably, a majority sufficiently strong might attempt to exclude the minority from participation in the plan.

A few cases lend support to the position that the court will not examine the reorganization plan upon the complaint of a minority bondholder.³⁴ As already stated, an adoption of this view would make all-important the question of the extent of the protection to be given with respect to the bid; yet none of the opinions referred to considers this question or reveals any awareness of the consequences of a refusal to consider the plan.

The recent denial by an Illinois appellate court of jurisdiction over the plan was made under somewhat different circumstances.³⁵ The plan was brought before the court not by an objecting bondholder but by the majority committee. A dissenter had objected to the confirmation of the sale on grounds of inadequacy of price and the committee had intervened, submitted its plan to the court, and argued that in view of the fairness of the plan the sale should be confirmed. The decree of confirmation was reversed, the court holding that the price was inadequate,³⁶ and that it was error for the trial court to consider the plan.³⁷ It is not entirely clear that

³² See *Coriell v. Morris White, Inc.*, 54 F. (2d) 255, 258 (C.C.A. 2d 1931), rev'd on another ground, *Nat'l Surety Co. v. Coriell*, 289 U.S. 426 (1933).

³³ See *Bethlehem Steel Co. v. International Combustion Eng. Corp.*, 66 F. (2d) 409, 412 (C.C.A. 2d 1933). Cf. *Investment Registry v. Chicago & M. E. R. Co.*, 212 Fed. 594 (C.C.A. 7th 1913).

³⁴ *Cralle v. Louisville Title Co.*, 244 Ky. 753, 52 S.W. (2d) 891 (1932); *Louisville Trust Co. v. Title Ins. & Trust Co.*, 255 Ky. 195, 72 S.W. (2d) 1040 (1934). See also *Bowling Green Trust Co. v. Virginia Passenger & Power Co.*, 164 Fed. 753, 755 (C.C. Va. 1908); *Bank of Manhattan Trust Co. v. Ellda Corp.*, 147 Misc. 374, 379, 265 N.Y.S. 115, 120 (1933). Cf. *Conley v. International Pump Co.*, 237 Fed. 286, 287 (D.C. N.Y. 1915).

³⁵ *Straus v. Anderson*, 283 Ill. App. 342 (1936).

³⁶ In its supplementary opinion, the court insisted that it was not refusing confirmation because of inadequacy of price alone but because of such inadequacy coupled with unfairness on the part of the majority. The unfairness was found in the fact that the property was said to be earning annually almost one-third of the purchase price. 283 Ill. App. 355, 358-9 (1936). It is hard to see how this factor is more than a circumstance bearing on the issue of inadequacy of price.

³⁷ The plan was presented to the court not only in justification of the low bid but also in order to secure an exemption of the new securities from registration under § 3 (a) (10) of the federal Securities Act of 1933, as amended. 48 Stat. 906 (1934), 15 U.S.C.A. § 77d (10) (1935). If state courts deny jurisdiction to approve the plan, committees will probably be induced to invoke § 77B of the Bankruptcy Act. See *In re Knickerbocker Hotel Co.*, 81 F. (2d) 981 (C.C.A. 7th 1936). This remedy, of course, may not always be available.

the court would also hold that a dissenter's objections to the fairness of the plan are not to be considered. On its facts, the case is probably authority only for the proposition that a fair plan furnishes no excuse for a "grossly inadequate" bid, a proposition considered in greater detail in the next section of this article. The same court might consistently hold that an unfair plan might justify a refusal to confirm any bid by the committee.³⁸

In an overwhelming majority of the cases, the courts *have* taken jurisdiction over the plan. Among these are foreclosure cases as well as cases of general creditors' bills, cases involving industrial and real estate corporations as well as those involving public utilities.³⁹ In one case it has even been held that solicitors for minority bondholders were entitled to an allowance of fees for bringing before the court objections which resulted in a modification of the plan.⁴⁰ But there has been some diversity of opinion as to the type of relief to be given if the plan is unfair, and as to the proper procedure for raising objections to the plan. In this connection the cases fall into two main groups. In the first group are those illustrating the view that if the plan is unfair, the committee will be required to make a relatively high bid.⁴¹ The second group of cases indicates an apparently more drastic remedy—that the committee will not be permitted to carry out

³⁸ The opinion, however, contains nothing to this effect. In criticizing the language in this case to the effect that the plan is of no concern to the court, another division of the same court said in *First Nat'l Bank v. Bryn Mawr Beach Bldg. Corp.*, 283 Ill. App. 267, 287 (1936): "If it should be held that the court has no jurisdiction to assume that function, examine the plan proposed, modify it if necessary and approve or reject it, the 'helpless minority' may obviously be left to the oppression of those who are strongly organized. It is partly for the very protection of this helpless minority that courts have assumed jurisdiction, and they will at the same time be vigilant to see that the dissenter be not 'permitted to create a maneuvering value in his bonds by opposing confirmation' of plans which in equity serve the best interests of the whole group."

³⁹ In *First Nat'l Bank v. Flershem*, 290 U.S. 504, 515 (1934), it was suggested in a footnote that cases where equity powers had been used in aid of the reorganization of railroads or other utilities might be distinguished on the ground of the public interest in continued operation. However this may be, the distinction should not be extended to support a denial of jurisdiction over the plan in non-utility cases. As outlined in this article, the main basis for this jurisdiction exists, regardless of the character of the enterprise, whenever sale to outsiders furnishes no practical solution.

⁴⁰ *First Nat'l Bank v. LaSalle-Wacker Bldg. Corp.*, 280 Ill. App. 188 (1935) (leave to appeal denied by Supreme Court). *McSurely, J.*, concurred upon another ground.

⁴¹ See cases cited notes 43, 44 and 45 *infra*. See also *In re Prudential Outfitting Co.*, 250 Fed. 504 (D.C. N.Y. 1918); *Central T. & S. Co. v. Chester County Elec. Co.*, 9 Del. Ch. 123, 77 Atl. 771 (1910); *First Nat'l Bank v. Bryn Mawr Beach Bldg. Corp.*, 283 Ill. App. 267 (1936). In the latter case the court appointed an attorney to represent non-depositing bondholders. *Id.* at 269. Cf. *Palmer v. Bankers' Trust Co.*, 12 F. (2d) 747 (C.C.A. 8th 1926).

an unfair plan by purchase at any price.⁴² In practical effect the two views, however, are seldom different; in either case a modification of the plan is usually effected.

It is not surprising that the first view (considering the plan in connection with the bid price) was taken in early reorganizations such as that of the *Chicago & Milwaukee Electric*.⁴³ This practice appeared to involve little departure from the practice in ordinary judicial sales. The rule as to inadequacy of price coupled with unfairness "in the sale" was easily extended to cover the case. But how hesitant was the assumption of this jurisdiction and how incomplete was the understanding of the problem is well illustrated by the following excerpts:

. . . , although in foreclosure proceedings, and especially in connection with the price bid at the sale, the court may take cognizance of a pending reorganization plan to ascertain whether the security holder is obtaining a just and fair return out of the property sold, it is not its province to shift its function to foreclose and sell the property to any affirmative duty to pass upon the quality of the reorganization plan. . . .

. . . , when a reorganization committee has offered what in the light of the security holder's rights under the mortgage is not a *fair plan*, the refusal of a bondholder to accept it, is not an equity chargeable against him when he seeks to object to the judicial sale; but the court will accord such bondholder a hearing to ascertain whether there has been a *fair sale*. If there has not been such, then, by way of 'opening a door of fair opportunity' to such bondholder, a resale should be ordered. In a sense, it may be true that foreclosures of the character before us are frequently instituted by parties as a means of, or incidental to, reorganization; but the court does not undertake to carry out the reorganization and by its decree declare it to be satisfactory to all parties in interest. Its only ultimate function can be to see that the security holder's interest in the property is converted to his use through a sale at a fair price.⁴⁴

⁴² See cases cited notes 47 to 52, inclusive, *infra*.

A number of cases involve a recognition of jurisdiction but do not clearly indicate the consequences of unfairness in the plan. See *Thomas v. Central Hanover Bank & Trust Co.*, 75 F. (2d) 227, 232 (App. D.C. 1934); *Mechanics' & Metals' Nat'l Bank v. Howell*, 207 Fed. 973, 978 (D.C. Conn. 1913), rev'd, *In re Howell*, 215 Fed. 1, 6 (C.C.A. 2d 1914); *Samuels v. Northeastern Public Service Co.*, 174 Atl. 127 (Del. Ch. 1934); *Schaffer v. Eighty-One Hundred Jefferson Ave. E. Corp.*, 267 Mich. 437, 448, 255 N.W. 324, 328 (1934).

Cf. Guaranty Trust Co. v. Missouri Pac. Ry. Co., 238 Fed. 812 (D.C. Mo. 1916).

⁴³ *Investment Registry v. Chicago & M. E. R. Co.*, 212 Fed. 594, 609-12 (C.C.A. 7th 1913).

⁴⁴ *Investment Registry v. Chicago & M.E. R. Co.*, 213 Fed. 492, 502, 503 (D.C. Wis. 1914). It should have been apparent that little protection would be given to an objector by merely ordering a resale so that he might bid. The objector had argued that because of unfairness in their plan the committee should be enjoined from bidding at the resale. The court refused this relief on the ground that it would not be conducive to obtaining an adequate price. *Id.* at 504. In an earlier case the same judge had suggested that in connection with the determining of the provisions of the decree of sale, such as that permitting the use of bonds

In the St. Paul Railway reorganization Judge Wilkerson said, "... the adequacy of a bid . . . must be viewed in the light of all the elements of the proposed plan."⁴⁵ Neither this opinion nor any of the others is explicit as to the standard for determining the price to be required if the plan is unfair, but, as already suggested, if a bid of less than the full, going-concern value is accepted, the dissenter is left with no fair alternative.

Under the second view referred to above,⁴⁶ the objector is afforded relief against exclusion from the plan or against an unfair plan even though the committee might be willing to bid the full value of the property as fixed by the court. This view has been taken in many cases and has been expressed and applied in a number of ways. Cases in which the courts consider the plan upon the application to confirm the sale, apart from any question of inadequacy of the bid, would seem authority for this position.⁴⁷ Furthermore, in two cases in state⁴⁸ and federal⁴⁹ courts in New York, even decrees of sale have been refused upon a showing that there was a

in payment of a bid, the minority's objections to the plan should perhaps be heard. *Continental & Commercial T. & S. Bank v. Allis-Chalmers Co.*, 200 Fed. 600, 609 (D.C. Wis. 1912).

The confusion still found on the whole subject is illustrated by statements in a recent treatise. The case from which the quotations above were taken was cited for the proposition "Controversies between bondholders as to the quality of a reorganization plan, however, will not be settled by the court whose primary duty is to foreclose the mortgage and sell the property." 3 Jones, Bonds and Bond Securities § 1445 (4th ed. 1935). Compare, however, § 1518 of the same work.

⁴⁵ *Guaranty Trust Co. v. Chicago, M. & St. P. Ry. Co.*, 15 F. (2d) 434, 442 (D.C. Ill. 1926).

⁴⁶ Pp. 527-8 *supra*.

⁴⁷ *Warner Bros. Pictures v. Lawton-Byrne-Bruner Ins. A. Co.*, 79 F. (2d) 804 (C.C.A. 8th 1935); *Bethlehem Steel Co. v. International Combustion Eng. Corp.*, 66 F. (2d) 409 (C.C.A. 2d 1933); *Flershem v. Nat'l Radiator Corp.*, 64 F. (2d) 847, 851 (C.C.A. 3d 1933). In this case, after upholding the adequacy of the bid, the court said, "The remaining question is whether the holders of old debentures . . . should be required to take new securities under the plan. The answer . . . depends on whether the proposed distribution of the new securities, as to character and quantity, is fair." It is apparent that the court is speaking of "requiring" the dissenter to take the new securities only in the sense of the coercion arising from the relatively small cash alternative. See p. 539 *infra* for a consideration of the Supreme Court's reversal of the decision confirming the sale.

See also *Shaw v. Railroad Co.*, 100 U.S. 605 (1879); *Duncan v. Mobile & O. R. Co.*, 8 Fed. Cas. 25, Fed. Cas. no. 4139, 3 Woods 597 (S.D. Ala. 1879).

⁴⁸ *Clinton Trust Co. v. 142 Joralemon St. Corp.*, 237 App. Div. 789, 263 N.Y.S. 359 (1933), 150 Misc. 418, 269 N.Y.S. 437 (1934).

⁴⁹ *Habirshaw Electric Cable Co. v. Habirshaw Electric Cable Co., Inc.*, 296 Fed. 875 (C.C.A. 2d 1924). See also *Continental & Commercial T. & S. Bank v. Allis-Chalmers Co.*, 200 Fed. 600, 609 (D.C. Wis. 1912).

committee acting under an unfair plan.⁵⁰ In another New York case it was held proper for the trial court to investigate allegations of unfairness in the majority's plan on an application for an order directing the trustee to purchase for the benefit of all bondholders.⁵¹ Still other courts have entertained separate actions to enjoin a committee from carrying out the plan.⁵²

The view illustrated in these decisions has the result of definitely thwarting reorganization under an unfair plan regardless of the committee's ability or willingness to bid. This view seems clearly preferable to one which recognizes jurisdiction over the plan only if the price bid is less than the full value of the property. The determination of such value will usually be a costly proceeding and will in the end only clothe a judicial guess with the dignity of an adjudication. In the case of a definitely unfair plan, justice to the majority does not require that the dissenter run the risk that the court's guess may be wide of the mark. Furthermore, assuring to all bondholders an opportunity to participate in the purchase under a fair plan is only giving to them the same protection which a single mortgagee has in his power to bid.⁵³ Where there are many creditors this protection may be secured for all only if the majority are required to admit the minority and to subject the plan to judicial scrutiny. The question would be presented in the strongest light if an attempt were made entirely to exclude the minority. There have been no square adjudications in this situation, presumably because committees are almost invariably not only willing but anxious to have all bondholders deposit. While some

⁵⁰ In *Eastern States Public Service Corp. v. Atlantic Public Utilities, Inc.*, 17 Del. Ch. 338, 156 Atl. 214 (1931), the plan was presented and approved on application by the receiver for authority to sell the property.

⁵¹ *Chase Nat'l Bank v. 10 E. 40th St. Corp.*, 238 App. Div. 370, 264 N.Y. S. 882 (1933). As to such trustee-purchase generally, see section V, p. 548 *infra*.

⁵² *Bergelt v. Roberts*, 144 Misc. 832, 258 N.Y. S. 905 (1932), *aff'd* 236 App. Div. 794, 258 N.Y. S. 1086 (1932); *Rice v. Pounds*, 153 Misc. 226, 274 N.Y. S. 637 (1934). In *Sullivan v. St. Louis San Francisco R. Co.*, 147 Misc. 485, 263 N.Y. S. 396 (1933), such an action was dismissed on the ground that the reorganization proceeding was one in the federal court.

In *Palmer v. Bankers' Trust Co.*, 12 F. (2d) 747, 754 (C.C.A. 8th 1926), confirming the sale in spite of objections to the plan raised by a minority bondholder, the court said, "If petitioner contends that there was some hidden scheme by which the stockholders of the new Denver Company were in fact enriched at his expense, he may still, perhaps, litigate that question by an independent bill." If the court means to suggest that the availability of a separate suit justifies confirmation of the sale in spite of unfairness in the plan, the suggestion would seem both unsound and unsupported. The court had apparently satisfied itself, however, that the petitioner's objections were unfounded.

⁵³ See *Wehle, Railroad Reorganization under Section 77 of the Bankruptcy Act*, 44 Yale L. J. 197, 212-4 (1934).

of the cases suggest doubts,⁵⁴ of late years the right to participate has generally been recognized.⁵⁵

Within the limits of this article little attention can be given to the question of the time when objections to the plan should be considered. Most frequently this has been done at the hearing on the application for confirmation of the sale,⁵⁶ and, indeed, until the committee has become the purchaser, the plan might be considered not strictly relevant. Realistically, however, there is no question but that the committee will make the highest bid and there is much to be said for an earlier consideration of the plan. Such a practice would relieve the judge from the pressure arising from the fact that disapproval of the plan after sale would necessarily involve substantial expense and delay in connection with a resale.⁵⁷ In a number of cases, especially those taking the view that a committee operating under an unfair plan will not be permitted to purchase at any price,

⁵⁴ *Jones v. Sierra Verdugo Water Co.*, 63 Cal. App. 254, 218 Pac. 454 (1923); *Cushman v. Bonfield*, 139 Ill. 219, 241, 28 N.E. 937, 943 (1893); *Chillicothe Paper Co. v. Wheeler*, 68 Ill. App. 343, 348 (1896); *Walker v. Montclair & G. L. Ry. Co.*, 30 N.J. Eq. 525 (1879); *Ring v. New Auditorium Pier Co.*, 77 N.J. Eq. 422, 77 Atl. 1054 (1910). Cf. *Starkweather v. Jenner*, 216 U.S. 524 (1910); *Rodger v. Bowie*, 134 App. Div. 596, 119 N.Y. S. 177 (1909).

⁵⁵ See *Investment Registry v. Chicago & M. E. R. Co.*, 212 Fed. 594, 610 (C.C.A. 7th 1913); *Warner Bros. Pictures v. Lawton-Byrne-Bruner Ins. A. Co.*, 79 F. (2d) 804, 810 (C.C.A. 8th 1935); *Reed v. Schmidt*, 115 Ky. 67, 80-1, 72 S.W. 367, 369 (1903); *Rodgers, Rights and Duties of the Committee in Bondholders' Reorganizations*, 42 Harv. L. Rev. 899, 900-4 (1929); 41 Harv. L. Rev. 377, 380 (1928); *Tracy, Corporate Foreclosures, Receiverships and Reorganizations* § 292 (1929).

Cases involving the voluntary sale of all assets of a corporation to a new corporation formed by the majority, upholding the right of all shareholders to participate in the purchase, perhaps afford an analogy. It may be suggested, however, that where the sale itself is brought about through the voluntary action of the majority the duty not to "freeze out" the minority is clearer than in the creditors' reorganization case. See *Warren, Voluntary Transfers of Corporate Undertakings*, 30 Harv. L. Rev. 335 (1917).

⁵⁶ *First Nat'l Bank v. Bryn Mawr Beach Bldg. Corp.*, 283 Ill. App. 267, 274-5 (1936), and other cases cited in notes 43, 45 and 47 *supra*.

⁵⁷ The effect of the traditional procedure is perhaps fairly illustrated by the case of the St. Paul Railway. Prior to the sale, the court dismissed the minority committee's petition to intervene for the purpose (among others) of attacking the plan. *Guaranty Trust Co. v. Chicago, M. & St. P. Ry. Co.*, 15 F. (2d) 434 (D.C. Ill. 1926). The dissenters were told that their objections would be considered at a later stage, although the opinion suggested that the merits of the petitioners' objections had not been entirely ignored. Leave to appeal from this decision was refused (*Guaranty Trust Co. v. Chicago, M., & St. P. Ry. Co.*, 15 F. (2d) 443 (D.C. Ill. 1926), and the Supreme Court refused *mandamus*. *Ex parte Jameson*, 273 U.S. 650 (1927). After the sale, when the dissenters renewed their objections, the court confirmed the plan apparently without opinion.

For an able discussion, see *Moore and Levi, Federal Intervention: I. The Right to Intervene and Reorganization*, 45 Yale L. J. 565, 595 ff. (1936).

the courts have examined the plan before the sale.⁵⁸ If the plan is considered relevant only if an inadequate price is bid, objections would properly be raised only on confirmation or in connection with the fixing of a minimum or upset price before sale, discussed in the next section.

Also beyond the scope of this article are the substantive criteria by which the fairness of the plan is to be judged. Much has been written on this subject and much remains in dispute.⁵⁹ But no recognition of the difficulties involved in passing upon the fairness of reorganization plans can justify a refusal to assume the jurisdiction.

III. THE DISSENTER'S CASH DISTRIBUTIVE SHARE

We have seen that adequate protection cannot be given to minority bondholders without assuring to them the opportunity to participate in a fair plan. What of the bondholder who is unwilling to participate?⁶⁰ What protection, if any, should courts give to him by way of assurance of a minimum sale price? If such protection is to be given, there arises, of course, the further question as to whether it shall be by fixing, before the sale, an upset price or minimum bid, or only by refusing confirmation of a sale for a price deemed inadequate. There has been more discussion of

⁵⁸ See cases cited in notes 48 to 52, inclusive, *supra*. See also *Sullivan v. St. Louis-San Francisco Ry. Co.*, 147 Misc. 485, 263 N.Y. S. 396 (1933). In *Samuels v. Northeastern Public Service Co.*, 174 Atl. 127 (Del. Ch. 1934), the plan was presented to the court prior to the sale and not in connection with the fixing of an upset price, apparently with a view to securing an exemption from registration requirements of the federal Securities Act of 1933.

⁵⁹ This is true both of reorganizations in receivership and foreclosure proceedings, and under § 77B of the Bankruptcy Act. Among the discussions of this subject are Swaine, *Reorganization of Corporations: Certain Developments of the Last Decade*, 27 Col. L. Rev. 901 (1927), 28 *id.* 29 (1928), also printed in Ballantine *et al.*, *Some Legal Phases of Corporate Financing, Reorganization and Regulation, 1926-1930*, 133 (1931); Bonbright and Bergerman, *Two Rival Theories of Priority Rights of Security Holders in a Corporate Reorganization*, 28 Col. L. Rev. 127 (1928); Buschek, *A Formula for the Judicial Reorganization of Public Service Corporations*, 32 Col. L. Rev. 964 (1932); Frank, *Some Realistic Reflections on Some Aspects of Corporate Reorganization*, 19 Va. L. Rev. 541, 698 (1933); Foster, *Conflicting Ideals for Reorganization*, 44 Yale L. J. 923 (1935); Spaeth and Friedberg, *Early Developments under Section 77B*, 30 Ill. L. Rev. 137, 154 (1935); Sabel, *Recent Economic Developments in Corporate Reorganizations*, 20 Minn. L. Rev. 117, 129 (1936).

As to the problem of securing a binding adjudication of the fairness of the plan, see Cutch-eon, *An Examination of Devices Employed to Obviate the Embarrassments to Reorganizations Created by the Boyd Case*, in Ballantine *et al.*, *op. cit. supra*, at 35; Frank, *op. cit. supra*, at 701-7.

⁶⁰ In presenting his objections to a sale at a comparatively low price the dissenter often characterizes the situation as a "freeze-out." The unfairness of this epithet is obvious in view of the fact that the committees make every effort to induce, if not cudgel, the dissenter into participation in the plan. "Force-in" rather than "freeze-out" would be a more apt characterization.

this procedural question,⁶¹ than of the fundamental question as to whether the amount of the bid should be controlled by either method, the question to which this section is devoted.

Too frequently it has been assumed or asserted without adequate analysis that at some stage the court should pass on the adequacy of the bid.⁶² This has been due very largely to the strategy of railroad reorganizers in a number of cases. These men or their counsel learned at a comparatively early date that they had more to gain than to lose from a policy of making only perfunctory opposition to the fixing of a substantial upset price.⁶³ They learned that they could usually count on the fixing of an upset price which would net dissenting bondholders less than the current market value of the bonds or the certificates of deposit.⁶⁴ They could thus be assured that most of the bonds would ultimately be deposited. Reorganizers of such properties usually lost nothing, therefore, when an upset price was fixed or when they voluntarily bid a substantial amount, and they found that by thus focusing attention upon the price they were sometimes able to forestall any vigorous inquiry into the fairness of their plan. The practice of fixing substantial upset prices thus became crystallized in these cases where the bonds had a market value and where financing such a bid involved no serious problem for the majority.

If the practice thus fixed were carried over to cases of reorganization of real estate or other bond issues where there is no active market for the bonds, the consequences would be entirely different. Where the bondholder is unable to sell his bond, the prospect of a substantial cash distributive share from the proceeds of the sale would often dissuade him from assenting to any plan. The result would be a large increase in the cash requirements to effect a reorganization, with resulting difficulties, in many cases,

⁶¹ See 26 Ill. L. Rev. 325 (1931). It is said with increasing frequency that the fixing of an upset price is discretionary. *Guaranty Trust Co. v. Chicago, M., & St. P. Ry. Co.*, 15 F. (2d) 434, 442 (D.C. Ill. 1926); *Palmer v. Bankers' Trust Co.*, 12 F. (2d) 747 (C.C.A. 8th 1926); *Bethlehem Steel Co. v. International Combustion Eng. Corp.*, 66 F. (2d) 409, 411 (C.C.A. 2d 1933).

⁶² See, for example, Dewing, *Financial Policy of Corporations* 1131 (3d rev. ed. 1934); 1 Quindry, *Bonds and Bondholders* §§ 316, 319, 340, 341 (1934); Wehle, *Railroad Reorganization under Section 77 of the Bankruptcy Act: New Legislation Suggested*, 44 Yale L. J. 197, 212 (1934); Anderson, *The Reorganization of Real Estate Bond Issues*, 1 John Marshall L. Q. 70, 80 (1935).

⁶³ See Weiner, *Conflicting Functions of the Upset Price in a Corporate Reorganization*, 27 Col. L. Rev. 132, 145 (1927).

⁶⁴ See p. 540 *infra*. In cases where relatively high upset prices were fixed, the courts could usually be induced, after unsuccessful attempts to sell, to reduce the upset price. See *Farmers' Loan & Trust Co. v. Oregon Pac. Ry. Co.*, 28 Ore. 44, 40 Pac. 1089 (1895); *Fearon v. Bankers' Trust Co.*, 238 Fed. 83 (C.C.A. 3d 1916).

in raising the necessary funds and burdening the property with prior charges. A large proportion of the bond issues going into default in the past six years have been issues for which no real market existed. It is for this reason that it has become essential to re-examine the problem of fixing an upset price or refusing confirmation of a sale at a low price.

Throughout the development of reorganization law, one group of writers has insisted that if all bondholders are permitted to participate in the reorganization and if the plan is fair, the court should give them no further protection—should neither fix an upset price nor refuse confirmation of a sale on the ground of inadequacy of price.⁶⁵ The early reorganization practice, prior to the development of the strategy referred to above, was apparently in accordance with this view. In the reorganization of the Mobile & Ohio in the seventies, the court said:

Looking at the difficulties which beset the subject on every side, we think that if we allow the non-subscribing bondholders to participate in the purchase of the property . . . we shall have done all that we can do under the circumstances to protect their interests.⁶⁶

In *Shaw v. Railroad Co.*,⁶⁷ the United States Supreme Court approved a decree confirming a sale for \$100,000 in a case involving bond issues totaling \$8,500,000. The Court overruled objections to the plan and used strong language with respect to efforts of a minority to hold up a reorganization approved by a majority. In neither of these cases, however, did the dissenters raise the question of the small amount of the bid.⁶⁸

The view that dissenters are entitled to no protection by way of assurance of an adequate price has recently been adopted by the Supreme Court of Illinois. In *Chicago Title & Trust Co. v. Robin*,⁶⁹ the question which the court discussed in great detail was that of the power of the trial court to order the trustee to bid for the benefit of all bondholders in the absence of a cash bid equal to the upset price.⁷⁰ One minority bondholder was

⁶⁵ See Joline, *The Method and Conduct of the Reorganization of Corporations* 83 (1910); Spring, *Upset Prices in Corporate Reorganization*, 32 *Harv. L. Rev.* 489 (1919); Colin, *Why Upset Price? An Argument for Reorganization by Decree*, 28 *Ill. L. Rev.* 225 (1933); O'Brien, *Sales in Bond Issue Foreclosures—and How They May Be Held* (paper read before The Legal Club of Chicago, February 5, 1934, and privately printed).

⁶⁶ *Duncan v. Mobile & Ohio Ry. Co.*, 8 Fed. Cas. 25, Fed. Cas. no. 4139, 3 Woods 597 (S.D. Ala. 1879).

⁶⁷ 100 U.S. 605 (1879).

⁶⁸ It is significant of the early practice, furthermore, that, in the case usually cited as marking the beginning of the upset price practice, the price fixed was only large enough to cover obligations of the receiver, *Blair v. St. Louis, H., & K. R. Co.*, 25 Fed. 232 (C.C. Mo. 1885).

⁶⁹ 361 Ill. 261, 198 N.E. 4 (1935).

⁷⁰ This question is discussed in section V of this article, p. 548 *infra*.

contending, however, that while it was error to order the trustee to bid, the fixing of an upset price for the protection of the minority was proper. After ruling upon the question of trustee-purchase, the court added:

What we have said above applies with equal force to the action of the chancellor in fixing an upset price below which the property could not be sold. The existence of financial panic does not warrant the setting aside of well-known rules of law to meet an alleged emergency. Public policy and the interests of debtors require that stability be given to judicial sales, and they should not be disturbed unless there has been some fraud, mistake or violation of duty by the officer making the sale or by the purchaser, none of which is shown here. Mere inadequacy of price, alone, is not cause for setting aside a judicial sale.⁷²

The court thus applied the usual rule as to judicial sales without discussing special considerations applicable to the reorganization cases.⁷²

In the event of a sale at a low price, the minority bondholder has one line of argument not available to a creditor in a case not involving reorganization. He may take the position that in his opinion there should be no reorganization, that the property should be sold for the highest price which an outsider will pay. He may then rely upon the fact already noted that the existence of the combined majority bondholders as most likely purchasers tends to discourage participation in the bidding by outsiders, that in this sense the majority may be said to have "chilled the bidding," and that, while their combination is in no sense improper, they may reasonably be required to bid as much as might have been secured had the sale not been so "chilled." This theory has never been developed in the cases,⁷³ but a number of them have suggested a similar standard for judging the adequacy of the bid. One of the most recent cases⁷⁴ involved objections by a minority bondholder to confirmation of a sale in a receivership proceeding. The bid was \$2,000,000 for property on which the first

⁷² 361 Ill. 261, 273, 198 N.E. 4, 9 (1935). *Herrick and Farthing, JJ.*, disagreed with this ground for reversal and *Wilson, J.*, dissented. The cases cited by the court, *Worden v. Rayburn*, 313 Ill. 495, 145 N.E. 101 (1925), and *Skakel v. Cycle Trade Pub. Co.*, 237 Ill. 482, 86 N.E. 1058 (1909), did not involve objections of minority creditors. No reference was made to *Equitable Trust Co. v. Chicago, P., & St. L. Ry. Co.*, 314 Ill. 96, 145 N.E. 290 (1924), in which an upset price had been fixed in a railroad case, apparently without objection.

⁷³ The *Robin* case has recently been relied upon in a decision dismissing a minority bondholder's tort action against the trustee under the mortgage securing a \$1,200,000 bond issue for permitting the property to be sold for \$100,000. *Herzog v. Chicago Title & Trust Co.*, Illinois Appellate Court, First District, No. 38,301, April 6, 1936.

⁷⁴ Similar reasoning is probably the basis of one writer's defense of "scrap value" as the standard in fixing an upset price. See *Tracy, Corporate Foreclosures, Receiverships and Reorganizations* § 307 (1929). *Cf. id.*, §§ 229, 240.

⁷⁵ *Warner Bros. Pictures, Inc. v. Lawton-Byrne-Bruner Ins. A. Co.*, 79 F. (2d) 804 (C.C.A. 8th 1935).

mortgage issues totaled almost \$6,000,000 and on which there were junior mortgages of \$1,850,000. In an introductory summary of the law, the court said that a bondholder "has a right to the value of his interest in the property if he chooses not to participate; . . ."⁷⁵ but the court immediately explained that the bid was to be declared inadequate "if it is 'grossly' lower than the value which should be realized for the property at a forced judicial sale."⁷⁶ Similarly, in *Thomas v. Central Hanover Bank & Trust Co.*,⁷⁷ the Court of Appeals of the District of Columbia approved the confirmation of a foreclosure sale where the trial court had said: "The court must determine whether the amount here bid is an adequate price, in these times and at a forced sale. . . ."⁷⁸ And in *Coriell v. Morris White, Inc.*,⁷⁹ it was held that dissenting creditors have "the right to share immediately in the proceeds of a forced sale of the corporation's assets."⁸⁰

⁷⁵ *Id.* at 811. At this point the court cited, among other cases, *First Nat'l Bank v. Flershem*, 290 U.S. 504 (1934), discussed p. 539 *infra*.

⁷⁶ *Ibid.* On p. 817 similar language was used to answer an argument of the objector that the aggregate face value of the securities to be issued under the plan was evidence of the value of the property. The court said that for the purposes of justifying the issuance of the new securities the value would be the "actual fair value at free sale" as distinguished from the standard applicable in considering objections to confirmation of the foreclosure sale. *Cf.* *Northern Pacific Ry. v. Boyd*, 228 U.S. 482, 507 (1912).

Hauer v. Appalachian Gas Corp., 19 Del. Ch. 283, 167 Atl. 839 (1933), probably represents a similar view. The court granted the committee's motion for sale at an upset price of \$825,000 although the debentures outstanding totaled \$12,600,000. The court expressed a conviction that "the assets can never, within any such time as this receivership could be reasonably expected to be kept open," sell for as much as the upset price upon which the objector was insisting.

⁷⁷ 75 F. (2d) 227 (1934), *cert. den.* 294 U.S. 726 (1934).

⁷⁸ *Id.* at 231.

⁷⁹ 54 F. (2d) 255 (C.C.A. 2d 1931), *rev'd* on other grounds in *National Surety Co. v. Coriell*, 289 U.S. 426 (1932).

⁸⁰ 54 F. (2d) 260. The trial court had approved a sale to a new corporation for securities. Holding that this violated the rights of dissenting creditors, the court nevertheless held that it was not necessary to order a resale for cash in the usual manner. The case was remanded to the trial court in order that there might be awarded to the dissenters such amounts as a master should determine that they would have received had a public sale been held on the usual terms. The court added however: "This sum must be paid in cash, or, at the option of each of the appellants, the preferred stock and notes offered to them may be valued as of the date the reorganization plan became effective and that sum paid in cash to them . . ." (54 F. (2d) 261). The dissenter is not, of course, entitled to such an alternative in the usual case. That it was deemed appropriate here only because of the improper sale first brought about by the majority is apparent from the cases cited by the court at this point, *Geddes v. Anaconda Mining Co.*, 254 U.S. 590 (1920), and *Jones v. Missouri-Edison Elec. Co.*, 203 Fed. 945 (C.C.A. 8th 1913). These were both cases of sales of corporate assets brought about improperly by majority shareholders.

It is not entirely clear, of course, from these quotations that the "forced sale value" suggested as a standard is the amount which would probably be bid by an outsider were the bidding not "chilled" by the "masterful" position of the majority committee. Any other interpretation, however, as will appear later in this section, either would be unintelligible or would impose an undue burden upon the majority.

A similar problem arose in an Illinois case⁸¹ where a corporate charter had expired and the period for reinstatement had elapsed. Most of the shareholders agreed to a proposal to have the assets transferred to a new corporation the shares of which should be issued to the shareholders of the old corporation *pro rata*. The non-assenting shareholders sued to set aside the sale, objecting to the price bid by the majority group.⁸² The court refused relief, saying:

The appellants had no right to require the other stockholders to take the property at a valuation fixed by them or by the court and to give them cash for their stock based on such valuation, and there was nothing in the bill from which the court could say that any outsider would give more than the price obtained.⁸³

Were it not for the last clause of this sentence, the decision would seem clearly an application of the rule recently applied by the same court in the *Robin* case,⁸⁴ that no relief whatever should be given with respect to adequacy of price. The last clause, however, makes possible the inference that relief might be given if it were shown that the bid was less than would have been secured at a sale unaffected by the bidding power of the majority.

Under the cases thus far discussed the objector who refuses to participate in a fair plan is given either no assurance as to the amount of his share of the proceeds of the sale or at the most the assurance that the majority must pay the "forced sale value."⁸⁵ In many cases it will make

⁸¹ Nowak v. National Car Coupler Co., 260 Ill. 260, 103 N.E. 222 (1913).

⁸² The problem there presented seems entirely parallel to that involved in a sale brought about by foreclosure or receivership proceedings. In each case the sale resulted from circumstances beyond the control of the majority and necessitated cooperation to avoid sacrifice. The situation is perhaps different in the case of a sale brought about by vote of the majority shareholders, where it has been suggested that if the majority purchase, the court should require a bid equal to the fair value of the property. Warren, Voluntary Transfers of Corporate Undertakings, 30 Harv. L. Rev. 355, 361 (1917).

As to sales in partition proceedings, see Kemp v. Waters, 165 Md. 521, 170 Atl. 178 (1934); New Orleans v. Howard, 160 Fed. 393 (C.C.A. 5th 1908); Matter of Bost, 3 Jones Eq. (N.C.) 482 (1857); 47 Harv. L. Rev. 1442 (1934).

⁸³ 260 Ill. 260, 103 N.E. 222, 224 (1913).

⁸⁴ Note 69 *supra*.

⁸⁵ The term "forced sale value" is, of course, used to denote the price which an outsider might be expected to bid were the majority not in the bidding.

little practical difference which of the two is adopted. Under the second, an objector who holds to his refusal to participate in the plan may receive a cash distribution somewhat larger than would be the case if the majority were entirely free to name their price. But even under the second view the distribution will not be large enough to induce large numbers of bondholders to withhold assent to the plan; nor will the cash requirements of the reorganization be increased to a degree likely to raise serious difficulties of financing. The first rule has the advantage of eliminating the necessity of determining the "forced sale value." Especially in depression times, and in the case of business properties, this would be highly conjectural and the cost of appraisals and of protracted hearings on this issue may well be considered an unwarranted burden. If a court declines to undertake the task of fixing "forced sale value," the minority bondholder who refuses to participate in a fair plan has little cause for complaint.

The position is sometimes taken, however, that minority bondholders are entitled to more protection than that afforded by either of the views which have been considered—that an upset price should be fixed at a figure higher than the "forced sale value." It has already been pointed out that general application of a rule requiring a bid of "fair value"⁸⁶ would make reorganization impossible, that if dissenters were thus assured a distribution in cash equivalent to the "fair value" of the securities issued to the majority, bondholders would have every reason to hold out and it would become impossible in many cases to secure sufficient assents to a plan to make it financially feasible. This is particularly true in cases where there is no active market for the securities. Of course such a rule could be applied in isolated cases where a large majority of assents had already been secured, but, as already suggested, if the rule were generally applied, if it became known that a dissenter could count on such generous treatment, the ranks of dissenters in future cases would be swelled so greatly as to result inevitably in stalemate.

These considerations have been recognized by the more fair-minded champions of the dissenters and the suggestion has thus been made that the upset price should be set as close to the fair value of the property as will permit the reorganization to succeed;⁸⁷ that the dissenters should thus receive as large a cash distribution as can possibly be given them in the

⁸⁶ The writer has no illusions as to the possibility of a simple definition of "fair value." The familiar "willing buyer-willing seller" notion is adequate for the purposes of this discussion.

⁸⁷ See Weiner, *Conflicting Functions of the Upset Price in Corporate Reorganization*, 27 Col. L. Rev. 132, 141 (1927).

particular case. Such a rule would of course place upon the majority the burden of financing such distributions, if necessary, by encumbering the property with heavy prior charges. It has never been made clear why this burden should be placed upon the majority for the benefit of bondholders who refuse to participate in a fair plan.⁸⁸

When this position is urged by sincere champions of the dissenter, it is usually apparent that they are influenced by skepticism as to reorganization plans, as to the motives of committees, as to the power of courts to give effective protection to the minority by way of scrutiny of the plan. One may concede some basis for these doubts without conceding the soundness of the position as to upset prices. We have already seen that full protection cannot be given without assuming jurisdiction over the plan. No hesitancy of the courts to assume this jurisdiction, no appreciation of the difficulties which it involves, justifies placing on majorities in all cases the heavy burden of a maximum price rule.

This general fear of reorganization abuses apparently underlies the opinion of Mr. Justice Brandeis in *First National Bank v. Flershem*.⁸⁹ In this case the upset price doctrine was pushed further than in any other reported decision. On its facts the case is probably consistent with the "forced sale value" rule. The price bid was only slightly higher than the cash and other liquid assets transferred. The amount would seem to have been clearly less than the "forced sale value," however that phrase be understood.⁹⁰ But the opinion suggests no such standard. The case was remanded with instructions for an appraisal of the properties. Two passages in the opinion suggest the rule that the properties should be appraised at the highest figure which the majority can pay:

Moreover, the existence of the Plan of Reorganization, assented to by a vast majority of the security holders, gave assurance of at least one bidder for the entire property

⁸⁸ As already indicated, it must be kept in mind that the dissenters are not alone in their desire for cash. Majority bondholders would in most cases be only too happy to take the fair value of their interest rather than new securities.

⁸⁹ 290 U.S. 504 (1934). While at the bar, Brandeis had shown his awareness of these dangers. See his book, *Other People's Money* (1914). "And, adding the duties of undertaker to those of midwife, the investment bankers became, in times of corporate disaster, members of security-holders' 'Protective Committees'; then they participated as 'Reorganization Managers' in the reincarnation of the unsuccessful corporations and ultimately became directors." *Id.* at 10.

⁹⁰ In the opinion in the Court of Appeals, however, it was said: "On the uncontradicted evidence, which was all he had to go on, the learned judge set an upset price for all assets of the corporation at \$2,500,000, or \$200,000 more than the highest figure the witnesses had given of what might be expected in liquidation." The case of the objectors apparently had not been well presented on this point.

who had confidence that the business . . . possessed a value greater than its liquidating value; and would, if necessary to effectuate the Plan, bid for the assets in cash more than the estimated liquidating value.⁹¹

. . . In valuing the assets the appraisers should also bear in mind that, even if part of the properties should have been sold as scrap, the Reorganization Committee was a willing purchaser for the rest.⁹²

These quotations, of course, do not evidence a clear espousal of the maximum upset price theory, but they are difficult to interpret in any other manner.⁹³ The Court has, however, recently declined to review the decision of the Court of Appeals of the District of Columbia in the *Thomas* case⁹⁴ in which the standard of "forced sale value" had avowedly been applied. This may be of some significance in view of the fact that the principal ground relied upon in the petition for a writ of *certiorari*⁹⁵ was the alleged disregard by the courts below of the decision in the *Flershem* case.

Little is to be gained from an elaborate analysis of the cases in which upset prices have been fixed or the adequacy of the bid tested on confirmation. As already indicated, in most of the cases the majorities have been willing to bid a substantial price so long as it would not give the dissenters more than the market value of their bonds. In some cases the courts have referred to these market values and have apparently acquiesced in the position of the committees that no higher upset price could be fixed,⁹⁶ although in the *Flershem* case this aim of the reorganization committee was referred to with evident disapproval.⁹⁷

In most of the cases the courts have referred to evidence of earnings, cost, or other items and have approved bids of relatively small amounts

⁹¹ 290 U.S. 504, 524 (1934).

⁹² 290 U.S. 504, 528 (1934). For a prior case emphasizing the need of a "trustworthy appraisal," see *National Surety Co. v. Coriell*, 289 U.S. 426 (1932).

⁹³ There seems no intelligible middle position between the "maximum price" and the "forced sale value" theories. In 34 Col. L. Rev. 706, 721 (1934), the writer argues: "It seems difficult to understand why the courts seek a sale value in a situation where a sale is neither contemplated nor possible. A more rational procedure would be to set the upset price with all of its functions kept clearly in mind, with an eye to reorganization, rather than to value. Of course the price must be within limits: the upper boundary must be the largest amount the committee can pay; the lower would seem to be the point at which competitive bidding would begin." The writer is content to leave the matter there, without any attempt to indicate what action a court should take between these limits.

⁹⁴ Note 77 *supra*.

⁹⁵ Petition, p. 20.

⁹⁶ *Warner Bros. Pictures, Inc. v. Lawton-Byrne-Bruner Ins. A. Co.*, 79 F. (2d) 804 (C.C.A. 8th 1935); *Guaranty Trust Co. v. Chicago, M., & St. P. Ry. Co.*, 15 F. (2d) 434 (D.C. Ill. 1926).

⁹⁷ 290 U.S. 504, 524, note 15 (1934).

without any articulation of the standard being applied.⁹⁸ In most cases the "forced sale" rule might explain the results; in many the amounts fixed were agreed to by the committees. Often bids have been approved as not "grossly inadequate" or "shocking."⁹⁹ In confirming sales at comparatively low prices, the courts sometimes emphasize that because of his unwillingness to join in a fair reorganization the objector deserves little sympathy.¹⁰⁰

It has sometimes been suggested that the minority bondholder has an added argument in states like Illinois where the owner of the equity in the mortgaged property has a statutory right to redeem the property from the foreclosure sale by paying the amount bid at the sale.¹⁰¹ Faced with this statute, without some arrangement with the equity owner, the committee would be unable safely to bid an amount substantially below the probable maximum value of the property during the redemption period. And in many cases the committee finds itself unable to finance a bid sufficiently high to insure against redemption. In this situation, to avoid a stalemate, it becomes necessary for the committee to cause the acquisition of the equity for the benefit of the majority bondholders. With the equity thus controlled, the committee may bid less than the value of the property and effect a so-called "quick redemption" immediately after the sale, thus cutting off further redemption rights.

Counsel for minority bondholders have sometimes argued that the low bid thus results from a "conspiracy" between the majority and the equity owner directed against dissenters and that confirmation of the sale should therefore be withheld.¹⁰² It is true, of course, that the equity is acquired

⁹⁸ *Central Trust Co. v. Washington County Ry. Co.*, 124 Fed. 813 (C.C. Me. 1903); *Equitable Trust Co. of N.Y. v. Western Pac. Ry. Co.*, 233 Fed. 335 (D.C. Cal. 1916); *Fearon v. Bankers' Trust Co.*, 238 Fed. 83 (C.C.A. 3d 1916); *Simon v. New Orleans, T., & M. R. Co.*, 242 Fed. 62 (C.C.A. 5th 1917); *Palmer v. Bankers' Trust Co.*, 12 F. (2d) 747 (C.C.A. 8th 1926); *Guaranty Trust Co. v. Chicago, M., & St. P. Ry. Co.*, 15 F. (2d) 434 (D.C. Ill. 1926); *Sebree v. Cassville & W. Ry. Co.*, 212 S.W. 11 (Mo. 1919).

⁹⁹ *Bovay v. Townsend*, 78 F. (2d) 343 (C.C.A. 8th 1935); *Provident Life & Trust Co. of Phila. v. Camden & T. Ry. Co.*, 177 Fed. 854 (C.C.A. 3d 1910); *Rospigliosi v. New Orleans, M., & C. R. Co.*, 237 Fed. 341 (C.C.A. 5th 1916); *Farmers' Loan & Trust Co. v. Oregon Pac. Ry. Co.*, 28 Ore. 44, 40 Pac. 1089 (1895). Cf. *Starkweather v. Jenner*, 216 U.S. 524 (1910).

¹⁰⁰ See, for example, *Central Trust & Savings Co. v. Chester County Elec. Co.*, 9 Del. Ch. 123, 126, 77 Atl. 771, 772 (1910).

¹⁰¹ Ill. State Bar Stats. 1935, c. 77, § 18.

¹⁰² A different argument is made in this connection in *Carey and Brabner-Smith, Studies in Realty Mortgage Foreclosures: V. Reorganizations*, 28 Ill. L. Rev. 1, 15 (1933). It is there said: "The purchase of the title assures redemption if the committee is outbid, and, in practical effect, prevents a bid, since no bondholder could afford to borrow money at a premium to bid for property under such conditions, when those representing the depositing

principally because of the difficulty resulting from the fact that the committee does not represent all bondholders. In the event that all bondholders are acting together, or in the case of a mortgage securing a single note, the bidder can protect against redemption by bidding an amount representing a generous estimate of the full value of the property during the redemption period. But we have already seen that any statutory or common law rule which would force a reorganization committee to make such a bid would in the long run make the reorganization process impossible, and that apart from statute a minority bondholder has no standing to insist that such a bid be made. The question under the Illinois statute thus becomes the following: Is the policy underlying the redemption statute violated by the arrangement between the equity owner and the majority bondholders?

The purposes of the redemption statute are to protect the debtor against an unjustly large deficiency judgment and to permit the satisfaction of as much of his indebtedness as possible out of the property.¹⁰³ Both of these purposes are effected to the extent that the mortgagee is forced or encouraged to bid the full value of the property. They are likewise effected in many cases, however, if the majority bondholders make the usual settlement with holders of redemption rights involving waiver of a deficiency judgment so far as the majority are concerned and a payment to the equity owner and junior lienors either in cash or securities. In this situation, while the arrangement is made solely with a view to making a bid below the value of the property, such a course is neither unjust to the minority bondholder¹⁰⁴ nor violative of the policy of the statutes.¹⁰⁵

bondholders would redeem from him immediately." The writers apparently infer that this is such chilling of the bidding as to warrant refusal to confirm a sale at less than the fair value of the property. This chilling, however, is the inevitable result of the statutory redemption system and furnishes one of the strongest arguments against that system. Outstanding redemption rights are always a factor preventing competitive bidding at foreclosure sales. While redemption is more certain to occur when the committee has acquired the equity, this factor is of little significance since even less certain redemption effectively discourages cash bidders. The assumption underlying the Illinois statutes is that protection of the debtor and junior creditors is best served by attempting to force the mortgagee to bid up to the value of the property even if the statutes enacted to this end have the effect of discouraging other bidders.

¹⁰³ See Becker and Harbert, *Redemptions from Judicial Sales under the Laws of Illinois*, Chicago-Kent Rev., May, 1929; Durfee and Doddridge, *Redemption from Foreclosure Sale—The Uniform Mortgage Act*, 23 Mich. L. Rev. 825, 839 (1925).

¹⁰⁴ If it should be determined that, apart from any statute, the dissenter may object to a sale at less than the "forced sale value," this objection would be unaffected by the statute.

¹⁰⁵ If the equity, however, is in the hands of a person not liable on the bonds, the acquisition of the equity by the committee will often not involve a waiver of a deficiency judgment, and a "quick redemption" may cut off the redemption right of the obligor as a defendant in the

But whatever view a court may take as to the rights of minority bondholders with respect to the amount of the bid, one thing should be clarified: the position of the trustee under the mortgage securing the bonds. If the mortgaged property were to be sold to outsiders, one would, of course, expect the trustee's duty to include reasonable efforts to see that the property bring as much as possible at the sale. Statements have sometimes been made suggesting that the trustee has a similar function in reorganization cases.¹⁰⁶ While it is true, of course, that it is not the function of the trustee actively to aid the majority where their interests conflict with those of the minority, it should be equally clear that it cannot be the duty of the trustee to take a position in support of the minority as against the majority. The trustee should have no duty to ask for a high upset price or to raise the issue of inadequacy of price on confirmation.¹⁰⁷ Thus the Illinois Supreme Court recently said:

... its duty as trustee was simply to sell the property to satisfy the debt. . . . It was for the creditors, and not the trustee, to see that the property was not sacrificed.¹⁰⁸

The position of the trustee has never been fairly and realistically analyzed.¹⁰⁹ In many cases trustees have permitted themselves to be used as a shield by the majority. Instead of taking the position suggested above, that on all issues where the majority and the minority have diverse interests they should represent themselves, trustees have often objected to intervention by minority bondholders on the ground that the interests of all bondholders were being adequately protected by the trustee.¹¹⁰ Of course,

foreclosure suit. While the law is as yet undeveloped on the point, it is possible that the obligor might thus have a sound objection to the settlement between the majority and the owner of the equity. If so, a court might require crediting of the full value of the property upon the debt. This is a problem related to that discussed in section IV of this paper, the problem of working out proper protection against unjust deficiency judgments without unduly hampering majority committees in their relations to the minority. However this problem may be solved, it would seem clear that the minority bondholder has no standing to complain of the effect upon the obligor of the acquisition of the equity by the committee.

¹⁰⁶ See, for example, *White v. Macqueen*, 360 Ill. 236, 248, 195 N.E. 832, 837 (1935).

¹⁰⁷ It might, of course, be contended that when the majority determine to purchase the property they are no longer to be considered as bondholders and that the sole duty of the trustee is to the minority. Such an argument fails to take proper account of the fact already referred to, that the majority become purchasers only as a means of salvaging their investment.

¹⁰⁸ *Chicago T. & T. Co. v. Robin*, 361 Ill. 261, 267, 271, 198 N.E. 4, 7, 8 (1935).

¹⁰⁹ On the general subject, see Posner, *Liability of the Trustee under the Corporate Indenture*, 42 Harv. L. Rev. 198 (1928).

¹¹⁰ For a bitter indictment of the action of the trustee in the St. Paul Railway case, see Lowenthal, *The Investor Pays*, c. 29 (1933). See also Moore and Levi, *Federal Intervention: I. The Right to Intervene and Reorganization*, 45 Yale L. J. 565, 602-4 (1936).

if it were settled that objections to the plan or the price are premature if raised before sale, opposition to such interventions would frequently be justified.¹¹¹ But as already noted,¹¹² the procedure is unsettled and majority committees have consistently attempted to postpone such questions as long as possible in order that the courts might be the more loath to cause further delays by upsetting the plan at the last moment. In this strategy trustees have too often been tools of the committees.

On questions as to the merits of the plan, where the interests of all bondholders are not divergent, the trustee might well perform a more active function, either supplementing, or conceivably replacing, the traditional protective committee. The recent assertion by the Circuit Court of Appeals for the Second Circuit that "A trustee of a mortgage may not attack a plan of reorganization as inequitable"¹¹³ would seem unfortunate, and, while it is based upon present practice, there is no judicial authority for the statement.

IV. CONTROL OF THE DEFICIENCY JUDGMENT

Thus far we have considered the sale price solely in connection with its effect upon the dissenting bondholder's cash distributive share. Under the usual procedure, however, another important function of the price is in determining the amount of the deficiency judgment. Although a nominal bid may be not unjust from the standpoint of a bondholder who refuses to assent to a fair reorganization plan, a deficiency judgment for the remainder of the debt may be unjust to other parties.¹¹⁴ In the case of bonds issued or guaranteed by an individual, this involves a real problem.¹¹⁵ In the case of a corporate obligor, the original corporation will usually not survive the reorganization except as an empty shell and thus a high deficiency judgment will not be of serious concern. The amount of the de-

¹¹¹ The minority, however, might well be entitled to be heard on the question of fixing the date of sale.

¹¹² P. 531 *supra*.

¹¹³ *In re Allied Owners' Corp.*, 74 F. (2d) 201, 203 (C.C.A. 2d 1934). As to a duty on the part of the trustee to bid, see section V, p. 547 *infra*.

¹¹⁴ See Weiner, *Conflicting Functions of the Upset Price in a Corporate Reorganization*, 27 Col. L. Rev. 132, 146-51 (1927).

¹¹⁵ In a state having a statute creating redemption rights like those existing in Illinois, the problem is not so acute where the obligor is also the owner of the equity. In this situation, as already discussed (pp. 541, 542 *supra*), the obligor has a strategic position by which he is able to secure ample protection by bargaining with the majority committee. But where there are obligors not controlling the equity, the problem considered in the text in this section is the same regardless of the existence of statutes creating redemption rights.

iciency, however, will have some bearing upon the extent to which the bondholders may share with unsecured creditors in any unmortgaged assets. In both of these situations there are persuasive grounds for suggesting that a nominal bid should not control the amount of the deficiency judgment.

Relief against deficiency judgments, particularly in cases of farm and home mortgages, has been one of the most striking legal developments of the depression years.¹¹⁶ In "normal" times a deficiency judgment based upon the price bid at an open (though forced) sale has not been thought unjust. A mortgagor has been left to protect himself, if possible, by finding bidders to compete with the mortgagee.¹¹⁷ The recent paralysis in the market for real estate and business properties, however, has caused a number of courts and legislatures to declare that the basis for the usual rule no longer exists and that property bid in by a mortgagee on foreclosure should be credited on the debt at some figure other than the perhaps arbitrary sum bid at the sale.

The extent of the relief to be given under the recent decisions and statutes is by no means clear.¹¹⁸ There has been considerable reaction from the extremes of debtor sympathy illustrated by some of the decisions of 1932 and 1933.¹¹⁹ The leading case is the Wisconsin decision in *Suring State Bank v. Giese*.¹²⁰ This case suggests that a bid equal to the "value"

¹¹⁶ See 84 U. of Pa. L. Rev. 223 (1935); 47 Harv. L. Rev. 299 (1933); 42 Yale L. J. 1236 (1933); Perlman, Mortgage Deficiency Judgments during an Economic Depression, 20 Va. L. Rev. 771 (1934); Eaton, Deficiency Judgments and Decrees, 20 Va. L. Rev. 743 (1934); 85 A.L.R. 1480 (1933); 89 *id.* 1087 (1934); 90 *id.* 1330 (1934); 94 *id.* 1352 (1935); 96 *id.* 853 (1935); 97 *id.* 1123 (1935).

¹¹⁷ In England the problem has not become acute since there the mortgagee has only the option of strict foreclosure (involving a waiver of the deficiency) or foreclosure by sale to an outsider. See Turner, An English View of Mortgage Deficiency Judgments, 21 Va. L. Rev. 601 (1935).

¹¹⁸ In some jurisdictions all such relief has been denied. *Kenly v. Huntingdon Bldg. Ass'n Inc.*, 166 Md. 182, 170 Atl. 526 (1934); *Langever v. Miller*, 124 Tex. 80, 76 S.W. (2d) 1025 (1934) (statute held unconstitutional).

¹¹⁹ In *Emigrant Industrial Sav. Bank v. Van Bokkelen*, 269 N.Y. 110, 199 N.E. 23 (1935), the court held open the entire question, expressing disapproval of *Monaghan v. May*, 242 App. Div. 64, 273 N.Y. S. 475 (1934).

¹²⁰ 210 Wis. 489, 246 N.W. 556 (1933). See also *Federal Title & Mtg. Guar. Co. v. Lowenstein*, 113 N. J. Eq. 200, 166 Atl. 538 (1933).

In *Levy v. Broadway Carmen Bldg. Corp.*, 278 Ill. App. 293 (1934), the court upheld the chancellor's refusal to accept a bid of \$50,000 where the total debt was \$70,250 and the court found a "market value" of \$77,400 (based upon reproduction cost of the building and appraised value of the land) and a "fair and reasonable market leasing value or economic value" of \$80,000.

should be insisted upon, and much is said as to "value in the sense of usefulness." The court even added the following:

... Furthermore, this real estate, which is suffering from the consequences of a period of readjustment through which we are passing, has potential or future value which may legitimately be taken into account.¹²¹

Apparently, at least one trial judge took this language at its face value and refused to confirm a sale to a mortgagee even though the deficiency judgment was waived, being of the opinion that the "value" exceeded the amount of the debt. The Supreme Court, however, reversed the decree, saying that the *Suring State Bank* case contained nothing to justify the trial court's assumption that it could consider the "'market value' as that expression is ordinarily used . . . , much less the value that the premises may have had at some remote time or may have in the future if the prices obtainable for farm products prevalent during such past remote period shall again prevail."¹²² And in the latest case the court said:

... The power of a court of equity [to force a mortgagee to forego his right to a deficiency judgment] is limited to securing justice in a particular case and to preventing an inequitable, unconscionable, and shocking result. . . . The fact that the bid made was \$10 less per front foot than the amount found by the court to be present value is not a circumstance which shocks the conscience of the chancellor. It indicates rather a disagreement as to present value.¹²³

We are not concerned in this paper with the extent of the relief to which debtors are entitled,¹²⁴ but rather with the effect of granting such relief in cases of bond issue foreclosures. If justice to the debtor is thought to require the crediting upon the debt of the "full value" of the property and if this should be done by fixing an upset price or by refusing confirmation of any lower bid, in reorganization cases the consequences would be serious. As already noted, if non-depositors could count on a cash distribution based upon such a bid, it would become increasingly difficult to secure majorities large enough to effect reorganization. We have seen that dissenters are not entitled to such treatment in their own right and it is equally important to see that they do not receive it as a by-product of relief of the debtor against a deficiency.

It is both necessary and possible that the problem of the dissenters' cash distribution and that of debtor relief be kept entirely separate. This

¹²¹ 210 Wis. 489, 491, 246 N.W. 556, 557 (1933).

¹²² *Kremer v. Rule*, 216 Wis. 331, 336, 257 N.W. 166, 169 (1934).

¹²³ *Weimer v. Uthus*, 217 Wis. 56, 57-9, 258 N.W. 358-9 (1935).

¹²⁴ It is possible that no intelligible standard can be worked out for such relief. See Wis. L. 1935, c. 319, § 281.206, requiring a showing that the bid was "unreasonably and unfairly inadequate."

may be done by (a) confirming the sale if the requirements developed in the preceding sections of this article are satisfied and (b) entering a deficiency judgment only for the difference between the debt and the "value" of the property taken at whatever standard is dictated by the court's view as to proper debtor relief.¹²⁵ This will mean, of course, that a dissenting bondholder's cash distribution and his share of the deficiency may not together equal the amount of the debt due him. But this result would not seem unjust, especially for a court holding that a bondholder is entitled to no protection with respect to the price if he refuses to participate in a fair plan.

But if dissenters are thought deserving of further protection, other solutions of the deficiency problem are possible.¹²⁶ The important thing, as already stated, is that no solution of this problem be cast in a form which involves forcing a bid by the committee of an amount higher than that required by the considerations outlined in section III of this article.¹²⁷ Almost no authority has been found upon this question. In two reorganization cases, guarantors were denied relief against deficiency judgments,¹²⁸

¹²⁵ Cf. *Suring State Bank v. Giese*, 210 Wis. 489, 246 N.W. 556 (1933); *Federal Title & Mtg. Guar. Co. v. Lowenstein*, 113 N.J. Eq. 200, 166 Atl. 538 (1933). These cases did not involve bond issues. In two recent cases, however, mortgagees have secured a reversal of decrees confirming the sale and yet denying a full deficiency judgment. *Big Bay Realty Co. v. Rosenberg*, 259 N.W. 735 (Wis. 1935); *Buel v. Austin*, 263 N.W. 82 (Wis. 1935). In practice the difficulty raised by these decisions is avoided by giving the mortgagee-purchaser the option to stipulate for a reduction of the deficiency or to have confirmation refused.

In a bond case it may appear anomalous to give the committee-purchaser a similar option, since the minority also are interested in the deficiency. If this difficulty is thought to be serious, the solution suggested in note 126 is available.

¹²⁶ One solution is based upon the fact that the dissenter's position is that of a creditor willing to have the property sold for whatever cash price an outsider will pay. There are indications that if a mortgagee is willing to let an outsider purchase at his foreclosure sale the sale price will more likely be accepted as the value for purposes of computing the amount of the deficiency judgment. See *Lurie v. Hockenjos Co.*, 113 N.J. Eq. 504, 167 Atl. 766 (1933), *aff'd* 115 N.J. Eq. 304, 170 Atl. 593 (1934). If this is so, the non-depositing bondholder might be able to insist on a deficiency judgment for his benefit computed by crediting upon the debt the forced sale value under current conditions. Then, if the court adopted the same standard in fixing the price which the majority must bid (p. 535 *supra*), the total received by the dissenter in cash and deficiency judgment will equal the amount of his claim. And if not, it will be because the court follows the view developed at the beginning of section III (p. 534). As between the obligor and the purchasing majority, however, it may be deemed just to prescribe a smaller deficiency judgment.

¹²⁷ P. 532 *supra*.

¹²⁸ *In re Howell*, 215 Fed. 1 (C.C.A. 2d 1914), *cert. den.* 235 U.S. 702 (1914); *Equitable Trust Co. v. Western Pac. Ry. Co.*, 244 Fed. 485 (D.C. N.Y. 1917), *aff'd* 250 Fed. 327 (C.C.A. 2d 1918), *cert. den.* 246 U.S. 672 (1918). Cf. *Ivanhoe Bldg. & Loan Ass'n v. Orr*, 295 U.S. 243 (1935).

The only cases reaching a contrary result are based upon questionable reasoning. In *Cen-*

but neither of these cases involved sales in a period of serious depression and in neither was it clear that the bid was less than the "forced sale value" of the property. In "normal" times a deficiency on the basis of such a bid will perhaps not be considered unjust. It is surprising that the problem has apparently not been raised in reported decisions in the last decade.

V. TRUSTEE-PURCHASE

The third principal device by which it has been suggested that minority bondholders might be protected is through purchase of the mortgaged property at the foreclosure sale by the trustee under the trust mortgage, for the benefit of all bondholders.¹²⁹ Before discussing the circumstances under which use may be made of this device, several important aspects of the problem should be considered. In the first place, since the trustee purchases for the benefit of all bondholders, the purchase involves no cash distribution to any bondholder. The trustee need pay in cash only such portion of his bid as represents prior charges, such as expenses of the sale, and may pay the balance by having the amount thereof credited upon all of the bonds *pro rata*. This consequence of trustee-purchase has made the device attractive to reorganizers embarrassed by the problem of providing cash for the dissenters. Probably for this reason affirmative provisions authorizing trustee-purchase are found even in some of the early trust mortgages.¹³⁰ The validity of such provisions has been sustained over the objection of minority bondholders insisting upon the usual type of sale involving a cash distribution for the dissenters.¹³¹

tral Trust Co. v. Cincinnati, T., & M. Ry. Co., 58 Fed. 500 (C.C. Ohio 1892), Judge Taft resorted to a very dubious interpretation of the reorganization agreement as "implying" a waiver of any right to a deficiency. In *Mechanics' & Metals' Nat'l Bank v. Howell*, 207 Fed. 973 (D.C. Conn. 1913), rev'd in *re Howell*, 215 Fed. 1 (C.C.A. 2d 1914), Judge Mayer held the majority precluded by the valuation of the property for the purpose of issuing the new securities. In neither of these opinions was the problem of the dissenters' rights in the deficiency given special consideration.

¹²⁹ For convenience this device is frequently referred to in this paper as "trustee-purchase." It should, of course, be distinguished from a purchase by the trustee for the majority group alone where no effort is made to force all bondholders to participate in the purchase. Whether such action on the part of the trustee is proper is beyond the scope of this article.

¹³⁰ See *Sage v. Central Railroad Co.*, 99 U.S. 334 (1878).

Many recent mortgages have included elaborate provisions not only for purchase by the trustee but also for formulation of a reorganization plan, transfer of the property by the trustee to a corporation organized pursuant to the plan, and distribution of the new securities to be issued therefor. See 2 Bogert, *Trusts and Trustees* § 247 (1935), where the use of such provisions is recommended.

¹³¹ *Kitchen Bros. Hotel Co. v. Omaha Safe Deposit Co.*, 126 Neb. 744, 254 N.W. 507 (1934). In a number of cases courts have construed as providing for trustee-purchase provisions

Some courts, even in the absence of any such provisions in the trust mortgage, have found sufficient basis for authorizing trustee-purchase in the general power of courts of equity to authorize a departure from provisions of trust instruments.¹³² In other jurisdictions, however, the opposite view has prevailed and objecting bondholders have been held entitled to a sale for cash.¹³³ The position of the objecting bondholder is strongest if he is arguing that postponing liquidation will only increase the loss, that immediate sale even at a sacrifice is the most desirable course—although there are frequently grounds for questioning the sincerity of the objecting bondholder. The question thus raised would seem the same as that involved in the famous *Rock Island* case,¹³⁴ where the court attempted by decree to force creditors to take new securities in satisfaction of their claims. While the Supreme Court has not spoken directly on the question, the existence of this power has not generally been conceded. A similar result has been reached in some cases under state statutes where an answer

which were probably not so intended. *Smith v. Mass. Mutual Life Ins. Co.*, 116 Fla. 390, 156 So. 498 (1934); *First Nat'l Bank v. Neil*, 137 Kan. 436, 20 P. (2d) 528 (1933). See also *Straus v. Chicago Title & Trust Co.*, 273 Ill. App. 63, 68 (1933), and *Chicago Title & Trust Co. v. Robin*, 361 Ill. 261, 267, 198 N.E. 4, 7 (1935).

¹³² *Hoffman v. First Bond & Mtg. Co.*, 116 Conn. 320, 164 Atl. 656 (1933); *Nay Aug Lumber Co. v. Scranton Trust Co.*, 240 Pa. 500, 87 Atl. 843 (1913). See also *Silver v. Wickfield Farms, Inc.*, 209 Iowa 856, 227 N.W. 97 (1929); *cf. Sanxey v. The Iowa City Glass Co.*, 63 Iowa 707 (1883).

For a striking instance of the exercise of power to authorize departure from provisions of a trust mortgage, see *New Jersey Nat'l Bank & Trust Co. v. Lincoln Mtg. & Title Guar. Co.*, 105 N.J. Eq. 557, 148 Atl. 713 (1930). See also 3 Bogert, *Trusts and Trustees* § 561 (1935).

¹³³ *Cosmopolitan Hotel, Inc. v. Colorado Nat'l Bank*, 96 Colo. 62, 40 P. (2d) 245 (1934); *Chicago Title & Trust Co. v. Robin*, 361 Ill. 261, 198 N.E. 4 (1935); *Detroit Trust Co. v. Stormfultz-Loveley Co.*, 257 Mich. 655, 242 N.W. 227 (1932); *Bradley v. Tyson*, 33 Mich. 337 (1876); *Equitable Trust Co. v. U.S. Oil & Refining Co.*, 35 F. (2d) 508 (D.C. Wyo. 1928); *Werner, Harris & Buck v. Equitable Trust Co.*, 35 F. (2d) 513 (C.C.A. 10th 1929). See also *Ketcham v. Duncan*, 96 U.S. 659 (1877); *Beckman v. Emery Thompson Machinery Supply Co.*, 9 Ohio App. 275 (1918). *Cf. Wheeler Kelly Hagney Trust Co. v. Heskett*, 141 Kan. 186, 40 P. (2d) 440 (1935).

In this connection it is somewhat surprising to find it argued that while a state statute denying this right to the dissenter may be unconstitutional under the impairment of contracts clause (as held in the *Detroit Trust Co.* case, *supra*) the powers of the chancellor are subject to no similar limitations. See Carey, Brabner-Smith and Sullivan, *Studies in Realty Mortgage Foreclosures: IV. Reorganization*, 27 Ill. L. Rev. 849, 855-6 (1933).

¹³⁴ *Phipps v. Chicago, R.I., & P. Ry. Co.*, 284 Fed. 945 (C.C.A. 8th 1922), *cert. granted*, 261 U.S. 611 (1923), dismissed, per stipulation, 262 U.S. 762 (1923). See Rosenberg, *Reorganization—The Next Step*, 22 Col. L. Rev. 14 (1922); Swaine, *Reorganization—The Next Step: A Reply to Mr. James N. Rosenberg*, 22 Col. L. Rev. 121 (1922); Rosenberg, *Phipps v. Chicago, Rock Island and Pacific Ry. Co.*, 24 Col. L. Rev. 266 (1924). Swaine, *Reorganization of Corporations, Certain Developments of the Last Decade*, 27 Col. L. Rev. 901, 924 (1927).

to the impairment of contracts argument has been found in the police power,¹³⁵ but in general it has been assumed that so radical a change in the remedies of a creditor requires an exercise of the bankruptcy power as in the provisions of Section 77B.

The weight of these objections by bondholders insisting upon a sale for cash can properly be determined only in the light of advantages which trustee-purchase might have over the traditional reorganization procedure. But at the threshold of any inquiry as to these advantages, there arises the question of what the trustee is to do with the property purchased: Is he, under court order, to carry out a reorganization, that is, to transfer the property to a new corporation in return for securities to be distributed to the former bondholders, or is he to hold and manage the property under the supervision of the court until sale to an outsider for an adequate cash price is possible?¹³⁶ A failure to face and answer this question before deciding whether in a given case the trustee may or should bid is responsible for much of the confusion on the subject.

If after purchasing for the benefit of the bondholders, the trustee is to hold and operate the property until a cash sale at an adequate price is possible, the desirability of trustee-purchase may seriously be questioned. In the case of an apartment house or perhaps an office building, management by the trustee for an indefinite period is by no means unthinkable. Objections have been raised that the trustee would be operating without a trust instrument defining his powers, necessitating frequent applications for instructions. It would seem, however, that this difficulty might be minimized by the insertion of proper provisions in the decree authorizing the purchase. Provisions in the decree should also obviate objections based upon assertions that the title to the property would become encumbered or clouded by judgments against the numerous beneficiaries (the former bondholders) or by dower claims. It is frequently provided in so-called "land trust" agreements that the interest of the beneficiaries shall be solely in the proceeds of the ultimate sale, and in such cases the courts have held, at least in some states, that such interests are personalty for purposes of dower, judgment liens, etc.¹³⁷ Similar provisions might be

¹³⁵ See 48 Harv. L. Rev. 1414 (1935).

¹³⁶ These questions have thus far not clearly been answered by courts approving the trustee-purchase device. The questions are well stated in the dissenting opinion in *Cosmopolitan Hotel, Inc. v. Colorado Nat'l Bank*, 96 Colo. 62, 79, 40 P. (2d) 245, 252 (1934).

¹³⁷ *Nicoll v. Mason*, 49 Ill. 358 (1868); *Whitaker v. Scherrer*, 313 Ill. 473, 145 N.E. 177 (1924); *Mallory v. Russell*, 71 Iowa 63, 32 N.W. 102 (1887). Cf. *Ashton v. Macqueen*, 361 Ill. 132, 197 N.E. 561 (1935).

inserted in the decree authorizing trustee-purchase.¹³⁸ Even if these technical difficulties are thus taken care of, doubts may arise in many cases as to the desirability of indefinite operation by the mortgage trustee as compared with transfer to a new corporation. Probably the Colorado court was unduly alarmed when it characterized the situation which would result from trustee-purchase as a "glorified receivership,"¹³⁹ but at least if a majority of the bondholders prefer some other disposition of the property one may well hesitate to force trustee-purchase upon them.

And if the property consists of a going business—a railroad, a hotel or an industrial plant—the difficulties involved in trustee-operation are multiplied. To be sure, such enterprises are frequently operated by receivers for substantial periods. The trustee, like a receiver, could make use of the old executive personnel. But trustees may well hesitate to assume the responsibility of conducting far-flung business enterprises. Under the present state of the law applicable to mortgage trustees in possession, they may have some justification for anxiety as to the extent of their liabilities. In any event, the experience of the past generations with corporate receiverships has hardly been such as to make one confident of the efficiency of trustee-operation of business properties.

Thus far we have assumed that, after purchasing at the foreclosure sale for the benefit of all bondholders, the trustee would hold the property until an advantageous cash purchaser might be found. It has often been suggested, however, that trustee-purchase should be used as a step toward prompt reorganization, that after perfecting title the trustee should present a reorganization plan and, after judicial approval of the plan, transfer the property to a new corporation and distribute stock of the corporation to the former bondholders.¹⁴⁰ Such a proposal at once raises

¹³⁸ But see 29 Ill. L. Rev. 218, 231 (1934).

Similarly, provisions imposing upon the trustee active duties of management should furnish the answer to any contention that the beneficiaries would immediately be entitled to partition.

¹³⁹ *Cosmopolitan Hotel, Inc. v. Colorado Nat'l Bank*, 96 Colo. 62, 79, 40 P. (2d) 245, 249 (1934).

For further instances of problems created by trustee-purchase or strict foreclosure, which is similar in result, see *Watson v. Scranton Trust Co.*, 240 Pa. 507, 87 Atl. 845 (1913); *Sturges v. Knapp*, 31 Vt. 1 (1858).

¹⁴⁰ See O'Brien, *Sales in Bond Issue Foreclosures—and How They May Be Held*, paper read before The Legal Club of Chicago February 5, 1934, and privately printed.

A third conceivable choice would be a public sale by the trustee at which a majority of the bondholders might bid as under the traditional reorganization practice. If this is done, however, the resort to trustee-purchase will have accomplished nothing except perhaps an expediting of the foreclosure proceeding. All of the other problems considered in this paper would remain, but focused upon the second sale.

the question as to what is gained by such procedure as compared with the traditional committee reorganization. One gain from the viewpoint of the majority has already been described—the elimination of the necessity of financing a cash distribution for dissenters. Apart from this, however, the advantages of trustee-purchase are not so clear.

Transferring reorganization leadership from a "committee" to a "trustee" is, of course, no panacea; in the past members of the committee have frequently been officers of the trustee. But in jurisdictions where doubt has existed as to the power of the court to examine the reorganization plan, trustee-purchase would have a definite advantage. The plan would be submitted as an important step in the administration of the trust and the duty of the court, not only to hear any objections raised but also to scrutinize the plan of its own motion, would be clear. And even in states where courts under the existing practice take jurisdiction over plans, under trustee-purchase their exercise of the jurisdiction might possibly be more vigorous and effective. Furthermore, judicial control over fees for services in connection with the reorganization would have an obvious basis. Under the traditional procedure, while fees for the receivers and their counsel and the trustee and its counsel in the foreclosure suit have been fixed by the court, the fees of the bondholders' committee and its counsel have usually not been subjected to control by the court,¹⁴¹ at least until recently.¹⁴² But if mortgage trustees are to take the primary responsibility for management and reorganization, many trust companies will have to broaden their activities and make their operations more flexible or else leave mortgage trusteeships to institutions specializing in such functions.

But whatever advantages trustee-purchase may involve as a focus around which to build a reformed reorganization practice, an entirely different question was presented by the attempts made in recent years to force the adoption of the device in cases where reorganizations were already under way in accordance with the usual committee procedure. In view of the fact that theretofore trustee-purchase had always been resorted to by majority committees as a means of forcing dissenters into a plan, it is one of the most curious developments in reorganization law that in Illinois this same device should have served dissenting bondholders for a time as the basis of their strongest challenge to the traditional practice.

¹⁴¹ See, for example, Lowenthal, *The Investor Pays*, cc. 21, 31 (1933).

¹⁴² *Chase Nat'l Bank v. Clark Henry Corp.*, 156 Misc. 767, 283 N.Y.S. 20 (1935). See 3 *Univ. Chi. L. Rev.* 476 (1936).

In *Straus v. Chicago Title & Trust Co.*,¹⁴³ the leading Illinois Appellate Court case (since disapproved), the court said:

It is a universal rule of law that a trustee is in duty bound to see that the property intrusted to his care is not lost to the beneficiaries. Courts will take judicial notice that property sold under foreclosure seldom, if ever, brings a figure at all commensurate with its value, and that under the present financial condition of the country there is a great depreciation in the values of real estate, and that a foreclosure sale of property will bring far less now than in normal times. . . . In these circumstances we think the property in question ought not to be sold at a price which will result in great loss to the bondholders, if this can be avoided by having the property bid in for the amount of the indebtedness, by the trustee, for their use and benefit.¹⁴⁴

To read this excerpt, and indeed to read the entire opinion, one would think that if trustee-purchase were not ordered the property would be sold to an outsider for whatever it would bring and the bondholders would lose everything but a nominal cash distribution. Nowhere did the Court mention that the alternative is not a sacrifice sale to an outsider but purchase by a committee under a reorganization plan in which all bondholders are urged to participate.¹⁴⁵

A similar viewpoint is expressed in a recent Nebraska case:

[The Court] cannot overlook the fact that in these times a large portion of the bondholders, being unable to bid by reason of lack of financial resources, would be at the mercy of those bondholders and others who are fortunate enough to have financial ability . . . to purchase the property at such sale for a fraction of its ordinary value, thereby enriching themselves, and depriving the small helpless investors of their just and legal rights.¹⁴⁶

¹⁴³ 273 Ill. App. 63 (1933).

¹⁴⁴ *Id.* at 67-8.

¹⁴⁵ See, however, the remarks of the same court in *Chicago Title & Trust Co. v. Robin*, 278 Ill. App. 20, 30 (1934): "The contention was also made in the *Bamburg* case, as here, that the court erred in directing the trustee to bid because a bondholders' committee had prepared a fair reorganization plan which was available. Whatever of merit or demerit there may be in the intentions expressed by the bondholders' committee, it is apparent that so far as the non-depositing bondholders are concerned, the plan means practically that they will be deprived of their property. The deposit agreement which appears in the record is attached to the intervening petition and made a part of it. We shall not undertake to discuss its provisions in detail further than to say that the bondholders who deposited thereunder seem in name at least to have their property entirely outside their own control and that the proceeds which they will receive therefrom both as to time and amount will be according to the pleasure of the committee. The plan adopted by the court has the merit of placing the property of all the parties interested under the jurisdiction of the chancellor and within the protection of his conscience."

See also 7 Rocky Mt. L. Rev. 282 (1935).

¹⁴⁶ *Kitchen Bros. Hotel Co. v. Omaha Safe Deposit Co.*, 126 Neb. 744, 755, 254 N.W. 507, 512 (1934). It is curious to find this language in a case holding that the majority may use trustee-purchase as a means of depriving an objector even of his right to his small cash distributive share.

See also *Smith v. Mass. Mutual Life Ins. Co.*, 116 Fla. 390, 403, 156 So. 498, 506 (1934); *Sage v. Central Railroad Co.*, 99 U.S. 334, 340 (1878); 28 Ill. L. Rev. 929, 933 (1934).

Surely this quotation involves an unfair statement of the problem. The assumption that majority committees attempt to deny the minority the right to participate with them is universally contrary to fact; the assumption that courts would be impotent to prevent such a "freeze-out" except by trustee-purchase is contrary to law.¹⁴⁷ To be sure, in a case in which the majority is violating this duty or is attempting to carry out an unfair plan, trustee-purchase would be one means of thwarting the wrong.¹⁴⁸ But, as we have seen, there are other means of safeguarding the minority.

The decision of the Illinois Appellate Court in *Straus v. Chicago Title & Trust Co.*¹⁴⁹ came in 1933 when some reorganizations had been effected through the usual committee procedure and many others were ready for the final steps. The suggestion that it might be the duty of the trustee to bid if no sale could be had at the full value of the property was a complete surprise to the bar. Damage suits were instituted on behalf of non-assenting bondholders against trustees who had failed to do so.¹⁵⁰ Counsel for committees, after some months of confusion, adopted rather generally the expedient of making all bondholders parties to the foreclosure suit, individually or by representation, in order to secure a binding adjudication as to the necessity of a bid by the trustee; and the rear guard counsel who had theretofore refused to concede jurisdiction over the reorganization plan hastened to present their plans to the court.

It would be difficult to overstate the confusion and waste which would have resulted had the Illinois Supreme Court sustained this attempt to force the adoption of trustee-purchase at a time when the courts were filled with such cases. There was, of course, no necessity for such a radical step. Doctrines which have already been discussed¹⁵¹ afforded to minority bondholders adequate protection. And in *Chicago Title & Trust Co. v. Robin*,¹⁵² the doctrine of the appellate court was repudiated. The supreme

¹⁴⁷ See section II of this article, p. 524 *supra*.

¹⁴⁸ *Clinton Trust Co. v. 142-144 Joralemon St. Corp.*, 237 App. Div. 789, 794-5, 263 N.Y. S. 359, 364-6 (1933). See also *Chase Nat'l Bank v. 10 E. 40th St. Corp.*, 238 App. Div. 370, 264 N.Y. S. 882 (1933).

¹⁴⁹ 273 Ill. App. 63 (1933).

¹⁵⁰ See *Herzog v. Chicago Title & Trust Co.*, note 72, *supra*, where the dismissal of such an action was affirmed on the authority of the *Robin* case, note 152 *infra*.

¹⁵¹ See sections II and III, pp. 524-44 *supra*.

¹⁵² 361 Ill. 261, 198 N.E. 4 (1935), followed in *Chicago Title & Trust Co. v. Bamburgh*, 361 Ill. 291, 198 N.E. 10 (1935) and *Grant v. West End Pine Bldg. Corp.*, 361 Ill. 488, 198 N.E. 349 (1935), rev'g 279 Ill. App. 190 (1935).

In the opinion in the *Robin* case the Supreme Court's distinguishing of the *Straus* case on the ground that there the bonds were issued by a trustee who had contracted against personal liability is hardly persuasive. 361 Ill. 261, 267, 198 N.E. 4, 7 (1935).

court put its decision on the broad ground that the chancellor lacked jurisdiction to order trustee-purchase in the absence of an appropriate provision in the trust mortgage. In taking the broader ground the court has apparently outlawed trustee-purchase entirely in Illinois, whether sought by the majority¹⁵³ or the minority, where no express provision has been made therefor. It might have been preferable to rely upon the absence of any circumstances justifying the exercise of such jurisdiction, and thus leave open the way for an evolution of reorganization practice in a direction which may have constructive possibilities.¹⁵⁴

The main burden of the foregoing argument may be restated very briefly. Any solution of the reorganization problem must be based upon a recognition of the common plight of the bondholders. In *Straus v. Anderson*¹⁵⁵ Mr. Justice Hebel was clearly right in saying that the court must consider and protect the rights of *all* the bondholders. But he and his colleagues apparently believed that somehow this goal could be reached by refusing to consider the reorganization plan and by insisting upon an "adequate" bid by the majority. The writer believes, however, that with this rule equal protection for all bondholders is usually impossible: that any standard for a minimum bid which will protect the dissenter adequately when the plan is unfair will inevitably amount to a denial of fair protection to the majority when the plan is fair. Hence the first conclusion: Jurisdiction over the plan is essential if all bondholders are to be protected.

The second conclusion is likewise required if "equal" protection is to be given: If opportunity to participate in a fair plan is afforded to all bondholders, the majority who purchase in order to avoid a sacrifice should not be required to bid more than an outsider might be expected to bid at forced sale, and perhaps no requirement should be imposed as to the amount of the bid.

Finally, a realistic analysis of the interests of *all* bondholders must determine our judgment as to trustee-purchase: The device should be adopted only if it involves net advantages over the traditional reorganization procedure; and as to many types of property and in many jurisdictions, such advantages are not apparent.

¹⁵³ As in *Lieberman v. Schoenlank*, 279 Ill. App. 467 (1935).

¹⁵⁴ See 49 Harv. L. Rev. 487 (1936).

¹⁵⁵ 283 Ill. App. 342, 352 (1936).