BANKRUPTCY AND REORGANIZATION: A SURVEY OF CHANGES. II*

EDWARD H. LEVI AND JAMES WM. MOORE†

METHODS OF ARRANGEMENTS IN THE UNITED STATES PRIOR TO THE DEPRESSION

IN THE United States, prior to the recent changes in the Bankruptcy Act, an arrangement could be consummated through one of three methods: a voluntary adjustment, bankruptcy, or an equity receivership. There were in addition special statutes dealing with the liquidation and reorganization of banks, insurance companies, and building and loan associations. State corporation acts also contained provisions under which reorganization might be effected, but these provisions were usually directed towards winding-up rather than reorganization. The chief characteristic of the voluntary adjustment was that creditors who did not agree to the readjustment could insist upon the complete use of the corporation's property for the payment of their debts. Bankruptcy reorganization was seldom resorted to because of the drastic nature of the remedy, the impatience of the bankruptcy court, and the inability to affect secured claims through the composition section of the bankruptcy act. While the equity receivership was not by any means a perfect forum for reorganization, it was nevertheless the most feasible and therefore the most popular.

A voluntary arrangement is one whereby creditors or owners attempt to effect a change in their rights without court action. The arrangement might take the form of an assignment for the benefit of creditors, making use of the facilities of trade associations.^{98a} The defect of the voluntary arrangement insofar as it applied to creditors was, that with few exceptions, a majority of creditors could not force other creditors to agree to a like change in their claims. This result might be arrived at, however, through indirect coercion, the granting of special rights to creditors who consented, or the threat that the management might take its skill and the

* This and an article which appeared in the December issue of the Review were prepared by the authors as reporters to the International Academy of Comparative Law, The Hague, on the liquidation and reorganization legislation in England, Canada, and the United States. The report was read at the Academy's 1937 session.

† Assistant Professors of Law, University of Chicago Law School.

^{98a} See Billig, *What Price Bankruptcy: A Plea for "Friendly Adjustment,"* 14 *Corn. L.Q.* 413 (1929).

good will to another business. But if stockholders were to receive benefits through an arrangement employing indirect coercion, dissenting creditors might be able to enjoin the transactions as fraudulent conveyances. An assignment for the benefit of creditors might practically force creditors into the arrangement if they desired to share in the assigned assets, but the arrangement itself was an act of bankruptcy, and creditors (normally three) could always upset the arrangement by filing a petition in bankruptcy. Further, in Massachusetts, the assignment was not effective against dissenters,⁹⁹ and in other states the presence of a preference in the assignment or preferences in connection with releases might make the assignment voidable.¹⁰⁰ In addition, under an assignment the business of the debtor could not be continued for purposes other than liquidation without making the assignment a fraudulent conveyance.¹⁰¹ There was one case where a voluntary arrangement might be imposed upon dissenting creditors. If the creditors under an indenture had surrendered their rights of individual action to a trustee who need not proceed against the debtor unless requested to do so by a certain percentage of the creditors, an agreement between a sufficiently large number of creditors and the trustee would make it impossible for an individual creditor to enforce his rights. This device was used in the case of *Allan v. Moline Plow*,¹⁰² and is apparently valid unless the percentage required to force the trustee to action is so high that the court will feel that it has been ousted of its jurisdiction.¹⁰³

The voluntary arrangement was of more importance in the readjustment of the rights of stockholders, particularly in the reduction of preferred stockholders' rights. The voluntary arrangement here loses some of its characteristics, for, to a limited extent, a plan might be imposed upon dissenting stockholders, and further, these stockholders, also to a limited extent, were able to gain court review of some of the aspects of the fairness of the plan. The voluntary arrangement as applied to stockholders could take any one of four forms: merger, consolidation, sale, or amendment of the corporate charter. Theoretically, a merger occurs when one corpora-

⁹⁹ See *May v. Wannemacher*, 111 Mass. 202 (1872); *Russell v. Woodward*, 10 Pick. (Mass.) 408 (1830). See also Glenn, *The Law of Fraudulent Conveyances* 7 (1923).

¹⁰⁰ *McCord-Norton Shoe Co. v. Brown*, 131 Kan. 19, 289 Pac. 417 (1930); *White v. Gotzhausen*, 129 U.S. 329 (1889). See *International Shoe Co. v. Pinkus*, 278 U.S. 261 (1929).

¹⁰¹ *Nicholson v. Leavitt*, 6 N.Y. 510 (1852). ¹⁰² 14 F. (2d) 912 (C.C.A. 8th 1926).

¹⁰³ *Linder v. Hartwell R. Co.*, 73 Fed. 320 (C.C. Ga. 1896); *Brown v. Denver Omnibus & Cab Co.* 254 Fed. 560 (C.C.A. 8th 1918); *Jones v. Atlantic and Western Ry. Co.*, 193 N.C. 590, 137 S.E. 706 (1927); *First National Bank of Dallas v. Brown*, 34 S.W. (2d) 412 (Tex. 1930); for a related problem, see *Poage v. Co-operative Pub. Co.*, 66 P. (2d) 1119 (Idaho 1937); 46 Yale L.J. 1041 (1937).

tion goes into another; a consolidation occurs when two corporations go together to form a third. A capital readjustment through a sale involves at least two steps: first, the sale of all the corporate assets to another corporation with the securities of the new corporation given to the old corporation as consideration for the sale; second, the distribution by the old corporation of the shares so received to its stockholders under a plan of reorganization. The distinction between a sale on the one hand, and a merger or consolidation on the other, is that a sale does not affect the status of the old corporation; it neither becomes a part of the new corporation nor is it automatically dissolved. If the corporation were immediately dissolved after the so-called sale of assets, the transaction might be held to have been in fact a merger and not a sale. Most state corporation acts do not authorize mergers or consolidations between corporations of different states.¹⁰⁴ And in many states a sale of the corporate assets for the purpose of recapitalization was prohibited if there were any dissenting shareholders.¹⁰⁵ The amendment of the corporate charter is the most direct method whereby a recapitalization may be achieved. Most state corporation acts today require a majority vote of about two-thirds of each class of shareholders affected before a merger, consolidation, sale or amendment may be consummated.¹⁰⁶

Fundamentally it will make little difference whether the arrangement is imposed through a merger, consolidation, sale, or amendment, save for the dissenter's right to payment of the appraised amount of his share which is least often found in the case of an amendment, and is usually present in the other cases. The dissenter who attacks a readjustment imposed through one of these methods may press two kinds of defects. He may urge that the necessary formal requirements of the state statute have not been met; thus, that the necessary majority has not been obtained. On the other hand, he may urge that the plan itself is unfair. Historically, he had two remedies and a possible third. He might sue either the corporation or the majority shareholders for the conversion of his shares of stock.¹⁰⁷ There were theoretical difficulties with this in that it could be argued that the assets were converted and not the shares. The dissenter might sue to have the entire transaction enjoined.¹⁰⁸ In this case his rem-

¹⁰⁴ See Fletcher, Corporations § 7182 (1932).

¹⁰⁵ *Abbott v. American Hard Rubber Co.*, 33 Barb. (N.Y.) 578 (1861); cf. *Meyerhoff v. Bankers Securities, Inc.*, 105 N.J. Eq. 76, 147 Atl. 105 (1929); 7 Va. L. Rev. 640 (1921).

¹⁰⁶ See Fletcher Corporations § 7063 (1932).

¹⁰⁷ *Wunsch v. Consolidated Laundry Co.*, 116 Wash. 44, 198 Pac. 383 (1921); see Lattin, Remedies of Dissenting Stockholders Under Appraisal Statutes, 45 Harv. L. Rev. 233 (1931).

¹⁰⁸ *Colgate v. U.S. Leather Co.*, 75 N.J. Eq. 229, 72 Atl. 126 (1909).

edy might be denied because of the intervention of the rights of innocent third parties, such as new stockholders or bondholders. A third possible remedy was that the dissenter might argue that the completed transaction had resulted in a dissolution of the corporation and therefore he was entitled to his rights and preferences as on dissolution.¹⁰⁹

The drastic and yet contingent character of the dissenter's remedies, together with the precedent of the English Companies Act of 1862 gave rise to appraisal statutes. The appraisal statutes, however, have caused no end of difficulty. It is correct to say that "the framers of the various statutes with respect to paying off dissenting stockholders have had little notion of the important problems involved."¹¹⁰ Thus the appraisal statutes usually do not indicate whether they are now the sole remedy given dissenters, or whether the dissenter may instead sue for the conversion of his share, in which case he may receive greater damages, or whether he may sue to have the transaction enjoined if he so prefers.¹¹¹ A rationale may be suggested. If the arrangement meets the formal requirements of the statute and is also fair, the dissenter will of course have no remedy unless the state appraisal statute gives him one. Under such circumstances the appraisal statute is not the exclusive remedy, but the only remedy. On the other hand, if the arrangement fails to meet the formal requirements of the statute, the appraisal provision is entirely non-operative, since it is only applicable to a sale, merger, or consolidation that meets the formal statutory requirements. Thus a dissenter should not be allowed to waive the lack of the necessary majority of stockholder approvals and gain an appraisal. If, however, the arrangement meets the formal requirements of the statute, but is unfair, the stockholder should be allowed to waive the unfairness and proceed under the appraisal provision, or refuse to waive the unfairness and sue to enjoin.

The charge of unfairness which the dissenter makes will be either that the majority has some special interest which is adverse to the minority and therefore the majority approval of the plan should be disregarded,¹¹²

¹⁰⁹ *Petry v. Harwood Electric Co.*, 280 Pa. St. 142, 124 Atl. 302 (1924); but see *United Milk Products Corp. v. Lovell*, 75 F. (2d) 923 (C.C.A. 6th 1935); *Windhurst v. Central Leather Co.*, 107 N.J.Eq. 528, 153 Atl. 402 (1931); see *Simms*, *An Application of the Doctrine that Consolidation Effects Dissolution*, 15 Va. L. Rev. 757 (1929).

¹¹⁰ *Lattin*, *Remedies of Dissenting Stockholders under Appraisal Statutes*, 45 Harv. L. Rev. 233, 244 (1931).

¹¹¹ *Tanner v. Lindell Ry.*, 180 Mo. 1, 79 S.W. 155 (1904); *Equitable Trust Co. v. Columbia Nat. Bank*, 145 S.C. 91, 142 S.E. 811 (1928). See *Weiner*, *Payment of Dissenting Stockholders*, 27 Col. L. Rev. 547 (1927); *Levy*, *Rights of Dissenting Shareholders to Appraisal and Payment*, 15 Corn. L. Q. 420 (1930).

¹¹² *Outwater v. Public Service Corp.*, 103 N.J.Eq. 461, 143 Atl. 729 (1928).

or that the minority has some interest which the plan destroys which is so fundamental that it is in the nature of a vested right. If the latter charge is made, the attack will be couched in the language of statutory construction or of unconstitutionality. It will be alleged that the state corporation act which grants the power to the corporation to amend its charter does not give the power to change a vested right. It will then be urged that if the change cannot be effected through amendment, it cannot be done indirectly through some other method. If the corporation act now does authorize the change, but did not at the time the stock was issued, it will be urged that the application of the statute will constitute an impairment of contract. Against such attacks it has been held that preferred stockholders may be deprived of the right to vote,¹¹³ of their proportionate right to dividends in the future,¹¹⁴ and of their right to have future dividends cumulate.¹¹⁵ The right to have payments made to a sinking fund for redemption purposes,¹¹⁶ and the right of preferred stockholders to accrued cumulative dividends have been held vested,¹¹⁷ however, and unchangeable. It is possible, however, that a more complicated plan of reorganization may compel a change in these vested rights through indirect coercion. Thus a new stock may be created which is prior to the old preferred and which will receive dividends even though the old preferred does not.¹¹⁸ The old preferred will be given their option to exchange their stock for this new prior preferred, or remain where they are and receive, as a practical matter, neither past nor future dividends.

Bankruptcy was the second method for consummating an arrangement in the United States prior to the depression. The reorganizers could either proceed under the ordinary bankruptcy provisions which are

¹¹³ *Randle v. Winona Coal Co.*, 206 Ala. 254, 89 So. 790 (1921).

¹¹⁴ See *Peters v. United States Mortgage Co.*, 13 Del. Ch. 11, 114 Atl. 598 (1921); *Davis v. Louisville Gas & Electric Co.*, 16 Del. Ch. 157, 142 Atl. 654 (1928).

¹¹⁵ *Yoakam v. Providence Biltmore Hotel Co.*, 34 F. (2d) 533 (1929).

¹¹⁶ *Yoakam v. Providence Biltmore Hotel Co.*, 34 F. (2d) 533 (1929).

¹¹⁷ *Yoakam v. Providence Biltmore Hotel Co.*, 34 F. (2d) 533 (1929); see comments in 4 *Univ. Chi. L. Rev.* 645 (1937); 46 *Yale L. J.* 985 (1937). For a case since the depression see *Keller v. Wilson*, 190 Atl. 115 (Del. 1936). A settlement was arrived at and the case dismissed upon stipulation over the objection of an intervener in *Keller v. Wilson* 194 Atl. 45 (Del. 1937) the doctrine of the *Keller* case, however, has been applied by the Court of Chancery to a corporation created after the amendment to the Delaware corporation act. *Johnson v. Consolidated Film Industries Inc.* (Del. Ch. 1937), see 192 Atl. 603 (Del. 1937); but see *Harr v. Pioneer Mechanical Corp.*, 65 F. (2d) 332 (C.C.A. 2d 1933).

¹¹⁸ See *Matter of Duer*, 270 N.Y. 343, 1 N.E. (2d) 457 (1936); *Yoakam v. Providence Biltmore Hotel Co.*, 34 F. (2d) 533 (1929); *Morris v. American Public Utilities Co.*, 14 Del. Ch. 136, 122 Atl. 696 (1923); *Johnson v. Lamprecht*, Ohio Ct. of App., Nov. 22, 1937, 8 Corp. J. 105 (1938).

framed for the purposes of liquidation and not reorganization, or under section 12 of the Act, the composition section. If the reorganizers proceeded under the ordinary bankruptcy provisions, they would effect a reorganization by becoming the purchasers at the bankruptcy sale of the assets of the debtor. Those creditors who did not wish to go into the plan of reorganization would be left to their share of the proceeds of the sale. The proceeds would usually be very small, although court approval of the sale would be necessary if the proceeds were less than 75 per cent of the appraised value of the property. Thus indirectly a dissenter would be forced to join the plan of reorganization if he were unwilling to take his share of the proceeds. If the plan put into operation by the purchasers were in violation of the doctrine of the *Boyd* case, to be later discussed, the new company might be held liable at a later date. The chief defect of the bankruptcy forum for reorganization, however, was that bankruptcy, as it had developed, was a mechanism for liquidation. The bankruptcy court would be loath to conduct the business of the debtor for any long period of time while a reorganization was being worked out. Further, the name bankruptcy connoted failure to most people. Debtors resisted the appellation, and creditors were not prone to invest in a "bankrupt" corporation which had reorganized.

The reorganizers might proceed under section 12 of the Bankruptcy Act. To do so, the debtor would have to offer a composition to his creditors after the petition in bankruptcy had been filed. If a majority in number and amount of the creditors accepted the composition, and the court gave its approval, having found that the plan was in the best interests of the creditors, the composition became binding on all unsecured creditors. It has been indicated by one court that the principles of the *Boyd* case would not apply under section 12; so that the company after composition would be free of possible liability even though the plan were unfair to certain creditors.^{118a} But there were three difficulties with the use of the composition section. In the first place secured claims were not affected by the section at all. It was thus impossible to achieve any complete readjustment. Secondly, it was necessary to deposit money to pay all those debts which had priority, and this in many cases was a severe requirement. Thirdly, under a composition agreement in bankruptcy, new securities in the form of stocks and bonds were ordinarily not used. Payment was either in cash or notes. There seems to have been no necessity for this requirement. The Bankruptcy Act speaks of "consideration" which should be broad enough to include stocks and bonds. A further general

^{118a} *Lindh v. Booth Fisheries Corp.*, 80 F. (2d) 733 (C.C.A. 9th 1935).

limitation on the use of bankruptcy for arrangements was that railroad and certain other corporations could not reorganize either through a bankruptcy sale or under section 12.

The third method of reorganization existing in this country prior to the depression was the equity receivership. In many respects it was the method which was most feasible, and it was most frequently used. The history of the equity receivership as applied to reorganizations is an illustration of both the ability of the common law to mold itself to meet new conditions and the weaknesses of its method. Traditionally a judgment creditor, who had execution upon his debtor's property returned unsatisfied, could gain the aid of a court of equity to obtain the property of his debtor which was beyond the reach of the processes of the law courts. Traditionally, also, the court of equity had control over decedents' estates when there was no other governmental agency taking care of them.¹¹⁹ The principle behind the jurisdiction of equity in both of these cases was that equity should aid the creditor in the enforcement of his debt and in the preservation of the debtor's estate for the benefit of all creditors provided no other governmental agency is already effectively performing the task. This principle would seem applicable to the requirements of reorganization. The form was a judgment creditor's bill after execution returned unsatisfied. The control over decedent's estates was apparently an isolated instance, which, because of the development of statute law, was forgotten and was no longer susceptible of growth and expansion.

In many instances, however, where a reorganization was desired, it was impossible to have a judgment creditor with execution returned unsatisfied. The property of the debtor was reachable through the ordinary processes of the law court. The individual creditor filing the bill could have his debt completely satisfied. If the debtor were insolvent, then a general creditor's bill could at least allege that the property of the debtor was insufficient to pay all the debts, that separate executions would result in dismemberment and a decrease in value, whereas equity might preserve the property intact. But in many cases the debtor was not clearly insolvent.¹²⁰ The defect of a lack of a judgment creditor with execution returned unsatisfied asking aid of the court of equity was thought to be cured by the debtor's consent to the appointment of a receiver. The necessity of the debtor's consent gave the debtor great control over the

¹¹⁹ See Glenn, *The Basis of the Federal Receivership*, 25 Col. L. Rev. 434 (1925); Sabel, *Equity Jurisdiction in Federal Receiverships*, 20 Iowa L. Rev. 83 (1934); Byrne, *Foreclosures of Railroad Mortgages in Some Legal Phases of Corporate Financing, Reorganization, and Regulation* (1917).

¹²⁰ See *Sage v. Memphis Rr. Co.*, 125 U.S. 361 (1888).

proceedings. He could insist upon knowing in advance what receiver was to be appointed. He could determine in what court the bill was to be filed. In addition, the reorganizers were interested in seeing that the receivership was to be in the federal court. Ancillary receivers would be necessary where the debtor had property beyond the jurisdiction of the court; the federal courts were thought more willing to appoint the principal receivers as ancillary receivers. The federal courts had more experience with reorganizations; reorganizers thought them more competent than the state courts to handle cases of this kind. Since the basis of federal jurisdiction was diversity of citizenship, it was necessary that the creditor filing the bill be a citizen of a different state than was the corporation, and have a claim in excess of \$3,000. It was important also that the creditor's bill not allege the insolvency of the debtor in the bankruptcy sense; that is, that the debtor's assets were insufficient to pay its debts, for the appointment of a receiver while thus insolvent was an act of bankruptcy which would allow unfriendly creditors to upset the equity receivership. The result of all these factors, the necessity of choosing a creditor, arranging that the federal court gained jurisdiction first, overseeing the allegations of the creditor's bill, and the central position of the debtor whose consent was necessary, was that the reorganizers in connection with the debtor had to arrange the whole process, and at times the debtor's attorney prepared the bill filed by a supposedly adverse creditor.

In the early days there was some indication that the debtor might be allowed to file the petition asking for a receivership and then proceed with a reorganization. This was done in 1884 in the reorganization of the Wabash, St. Louis and Pacific Railway Company.¹²¹ The opposition was great. It was asked, "What equity has a man who cannot pay his debts to have a court of justice take charge of his property and manage it for the mere purpose of holding his creditors at arms length?"¹²² One state court declared that a debtor's petition "no more instituted an actual controversy than would the filing of a copy of the Lord's prayer."¹²³ At one time it was thought that a creditor who filed the bill would be liable for the expenses of the receivership if the assets were insufficient.¹²⁴ The case was reversed,¹²⁵ but the warning was given that such liability might be

¹²¹ *Wabash, St. L. & P. Ry. Co. v. Central Trust Co. of N.Y.* 22 Fed. 138 (1884); see *Macon Ry. v. Parker*, 9 Ga. 377 (1851).

¹²² 21 Cent. L. J. 2 (1885).

¹²³ *State ex rel. Merriam v. Ross*, 122 Mo. 435, 25 S.W. 435 (1894).

¹²⁴ *Chapman v. Atlantic Trust Co.*, 119 Fed. 257 (C.C.A. 9th 1902), 145 Fed. 820 (C.C.A. 9th 1906).

¹²⁵ *Chapman v. Atlantic Trust Co.*, 208 U.S. 306 (1908).

imposed if the receivership were improper.¹²⁶ This increased the pressure for the allowance of a debtor's petition. But in 1908 the Supreme Court apparently placed its full blessing on the equity receivership obtained on the petition of a non-execution creditor if the debtor consented,¹²⁷ and as a consequence the need for proceedings instituted by a debtor's petition diminished. Despite some opposition, particularly from proponents of the state courts, the federal consent receivership flourished for many years. Even in its hey-day, however, it was not permitted for an individual debtor.¹²⁸ Execution would have to be returned unsatisfied in that case. In 1928 the turn of the tide was seen. The Supreme Court stated that the only reason why such receiverships had been permitted in the past, was because "not seasonably objected to."¹²⁹ By that time, however, the equity receivership had adapted itself in many ways to the needs of reorganization.

The debtor was protected from the attacks of separate creditors by the equity receivership. Its business was continued under the supervision of the receiver. The income received by the receiver, after paying the expenses of administration and of the business, went towards the claims of the creditor or of the creditors for whom the bill was filed. The trustee under the mortgage indenture could intervene in the receivership or foreclose, in which case the foreclosure and the receivership would be consolidated and the trustee would then receive future income. A peculiar rule in some states allowed a junior mortgagee who foreclosed first to obtain the income even after the senior mortgagee had intervened; this allowed the debtor to prefer creditors by arranging the order of defaults.¹³⁰ In the case of utilities, the equity court, by judicial fiat, created a rule which allowed it not only to apply to income, but in certain cases, the corpus of the mortgage to the payment of debts created a short time before the receivership, when the debts were for work or materials furnished as part of the necessary operating expenses of the business.^{130a} This rule

¹²⁶ *Burnrite Coal Co. v. Riggs*, 274 U.S. 208 (1927).

¹²⁷ *In re Metropolitan Ry.*, 208 U.S. 90 (1908). Creditors were denied leave to mandamus the judge to dismiss the receivership.

¹²⁸ *Davis v. Hayden*, 238 Fed. 734 (C.C.A. 4th 1916); *Hogsett v. Thompson*, 258 Pa. 85, 101 Atl. 941 (1917).

¹²⁹ *Harkin v. Brundage*, 276 U.S. 36 (1928).

¹³⁰ *Lynch v. Donahoe*, 205 Iowa 537, 215 N.W. 736 (1928).

^{130a} For discussion of preferences see Blair, *Priority of the United States in Equity Receiverships*, 39 Harv. L. Rev. 1 (1925); Fordham, *Preferences in Prereceivership Claims in Equity Receiverships*, 15 Minn. L. Rev. 261 (1931); Hirth, *Priority of Claims in Public Utility Receiverships*, 27 Mich. L. Rev. 241 (1929); Wham, *Preference in Railroad Receiverships*, 23 Ill. L. Rev. 141 (1928).

made it easier for utilities to gain necessary supplies in the pre-receivership days. The rule itself was contrary to the maxim *qui prior est in tempore, potior est in jure*. Judge Drummond of the 7th federal circuit seems to have been very largely instrumental in the birth of the doctrine during the receivership of the Chicago and Alton Railroad in 1859. The high handed manner in which this judge ruled his court in this and other matters is illustrated by the saying attributed to that period that "God rules in Israel, but Thomas Drummond in the 7th Circuit."³¹

Despite the rule allowing a preference for necessary work and materials, which was only applicable to utilities and has only been applied to railroads by the Supreme Court, the property in receivership usually required rehabilitation. The equity court, again by judicial fiat, created a rule to take care of this need. Receivers' certificates could be issued for the purpose of raising funds to be used for the business. If the debtor were a utility, these certificates would rank as prior liens on the property.³² This rule had its origin shortly after the Civil War when many railroads were in receivership. The rule met extreme opposition. One Alexander Clayton of Mississippi, writing in the American Law Review in 1878 relieved himself as follows:

"Alas for the day when the owner's right and title to property can be subjected to the discretion of any court, and when a constitutional provision can be made subject to the idea of undefined necessity! It has been said that you cannot measure a live snake: *that* is quite as easy a task as to measure the necessities of a railroad for money when in the hands of a receiver."³³

Nevertheless receivers' certificates continued to be more widely used. In the reorganization of the Wabash, occurring in 1915, there were receiver's certificates to the extent of more than sixteen million.³⁴

While the business was being conducted by the receiver and expenditures were being made for its rehabilitation, the reorganizers had formed a committee for each class of security and stock and were soliciting the deposit of these securities and shares. The deposit agreement set forth the powers of the committee, which were extremely broad. The onetime head of the New York reorganization bar, after enumerating all the powers that should be provided for in the deposit agreement, stated ". . . you will be surprised to find how willing security holders are to

³¹ Gresham, *Life of Walter Quintin Gresham* 366 (1919).

³² *Miltenberger v. Logansport Ry.*, 106 U.S. 286 (1882).

³³ 13 Am. L. Rev. 41.

³⁴ Thacher, *Modern Receiverships*, 4 Calif. L. Rev. 32 (1915).

place almost unlimited powers in a committee of reputable men."¹³⁵ These "reputable men," however, as one court pointed out in 1900, did not exercise these powers "entirely from philanthropic motives."¹³⁶ The early deposit agreements contained no plan of reorganization, but gave the committee the power to work one out which would be binding on depositors if a majority of them did not dissent within thirty days after its announcement. Later agreements sometimes outlined plans of reorganization, and in any event gave dissenters an opportunity to withdraw within a certain time after the announcement of the plan, upon the payment of an assessment.

In addition to the power to work out a plan of reorganization, the deposit agreement usually included powers to sell securities deposited with it; to buy and manage the property; to agree to a modification of the mortgage itself; to agree to the issuance of receivers' certificates; to fix the compensation of members of the committee and the right of members to become underwriters of new securities issued by the reorganized company; to constitute members of the committee voting trustees; to incur expenses and to pledge the deposited bonds as collateral for the repayment of the expenses, to pledge the corporate property for the same purpose, and to compromise claims against the debtor's property. The reason for the large enumeration of powers in the agreement was that courts sometimes construed the agreement against the committee. Thus the inclusion of stockholders in the plan of reorganization might be considered beyond the power to draw up a plan for bondholders which would allot to them "their proportionate interest."¹³⁷

All security holders of a given class have the right to deposit with the committee, although early cases indicate an opposite tendency. Undoubtedly also the committee may set a reasonable time after which it will no longer receive deposits. It is usually thought that no time before the property has been sold will be considered reasonable. In *Keane v. Moffly*¹³⁸ it appears that the final date may have been before the sale, and a stockholder who had previously not deposited was successfully refused admittance. The case is sometimes explained on the theory that it deals with stockholders and not bondholders, but the distinction should

¹³⁵ Cravath, *Reorganization of Corporations; Bondholders' and Stockholders' Protective Committees in Some Legal Phases of Corporate Financing, Reorganization and Regulation* 153, 181 (1917).

¹³⁶ *United Water Works Co. v. Omaha Water Co.*, 164 N.Y. 41, 58 N.E. 58 (1900).

¹³⁷ *Ibid.*

¹³⁸ 217 Pa. 240, 66 Atl. 319 (1907); see the comments in *Rodgers, Rights and Duties of the Committee in Bondholders' Reorganization*, 42 Harv. L. Rev. 899, 903 (1929).

not make a difference. Rather it seems that the duties of committees to all security holders have increased since the day of *Keane v. Moffly*. Sometimes the court's order or confirmation of sale is contingent upon the committee agreeing to allow latecomers to deposit. On the other hand the committee may regulate the depositor's right to withdraw his security from the committee. While it is no longer customary to bind the depositor by the lack of majority dissent of all the depositors, the agreement may provide that there shall be no withdrawal until a plan is announced, and then that withdrawal must be within thirty days. Judge Mayer, who had proved himself courageous in reorganization law,¹³⁹ felt himself powerless to modify such an agreement.¹⁴⁰ The power of the committee to pledge securities, and to use the securities in buying the property may practically prevent the withdrawal of one whose security has been so used. The power to abandon a plan and to prepare a new one has the same effect if withdrawal is prevented until the actual plan has been announced.

The members of committees may be thought to be fiduciaries, but they have protected themselves from liability by broad exculpatory provisions. They have stipulated that they shall not be liable to depositors who withdraw their securities, or who receive new securities. In a simple case, they would probably not be liable for misconduct to non-depositors, although the dominant position of the committee may eventually cause such liability, as duty follows power. The utility of the committee is debatable. An active committee may secure the appointment of an independent receiver, save money by insisting upon the business-like operation of the debtor, preserve the integrity of the claims they represent by a rigorous analysis of the status of other claims and the distribution of income. On the other hand membership on a committee gives great opportunity for abuse of power. Through committees, investment houses and large institutional investors are able to control reorganizations in many cases. The opportunities for speculation and control of the market are many. The committee may well represent its own interest and not the interest of the depositor.¹⁴¹

A receivership is supposed not to be an end in itself. The formal end of the equity receivership for the purpose of reorganization is reached when

¹³⁹ See *Graselli Chemical Co. v. Aetna Explosives Co. Inc.*, 252 Fed. 456 (C.C.A. 2d 1918).

¹⁴⁰ *Habirshaw Electric Cabel Co. v. Habirshaw Electric Cable Co. Inc.*, 296 Fed. 875 (C.C.A. 2d 1924), *cert. den.* 265 U.S. 587 (1924).

¹⁴¹ The Securities and Exchange Commission's Report on the Study and Investigation of the Work, Activities, Personnel, and Functions of Protective Reorganization Committees, Part II (1937) illustrates this.

the property of the debtor is sold by the court to pay the claims of creditors. The committee, which is sometimes composed of several separate committees, purchases at the sale. The property is conveyed to a new company which issues certificates of ownership or of indebtedness in some form to the committee which then distributes them according to the plan of reorganization. A creditor who does not wish to deposit his securities with the committee will be given his pro rata share out of the proceeds in the hands of the court for the purpose of paying creditors. But the proceeds will usually not be very great. This is because there will be no bidders competing with the committee in the ordinary case. Outside bidders, even if any were minded to become such, would have to pay cash. The committee need not. For the creditors' claims which it holds, it can pay in claims. It need raise cash only for the purpose of paying the costs of administration, the expenses of the sale, and the pro rata share of dissenters. Outsiders wishing to gain control of the debtor would normally purchase the securities of the debtor at a reduced rate during the receivership period. Outsiders might organize their own committee and solicit deposits. But committees will usually not compete at the sale. One committee may purchase the securities of another in order to rid itself of a rival, and while this may be a chilling of the bid so that if the court discovers what has happened,¹⁴² a resale may be ordered, a resale is obviously no remedy. So far as competition is concerned, the committee, capable of bidding higher than anyone else can, may bid very low. Hence, what is called the masterful position of the committee.¹⁴³

There were certain devices which to some extent controlled the masterful position of the committee. These devices were the debtor's statutory right of redemption, the upset price, the court's power over confirmation of the sale, setting the date of sale, and on the decree of foreclosure, trustee purchase, and the doctrine of the *Boyd* case. As will be seen, the committee in turn could make use of some of these devices for its own advantage.

Many state laws give the debtor a right to redeem the property from the sale by the payment of the amount bid.¹⁴⁴ Theoretically this protects the debtor from a low bid and a high deficiency judgment. In the reorganization of a corporation, the deficiency judgment runs against the corpo-

¹⁴² *Investment Registry v. Chicago & M. E. R. Co.*, 213 Fed. 492 (1914); see Katz, *Protection of Minority Bondholders*, 3 *Univ. Chi. L. Rev.* 517, 528 (1936).

¹⁴³ See *Investment Registry v. Chicago M. E. R. Co.*, 212 Fed. 594, 610 (C.C.A. 7th 1913).

¹⁴⁴ See *Durfee and Doddridge, Redemption from Foreclosure Sale—The Uniform Mortgage Act*, 23 *Mich. L. Rev.* 825 (1925).

rate debtor which remains, as it is said, an empty shell after reorganization and probably does not mind the deficiency judgment. The redemption right insofar as it forces a high bid and a low deficiency judgment protects the unsecured creditor who need not share the free assets with the secured creditor; it aids the dissenter by increasing his pro rata share in the proceeds; it aids guarantors if their liability is to be set by the amount bid. But the purchasing committee will usually buy the redemption right from the corporation. And in practice the consideration for this purchase goes to the stockholders, who have no right to keep the consideration, but who otherwise would prevent the corporation from selling the redemption right. The redemption right does not then result in a high bid, but in a fraudulent conveyance to stockholders.

The federal court, more lately the state courts, would set an upset price below which it would not allow the property to be sold. The device has only been used extensively in the case of corporate debtors. At first the upset price was no protection for dissenters, for it was set at the total amount of court costs and of outstanding receivers' certificates. Later the upset price in practice came to be set at a figure which would insure the dissenter getting slightly less than the estimated market price of the new securities. A higher upset price, if known in advance, would make the dissenter's position so attractive as to increase the number of dissenters beyond the capacities of the committee to raise cash.¹⁴⁵ A lower upset price would fail to recognize the dissenter's claim that the masterful position kept outside bidders from the sale. The committee was thus forced into a bargaining position: to pay as much as it could or would pay and still proceed with the reorganization. The upset price was a weapon with which the court could bargain with the committee.

Theoretically the duty of the court was to see that the sale was fair. Fraud in the sale would result in a refusal to confirm the sale. Traditionally a low bid except in extreme cases did not indicate fraud. In the railroad reorganization cases the doctrine was first expanded so that a low price together with an unfair plan of reorganization came to mean an unfair sale. Soon in the reorganization of large industrials the court would examine the plan on application for confirmation of the sale. After the *Boyd* case, reorganizers, too, were anxious to have the court examine the plan on confirmation. They knew that in almost every case confirmation would be given, because at that late date, the time and expense put into the finished plan, together with the large number of assenting security holders, would weigh the scales heavily in favor of the plan. Dissenters sometimes succeeded in having the plan examined upon application for a decree of foreclosure, and

¹⁴⁵ See Katz, Protection of Minority Bondholders, 3 Univ. Chi. L. Rev. 517, 532 (1936).

upon application to have the date of sale set. In the reorganization of the Missouri Pacific Railway in 1916, Judge Hook, upon an application to strike the intervening petition of creditors from the files, voiced his objections to the plan at an early stage with the result that the plan was changed.¹⁴⁶ In the *Graselli Chemical Co. v. Aetna Explosives Company* case in 1918, Judge Mayer granted an injunction against a meeting of preferred stockholders when the meeting might have been the first step in an unfair plan, and he later outlined what he considered a fair plan of reorganization to the parties in interest.¹⁴⁷ But these were the rare cases. The *Aetna* case was sufficiently unusual to be termed "a milestone in reorganization."¹⁴⁸ Since the case only dealt with a stockholder reorganization, it was distinguishable, and to many persons no milestone at all.

Many trust indentures specifically grant the trustee power to purchase the property at the sale for the benefit of all the security holders of that class.¹⁴⁹ Most indentures grant the trustee broad general powers from which this special power might be deduced if a court were so minded. In the early days of the depression, reorganizers thought of trustee purchase as a useful device against dissenters who would be forced into a common holding of the property. But the device was double-edged, for committees would equally have their plans upset if a trustee acting under the supervision of the court were compelled to purchase. Undeveloped though it was, the trustee purchase device was potentially of great power.

It was the *Boyd* case,¹⁵⁰ however, which caused most excitement for many years in the reorganization law in the United States. The *Boyd* case and its precursors were said to be perpetual spectres; they were demoniacal. Lawyers were warned to know about the *Boyd* case if only to prevent their being instructed upon it by their clients. A flood of explanatory literature followed in the wake of the *Boyd* case.¹⁵¹ Finally commentators

¹⁴⁶ *Guaranty Trust Co. v. Missouri Pac. R. R.*, 238 Fed. 812 (1916).

¹⁴⁷ *Graselli Chemical Co. v. Aetna Explosives Company*, 252 Fed. 456 (C.C.A. 2d 1918).

¹⁴⁸ See Rosenberg, *The Aetna Explosives Case—A Milestone in Reorganization*, 20 Col. L. Rev. 733 (1920), reprinted in Rosenberg, Swaine, Walker, *Corporate Reorganization and the Federal Court* (1924), a collection of essays valuable today in showing the development of the equity receivership in the days just before the depression.

¹⁴⁹ *Sage v. Central Rd. Co.*, 99 U.S. 334 (1878).

¹⁵⁰ *Northern Pacific v. Boyd*, 228 U.S. 482 (1913).

¹⁵¹ In particular see Swaine, *Reorganization of Corporations: Some Developments of the Last Decade*, 27 Col. L. Rev. 901 (1927); Frank, *Some Aspects of Corporate Reorganization*, 19 Va. L. Rev. 698 (1933); Bonbright and Bergerman, *Two Rival Theories of Priority Rights on Reorganization*, 28 Col. L. Rev. 127 (1928); Buschek, *A Formula for the Judicial Reorganization of Public Service Corporations*, 32 Col. L. Rev. 964 (1932); Foster, *Conflicting Ideals for Reorganization*, 44 Yale L. J. 923 (1935); in connection with Mr. Buschek's article, note *Mountain State Power Co. v. Jordan Lumber Co.*, 293 Fed. 502 (C.C.A. 9th 1923).

discovered, some with chagrin, that the *Boyd* case as "understood" was a tame beast. Its demons were friendly. The precursor of the *Boyd* case, everyone agreed, was *Louisville Trust Co. v. Louisville Railway Co.*¹⁵² There bondholders and stockholders agreed to a reorganization of the railroad company in order to allow the railway to escape liability to general creditors who held a guaranty of the company. The decree of foreclosure and sale was set aside on the petition of the general creditors. The court felt that stockholders could not be given an interest in the new company when, by agreement with the bondholders, general creditors were kept from participating. The precursor of the *Louisville* case, which in its own time was a spectre of its own, scholars agreed was *Railroad Co. v. Howard*.¹⁵³ There stockholders and bondholders joined in a plan of reorganization which was to exclude general creditors from participation. The court held that the claims of the unsecured creditors could be satisfied out of the securities allocated for stockholders; the securities at that time had not been distributed.

The *Boyd* case was somewhat more complicated. Stockholders were allowed to participate in the reorganization of the Northern Pacific Railroad upon paying a cash assessment; certain unsecured creditors were not. If the capitalization of the new company did not reflect stock watering, the assets of the old company were more than sufficient to pay off the bondholders, and the unsecured creditors therefore had an equity not recognized in the reorganization. After the plan of reorganization had succeeded and the new corporation was making money, Boyd sued the new corporation as an unsecured creditor on the theory that stockholders by being allowed to participate had received assets which belonged to the unsecured creditors. Recovery was allowed. A more exact form of relief, but one difficult to administer, would have been to have held the old stockholders individually liable for the proportionate amount of value in their new shares which belonged to this unsecured creditor. It has been pointed out that if the old bondholders had received stock in the new corporation, the relief allowed in the *Boyd* case would have been unfair to them. On the theory of the *Boyd* case, however, the new corporation would not be liable for any more than the assets which it obtained from the old company exceeded the claims of bondholders.

The difficulty with the *Boyd* case was that one Paton, an unsecured creditor, had attacked the plan of reorganization before the sale had been consummated, and his plea had been denied on the theory that there

¹⁵² 174 U.S. 674 (1899).

¹⁵³ 77 U.S. 392 (1868).

were insufficient assets to pay the first mortgage bondholders.¹⁵⁴ The Supreme Court in the *Boyd* case was willing to accept the estimate of value established in the *Paton* case. Liability was imposed either because of collusion between stockholders and bondholders, or because value is a doubtful concept and the danger to unsecured creditors is great. But a few things are clear. Prior to the depression it was thought necessary to allow stockholders to participate in order to gain from them the payment of a cash assessment. Because stockholders might be receiving value above the assessment, and stockholders thought they were, unsecured creditors would have to be allowed to participate. The unsecured creditors had to receive more than stockholders; no one knew how much more. Reorganizers could utilize the tamed demon of the *Boyd* case to frighten all classes of security holders into line. Bondholders must give up something to unsecured creditors as the price of stockholder admission; unsecured creditors could not complain because if stockholders were left out, they would receive nothing; stockholders were told that if they demanded too much they would upset the whole plan. Actually in very few cases was the doctrine of the *Boyd* case applied to create liability or upset a plan of reorganization. Sensibly enough, the demon was content to allow reorganizers to worship before it; it showed itself but seldom.

But the *Boyd* case did change reorganization practice. Reorganizers desired a hearing on confirmation of the plan, as they felt that this afforded some protection. Notice of this hearing would be sent to creditors. Upon confirmation the court would reserve to itself exclusive jurisdiction to try all claims arising against the new corporation out of the plan of reorganization. In this manner it was hoped to get some binding adjudication on the plan. This adjudication was held binding (1) on a creditor who had filed his claim,¹⁵⁵ (2) on a non-filing creditor within the jurisdiction, who had been served with general notice (but no notice relative to the hearing of the plan),¹⁵⁶ and (3) on a creditor who was outside the jurisdiction, but had appeared.¹⁵⁷ The validity of the adjudication, nevertheless, remained

¹⁵⁴ *Paton v. Northern Pacific R. R. Co.*, 85 Fed. 838 (1896). The difficulties of evaluation under the *Boyd* case cannot be avoided by any such rule of thumb as employed by Mr. Justice Holmes in *Kansas City Ry. v. Guardian Trust Co.*, 240 U.S. 166, 176 (1916): "The stockholders of the Gulf Company in their exchange paid ten dollars a share for stock of the appellant received by them. Therefore it must be assumed that the stock of the appellant was worth at least that amount."

¹⁵⁵ *St. Louis & San Francisco Ry. Co. v. McElvain*, 253 Fed. 123 (1918).

¹⁵⁶ *Chicago, Rock Island and Pacific Ry. Co. v. Lincoln*, 284 Fed. 955 (C.C.A. 8th 1922).

¹⁵⁷ *St. Louis R. R. v. Spiller*, 274 U.S. 304, 313 (1927). Cf. *International Ins. Co. v. Sherman*, 262 U.S. 346 (1923); *Wabash R. R. Co. v. Adelbert College*, 208 U.S. 38 (1908).

somewhat tenuous, and its effect on a creditor outside the jurisdiction and who had not appeared was even more doubtful.¹⁵⁸

As a result of the increased jurisdiction over the reorganization which the equity receivership court now exercised, the adaptation of the receivership forum to reorganization was almost made complete. In *Phipps v. Chicago Rock Island*,¹⁵⁹ Judge Carpenter felt that he could dispense with the sale entirely. The plan having been found fair, creditors were to receive the new securities offered them. There were to be no cash proceeds. The *Phipps* case was the farthest outpost. It was distinguishable because there were no secured creditors, and because the new securities were listed on the stock exchange and were readily marketable. In *Coriell v. White*¹⁶⁰ it was later said that dissenters must at least be given their option to take the forced sale value of their securities, or the appraised value of the securities offered to them under the plan.

Under normal conditions, the dictum in *Coriell v. White* might have served to complete a system of arrangements in the United States. But the depression had already come upon the country. The weaknesses of the system of arrangements were laid bare. Under the impact of the depression, new laws, judge-made and legislative, came into being. The old problems of an adequate forum for reorganization, the treatment of dissenters, and the supervision of an economically sound and fair plan of reorganization came in for new treatment. The heyday of change, and sometimes reform, had come.

CHANGES DURING THE DEPRESSION

Much of the reform legislation was experimental, of an emergency character, and ill-drafted. A great deal of the judge-made law was surreptitious and later abandoned. On the other hand, out of the state and federal legislation, and out of the judicial sharpening of new devices for the handling of arrangements, a new scheme of arrangements begins to appear. The imprint of the British practices on reorganization is clearly seen in this new scheme. Much of the old practice remains. The growth of the system was clearly evolutionary; the depression merely quickened the process.

STATE STATUTES

The early days of the depression found the state legislatures hard pressed to meet the demands of debtors for relief. This phenomenon has

¹⁵⁸ See Frank, Some Aspects of Corporate Reorganization, 19 Va. L. Rev. 698 (1933).

¹⁵⁹ *Phipps v. Chicago R. I. and P. Ry. Co.*, 284 Fed. 945 (1933).

¹⁶⁰ *Coriell v. White*, 54 F. (2d) 255 (C.C.A. 2d 1931); *id.* 289 U.S. 426 (1932).

accompanied all depressions in the United States. It was to prevent widespread debtor relief laws, that the federal constitution prohibits the states from impairing the obligation of contracts.¹⁶¹ Well-rooted doctrine allows the state to change the method of enforcement, but not the substance of the obligation.¹⁶² The substance of the obligation itself, however, may be conditioned upon the public weal if the business is one affected with a public interest.¹⁶³ To some degree all businesses are affected with the public interest, actually if not legally.¹⁶⁴ The interest is greater in times of emergency. On the other hand, it is said that an emergency will not create a power in the state.¹⁶⁵ It may provide the opportunity to exercise a power which already exists.¹⁶⁶ The constitutionality of state moratoria statutes was therefore dubious. The statutes were nevertheless passed, as similar legislation had been enacted by states to meet prior economic crises.¹⁶⁷ Even when held unconstitutional at a later date, they had performed a useful function of government in tiding debtors over the extreme period of the depression and in substituting the apparently orderly processes of government for widespread debtor resistance to law.

The most famous moratorium statute was that passed by the Minnesota legislature in 1933.¹⁶⁸ The redemption period could be extended by the court for a "just and equitable" period, but not beyond May 1, 1935. The mortgagor was allowed to remain in possession but was required to pay a reasonable rental value, which was to be applied on the interest, taxes, and the mortgage indebtedness. Interest was to continue on the loan, and the mortgagee's right to a deficiency judgment in the event that there was no redemption was preserved. Alabama,¹⁶⁹ Arkansas,¹⁷⁰

¹⁶¹ 2 Willoughby, *Constitution of the United States* 1097 (1910); 1 Beard, *The Rise of American Civilization* 328 (1927).

¹⁶² *Sturges v. Crowninshield*, 4 Wheat. (U.S.) 122, 200 (1819); see *Von Hoffman v. City of Quincy*, 4 Wall. (U.S.) 535 (1866).

¹⁶³ See *Block v. Hirsh*, 256 U.S. 136 (1921); Sharp, *Movements in Supreme Court Adjudications—A Study of Modified and Overruled Decisions*, 46 Harv. L. Rev. 361 (1933).

¹⁶⁴ Adler, *Business Jurisprudence*, 28 Harv. L. Rev. 135 (1914).

¹⁶⁵ See *Home Building & Loan Association v. Blaisdell*, 290 U.S. 398, 425 (1933); *Wilson v. New*, 243 U.S. 332 (1917).

¹⁶⁶ See *Judicial Declaration of the Termination of an Emergency*, 47 Yale L. J. 124 (1937); 1 Univ. Chi. L. Rev. 639 (1934).

¹⁶⁷ See Warren, *Federal Process and State Legislation*, 16 Va. L. Rev. 546 (1930) for discussion of prior state stay, tender and appraisal laws.

¹⁶⁸ Minn. L. 1933, c. 339, p. 514. For general discussion of moratoria statutes see Bunn, *The Impairment of Contracts: Mortgage and Insurance Moratoria*, 1 Univ. Chi. L. Rev. 249 (1933); Feller, *Moratory Legislation*, 46 Harv. L. Rev. 1061 (1933).

¹⁶⁹ Ala. L. (1935), No. 146.

¹⁷⁰ Ark. Acts (1933), Nos. 129, 252, 278.

California,¹⁷¹ Idaho,¹⁷² Illinois,¹⁷³ Iowa,¹⁷⁴ Kansas,¹⁷⁵ Louisiana,¹⁷⁶ Maryland,¹⁷⁷ Michigan,¹⁷⁸ Mississippi,¹⁷⁹ Montana,¹⁸⁰ Nebraska,¹⁸¹ New Jersey,¹⁸² New York,¹⁸³ North Carolina,¹⁸⁴ North Dakota,¹⁸⁵ Oklahoma,¹⁸⁶ South Dakota,¹⁸⁷ Virginia,¹⁸⁸ Wisconsin,¹⁸⁹ and Texas,¹⁹⁰ passed moratoria laws which operated on the redemption period, postponed sale, or decreased the deficiency judgment.

The Minnesota act was held not violative of the Federal Constitution in *Home Building and Loan Association v. Blaisdell*,¹⁹¹ a decision which carefully weighed the statutory protection afforded creditors. The Minnesota act provided compensation for the creditor; preserved the mortgagee's right to a deficiency judgment; was to be operative only for a limited time; and although the statute was applicable to cases where the mortgagee had obtained a foreclosure judgment, the *Blaisdell* case itself involved foreclosure by advertisement. Accordingly many state acts were invalidated because such legislation did not protect the creditor to the extent that the Minnesota Act had done. The Arkansas,¹⁹² North Dakota,¹⁹³ and Oklahoma¹⁹⁴ acts were held unconstitutional because they provided no compensation for the creditor. The California¹⁹⁵ and New Jersey¹⁹⁶ statutes, which provided for a valuation of the debtor's property in order to reduce the deficiency judgment, were held unconstitutional

¹⁷¹ Cal. Code of Civil Procedure § 580a.

¹⁷³ Ill. L. 1933, § 3.

¹⁷² Idaho L. 1933, c. 150.

¹⁷⁴ Iowa L. 1933, c. 179.

¹⁷⁵ Kan. L. 1933, c. 232, § 2; Kan. L. Sp. Sess. 1934, c. 3, § 2; Kan. L. 1935, c. 226.

¹⁷⁶ La. Acts 1934, No. 159; La. Acts 2d Ex. Sess. 1934, No. 2.

¹⁷⁷ Md. Ex. Sess. of G. A. 1933, c. 57.

¹⁷⁸ Mich. Pub. Acts 1933, No. 98, § 4; Mich. Pub. Acts Ex. Sess. 1934, No. 20, § 3.

¹⁷⁹ Miss. L. 1934, c. 247.

¹⁸¹ Neb. L. 1933, c. 65.

¹⁸⁰ Mont. L. 1933, c. 116.

¹⁸² N.J. L. 1935, c. 88.

¹⁸³ N.Y. L. Ex. Sess. 1933, c. 794, § 2; N.Y. Civil Practice Act, § 1083-a.

¹⁸⁴ N.C. L. 1933, c. 275.

¹⁸⁶ Okla. L. 1933, c. 16, §§ 2-4.

¹⁸⁵ N.D. Sess. L. 1933, c. 157.

¹⁸⁷ S.D. L. 1933, c. 135.

¹⁸⁸ Va. Code Supp. 1932, § 4167(17), cl. 6, as amended by Acts 1934, c. 142.

¹⁸⁹ Wis. Stat. 1933, c. 125.

¹⁹⁰ Tex. Acts 2d. Called Sess. 1934, c. 16; Tex. Acts, 3rd. Called Sess. 1934, No. 11, c. 24, § 1.

¹⁹¹ 290 U.S. 398 (1933).

¹⁹² *Worthen Co. v. Kavanaugh*, 295 U.S. 56 (1935).

¹⁹³ *State v. Klein*, 63 N.D. 514, 249 N.W. 118 (1933).

¹⁹⁴ *State v. Waterfield*, 167 Okla. 209, 29 P. (2d) 24 (1934).

¹⁹⁵ *Bennett v. Superior Court of Los Angeles County*, 5 Cal. App. (2d) 13, 42 P. (2d) (1935).

¹⁹⁶ *Fidelity Union Trust Co. v. Bryant*, 14 N.J. Misc. 243, 183 Atl. 825 (1936).

and were at least distinguishable from the Minnesota statute, although the decisions, in view of contemporaneous judge-made law,¹⁹⁷ seem extremely questionable. The Virginia¹⁹⁸ and Wisconsin¹⁹⁹ laws were not limited to a definite period and were therefore held unconstitutional. The Second Kansas Moratorium series of laws²⁰⁰ and the New York statute²⁰¹ were held inapplicable to foreclosures in which judgments had been entered before the passage of the acts. The First Kansas Moratorium Statute which authorized the governor of the state to extend the redemption period for an additional six months was held to be an unconstitutional delegation of power under the Kansas constitution.²⁰² The Maryland court²⁰³ decided that its own statute, which deprived the holder of a fractional interest in a mortgage of summary decree of foreclosure until 25% of the fractional holders agreed, was unconstitutional under the federal constitution, but the United States Supreme Court reversed.²⁰⁴ The Texas court held that its statute, which appears constitutional under the federal constitution and the ruling in the *Blaisdell* case, was unconstitutional under the Texas constitution and so prevented appeal to the Supreme Court.²⁰⁵ The *Blaisdell* case, of course, while persuasive, did not conclude any state court in the interpretation of its own constitution, even though the provisions of the state and federal constitutions might be identical.

The state legislatures were also called upon to enact creditor relief laws. The inability of majority bondholders to raise cash to pay off dissenters and the ever increasing number of dissenters who desired cash made it impossible for security holders to effect a reorganization. A provision whereby the majority of security holders could effect a reorganization was required. Inasmuch as banks are under some state supervision anyway, it was not so great a step to enact special laws dealing with the

¹⁹⁷ See text as to non-statutory changes during the depression.

¹⁹⁸ *Citizens Mut. Bldg. Ass'n. v. Edwards*, 189 S.E. 453 (Va. 1937).

¹⁹⁹ *Hanauer v. Republic Bldg. Co.*, 216 Wis. 49, 255 N.W. 136 (1934).

²⁰⁰ *Kansas City Life Ins. Co. v. Anthony*, 142 Kan. 670, 52 P. (2d) 1208 (1935); *Farm Mortg. Holding Co. v. Miller*, 143 Kan. 790, 57 P. (2d) 35 (1936); *Phoenix Joint Stock Land Bank of Kansas City v. Conrad*, 143 Kan. 359, 55 P. (2d) 347 (1936); see *Union Cent. Life Ins. Co. v. Pletcher*, 144 Kan. 359, 58 P. (2d) 1158 (1936).

²⁰¹ *Feiber Realty Co. v. Abel*, 265 N.Y. 94, 191 N.E. 847 (1934).

²⁰² *Oakland State Bank v. Bolin*, 141 Kan. 126, 40 P. (2d) 437 (1935).

²⁰³ *United States Mortgage Co. v. Matthews*, 167 Md. 383, 173 Atl. 903 (1934).

²⁰⁴ *United States Mortgage Co. v. Matthews*, 293 U.S. 232 (1934).

²⁰⁵ *Travelers' Ins. Co. v. Marshall*, 124 Tex. 45, 76 S.W. (2d) 1007 (1934); see also *Cattle Raisers Loan Co. v. Doan*, 86 S.W. (2d) 252 (Tex. Civ. App. 1935).

rights of creditors to effect a reorganization. The Mississippi statute which permitted the reopening of closed banks upon a plan of reorganization proposed by three-fourths of the creditors, approved by the Superintendent of Banks and confirmed by the court, was held constitutional in *Doty v. Love*.²⁰⁶

It was only a slightly further step to protect the holders of claims against guaranty mortgage companies, which, like banks, were already subject to some regulation. In New York the problem of the holders of guaranteed mortgage certificates was particularly acute. These companies had sold guaranteed certificates of participation in a single bond and mortgage or in a group of bonds and mortgages. The business had reached widespread proportions. With the drop in real estate values the companies registered appalling losses, partially due to the unwise manner in which their business had been conducted.²⁰⁷ Immediate liquidation would have been fruitless. The future value of their claims depended in part on the rehabilitation of the real estate, and on the other hand on the ability of the security holders to stay the enforcement of all claims and to have the assets of the guaranty company preserved while the slow process of rehabilitation was taking place. The New York legislature responded by the passage of the Schackno Act,²⁰⁸ which authorized the Superintendent of Insurance to take over the functions of the debtor, and to enforce a plan of reorganization to which the holders of two-thirds in amount of the certificates had agreed, provided there had been court approval of the plan. A later act, the Mortgage Commission Act,²⁰⁹ provides for a commission to assume the duties given by the Schackno Act to the Superintendent of Insurance. A plan of reorganization may be effective under the new act, however, unless one third in amount of the security holders affirmatively dissent, but the plan must provide a method whereby dissenters may realize the value of their securities. Both Acts have been held constitutional by the New York Court of Appeals.²¹⁰

²⁰⁶ 295 U.S. 64 (1935). See *City of Holton v. Kansas State Bank*, 144 Kan. 352, 59 P. (2d) 41 (1936); see also Iowa Code 1935, § 9239-a(1-5); Mich. Comp. Laws (Mason, Supp. 1935) § 11962-1; Miss. Code Ann. (Supp. 1933) § 3817-1; Nev. Stat. 1933, c. 190, § 68-75; N.H. Pub. Laws 1926, c. 263; N.Y. Banking Laws 1933, § 61-a; N.D. Laws 1933, c. 72; Ohio Laws 1935, pp. 34-36; S.C. Code (Supp. 1934) § 7856; Vernon's Tex. Ann. Civ. Stat. 1925, art. 454; Vt. Pub. Laws 1935, § 6761-6770.

²⁰⁷ See Reis, *False Security* 58-84 (1937). According to Mr. Reis' figures, \$1,008,814,205.08 of the guarantees were in default.

²⁰⁸ Chapter 745 as amended by chapter 780 of the Laws of 1933. The Schackno Act is discussed in 34 Col. L. Rev. 663 (1934); 35 Col. L. Rev. 874 (1935).

²⁰⁹ N.Y. L. 1935, c. 19.

²¹⁰ *People v. Title & Mortgage Guarantee Co.*, 264 N.Y. 69, 190 N.E. 153 (1934); *In Re 1175 Evergreen Ave. Borough and County of Bronx*, 270 N.Y. 436; 1 N.E. (2d) 838 (1936).

California²¹¹ and New Jersey²¹² have provisions slightly similar to the Schackno Act. The California law allows amendments of the trust agreement under which certificates are held, with the approval of the holders of seventy-five per cent in amount of the certificates, and the approval of the commissioner; it allows a conservator to be appointed for the debtor and provides for the reorganization of the debtor with the consent of a majority of the security holders and the approval of the court. The New Jersey law allows the appointment of the Commissioner of Banking and Insurance as trustee of the debtor, and allows a plan of reorganization to be effected with the approval of the court and two-thirds of the security holders. Apparently a general rehabilitation plan will also require the consent of two-thirds of the stockholders.

Michigan and New York have taken the lead in rather far-reaching legislation dealing with the problem of bondholders under real estate mortgages, even though the debtor had not previously been subject to regulation as had the guaranty mortgage companies in New York. Their statutes not only provide means whereby dissenters may be bound to a plan of reorganization, but they attempt to regulate the reorganization process so as to eliminate some of the evils which have lessened the value of protective committees. In 1931, Michigan passed an act which allowed the court on the written request of a majority of the bondholders to purchase the property for the benefit of all the bondholders.²¹³ This statute was held unconstitutional as an impairment of contract,²¹⁴ but it was particularly vulnerable in not specifically providing for notice to dissenters. At that time the total amount of real estate bonds outstanding in Michigan were \$449,743,000. Of these, \$344,974,000 were in default.²¹⁵ The trustee purchase act was repassed in substantially the same form but with an express provision requiring notice.²¹⁶ In addition the Michigan legislature provided that fifty-one per cent of all the holders, who were also the holders of more than four-fifths in amount of the bonds, might agree with the grantor to an extension and a modification of a limited number of obligations of the debtor.²¹⁷ The Michigan court is apparently going to construe this act very strictly.²¹⁸

²¹¹ Statutes of California, c. 145, arts. 7, 8.

²¹² N.J. L. 1934, c. 3, 16.

²¹³ Mich. Pub. Acts 1931, No. 111.

²¹⁴ *Detroit Trust Co. v. Stormfultz-Loveley Co.*, 257 Mich. 655, 242 N.W. 227 (1932).

²¹⁵ Macdonald, *The Problem of the Defaulted Real Estate Mortgage Bond in Michigan*, 14 Mich. St. Bar J. 220, 221 (1935).

²¹⁶ Mich. Pub. Acts 1933, No. 210.

²¹⁷ Mich. Pub. Acts 1933, No. 114.

²¹⁸ See *Smith v. Union Guardian Trust Co.*, 271 Mich. 118, 260 N.W. 132 (1935) (interest payment requirements may not be modified).

Michigan has also set up a Public Trust Commission which has broad supervisory powers over committees in reorganizations.²¹⁹ Committees are required to obtain licenses from the Commission, which has broad power to prevent "fraud, deception or damage" to security holders, and to revoke licenses in the furtherance of that objective. Committees are not allowed to take any action for bondholders without permission from the Commission. The Commission has supervisory powers over fees, and committee members are expressly made fiduciaries for all security holders, whether the security holders have deposited or not. The committees are required to file whatever lists of security holders they have with the commissions. At the present time it is too early to determine how the Commission is functioning.

In New York, pursuant to the Burchill law,²²⁰ the trustee under the mortgage indenture is empowered either (1) to purchase the property for the benefit of all the bondholders and later to sell it with the court's consent and the consent of eighty-five per cent of the principal amount of the bonds, or (2) the trustee may purchase the property pursuant to a court-approved plan of reorganization, which contains a maximum and minimum bid to be made for the property. If the indenture contains no provision authorizing the purchase of the property for all the bondholders, and no statute reaching the same result is applicable, then a dissenter is entitled to his share of the value of the property as on public sale. Otherwise the plan is binding on all security holders if one-third of the security holders do not file dissents within twenty days after the approval of the plan.

The Burchill Act has been amended and supplemented by the Streit Act²²¹ which regulates the obligations of trustees under indentures, committees, and management companies. The trust indenture must have a provision requiring the trustee upon default to take steps to secure the rents and profits, and to render annually, after default, a summarized statement of income and expenditures. The trustee may not be a trustee under any other mortgage on the property; he may not have a financial interest in either the debtor or in any company managing the property. The setting of an upset price is made mandatory save where the court has approved a plan containing a minimum and maximum bid under the Burchill law, or where all bondholders have agreed. A deposit agreement to be valid or binding under the Streit Act must provide that the

²¹⁹ Mich. Pub. Acts 1933, No. 89.

²²⁰ N.Y. L. 1933, c. 729.

²²¹ N.Y. L. 1936, c. 900 amending N.Y. L. 1909, c. 52.

fees of the committee shall be subject to the approval of the court, that the deposit agreement may not be amended without approval of the court, and that the securities deposited with the committee may not be sold, pledged, or otherwise disposed of without either the unanimous consent of the depositing bondholders or the approval of the court, and if sold, the court must pass on the fairness of the price. Further, committee members may have no interest in the depository. Management companies are required to provide a surety bond equal to at least the gross rental or income of the property for the three preceding months; they may not have officers, directors, or stockholders, who are officers, directors, or employees of the committee, or who are voting trustees, officers, or directors of the corporation acquiring title to the property unless a majority of the security holders in amount approve. Voting trust agreements are limited to five years for the reorganized companies, and the indenture trustees, members of committees, and their attorneys may not become voting trustees, officers, or directors of the new corporation unless this fact has been disclosed to the court and a majority of investors approve, or unless the court has approved such a provision in the plan under Burchill proceedings. The salaries of voting trustees, officers and directors of the new company and the fees of trustees or committees in possession of the property must be approved by the court.

Illinois,²²² Minnesota,²²³ Pennsylvania,²²⁴ and Washington²²⁵ have adopted statutes which are similar to that proposed in the Uniform Corporation Act, section 59. They in effect allow three fourths of creditors and stockholders to agree to a plan of reorganization if sanctioned by the court. The validity of these acts, as well as that of the Burchill Act, may be questioned on at least two grounds. First, the ability of creditors to bind other creditors may be considered an impairment of contract if the debt were created before the provision. This is probably an unnecessary and unfortunate conclusion, but the constitutionality of the Schackno Act might be distinguished because the regulation of guaranty mortgage companies is more within the province of the state, since they conduct a business analogized to insurance,²²⁶ traditionally a business affected with a public interest. Second, the presence of reorganization sections in the present bankruptcy act may make all state reorganization proceedings

²²² Ill. State Bar Stats. 1935, c. 32, § 90(c).

²²³ Minn. Stat. (Mason's Supp. 1934), § 7492-54.

²²⁴ Purdon's Pa. Stat. 1936, tit. 15, § 2852-1109(3).

²²⁵ Wash. Rev. Stat. Ann. (Remington's Supp. 1935), § 3803-58.

²²⁶ See 43 Yale L. J. 1007 (1934).

under statute void.²²⁷ In this respect, the provisions in the Illinois and Pennsylvania statutes may be safer than the Minnesota provision. The former place the reorganization section as a part of liquidation and dissolution; Minnesota does not. It might be contended that the state dissolution proceedings survive, while reorganization proceedings do not. The Washington statute treats such an arrangement between creditors as connected with dissolution proceedings, but it may negative this advantage by making rules applicable in bankruptcy proceedings applicable in dissolution proceedings.

THE REORGANIZATION AMENDMENTS TO THE BANKRUPTCY ACT

We have already mentioned that it was the problem of the dissenters' right to cash which drove reorganizers to seek legislation changing reorganization practice. The depression increased the number of dissenters, since bondholders were more desirous of liquidating their claims at once and were distrustful of committees; on the other hand, the depression made it more difficult for the majority committee to raise the necessary cash. Stockholders were unable to contribute funds to the reorganization in order to maintain their position in the plan. There were other factors which contributed to reorganization legislation. The *Boyd* case was still something of a spectre. The difficulties of gaining a binding adjudication on the plan, the desire of minority interests to have an early hearing on the plan, and the uncertain attitude of the courts towards the consent receivership contributed to the desire for legislation. Federal legislation was desired because it would avoid the provision against impairment of contracts which is directed solely at the states, and it would be given added strength as coming under the bankruptcy power. Uniformity would result from federal legislation; many of the jurisdictional difficulties inherent in state legislation would be avoided; and, also, reorganizers would have the assurance that reorganizations could continue to proceed in the federal courts, which were thought more capable in this field than the state courts. Accordingly, Congress in 1933 passed three acts as amendments to the Bankruptcy Act: section 74, which deals with the adjustment of claims against unincorporated debtors;²²⁸ section 75 which deals, with the adjustment of claims against a farmer,²²⁹ and section 77, which deals with the reorganization of railroads engaged in interstate com-

²²⁷ On the conflict between federal and state power, see *Chicago Title & Trust Co. v. Forty-One Thirty-Six Wilcox Bldg. Corp.*, 58 S.Ct. 125 (1937); *State of Texas v. Donoghue*, 58 S.Ct. 192 (1937).

²²⁸ 47 Stat. 1467 (1933), 11 U.S.C.A., § 201 (1936).

²²⁹ 49 Stat. 246 (1935), 11 U.S.C.A., § 202 (1936).

merce.²³⁰ In 1934, two more amendments were added: section 77B, which deals with the reorganization of corporations generally,²³¹ and section 80, which deals with the readjustment of claims against minor subdivisions of the states.²³² As we have noted, Section 80 was held unconstitutional by the Supreme Court, but new municipal debt readjustment legislation has been enacted.²³³ Section 75 is supposedly a temporary act to expire in 1938.²³⁴ In many respects section 77 represents a maturer reflection on the problems of reorganization; it was completely rewritten in 1935, and is the latest of the reorganization acts, with the exception of the new municipal debt readjustment act, approved Aug. 17, 1937.

Sections 74, 75, and 77B have many things in common. All of them adopt, in addition to the bankruptcy definition of insolvency, the equity definition, an inability to pay debts as they mature, as a basis for jurisdiction. All allow the debtor to file a petition stating that it is insolvent or unable to meet its debts as they mature and that it wishes to propose an arrangement with its creditors; allow a stated majority of creditors to agree to an arrangement which when approved by the court is binding on all creditors; recognize that in certain instances a plan may be imposed on all creditors even though the necessary majorities have not been obtained; require the court to find that the plan of arrangement is a fair plan; although none of them states what a fair plan is; provide for the appointment of an officer of the court who may conduct the debtor's business. In all of the acts the jurisdiction of the federal court over the debtor's property is greater than it would be if the proceedings were in ordinary bankruptcy or in equity receivership. In many important respects, however, the acts differ.

Petitions. Creditors may file petitions under sections 77 and 77B asking that the corporation be reorganized. The requirement under section 77 is that the petitioning creditors have claims aggregating an amount not less than five percent of all the indebtedness of the corporation. Under 77B three creditors with claims aggregating \$1,000 in excess of the value of the security held by them may file such a petition. But creditors filing an involuntary petition under section 77B will have to either prove an act of bankruptcy or that a prior equity receivership or bankruptcy pro-

²³⁰ 49 Stat. 1969 (1936), 11 U.S.C.A., § 205 (1936).

²³¹ 50 Stat. 622 (1937), 11 U.S.C.A., § 207 (1936).

²³² 49 Stat. 1203 (1936), 11 U.S.C.A., § 303 (1936).

²³³ See Levi and Moore, *Bankruptcy and Reorganization: A Survey of Changes*, 5 Univ. Chi. L. Rev. 1, 32 n. 82 (1937).

²³⁴ H.R. 6452 (1937) and S. 2215 (1937) would remove the time limitation.

ceeding is pending. The Supreme Court has held that "prior equity receivership" alludes to the equity receivership on a creditor's bill, and not to the receivership which is an incident to a foreclosure proceeding.²³⁵ It has also been held, although the matter is still doubtful, that the creditors who file an involuntary petition under section 77B must be creditors of the debtor, and not merely creditors having claims against the debtor's property.²³⁶ Decisions on the latter point would seem applicable to section 77 as well. Where creditors do file petitions under sections 77 and 77B, the corporation is given ten days in which to respond, and if the debtor files its own petition within that time it will be given precedence.²³⁷ Creditors may not file involuntary petitions under sections 74 and 75.²³⁸ Creditors may file an involuntary petition in ordinary bankruptcy against a debtor, who may then file a petition under section 74 or section 77B, if the debtor is a corporation, as an answer. This indirect method is not applicable to sections 75 and 77, since farmers and railroad corporations may not have involuntary petitions in bankruptcy filed against them.

Good Faith. The petition for an arrangement must be found by the court to have been filed in good faith²³⁹ under sections 74, 77, and 77B. There is no such requirement under section 75. Under the good faith provision it has been held that a corporation may not convey its assets to an individual and proceed as a non-corporate debtor under section 74.²⁴⁰ Under 77B there have been comparable problems concerning (1) whether a debtor might incorporate for the purpose of 77B proceedings, and (2) whether a debtor, once a corporation but now dissolved under state law, may file a petition in good faith under 77B, or have a petition filed by creditors in good faith against it. At first the trend of the decisions indicated that in all of these cases, the former lack of corporate existence, or the present dubious nature of corporate existence would prove no in-

²³⁵ Duparquet, Huot & Moneuse v. Evans, 297 U.S. 216 (1936); Tuttle v. Harris, 297 U.S. 225 (1936).

²³⁶ Matter of Draco Realty Co., 11 F. Supp. 405 (N.Y. 1935). See *In re* 1530 North Kedzie Building Co. report of special master (N.D. Ill., 1936) reversed on other grounds (N.D. Ill., 1936) where it was said creditors with claims only against the debtors' property might file the petition.

²³⁷ See *In re* Kelly-Springfield Co., 10 F. Supp. 414 (Md. 1933).

²³⁸ For a holding that a charitable corporation may not have a petition filed against it under 77B, see *In re* Michigan Sanitarium & Benevolent Ass'n., C.C.H. 4804 (E.D. Mich. 1937).

For recent discussion of § 75(s) see Diamond and Letzler, The New Frazier-Lemke Act: A Study, 37 Col. L. Rev. 1092 (1937).

²³⁹ See *In re* Piccadilly Realty Co., 78 F. (2d) 257 (C.C.A. 7th 1935), when the financial condition of the debtor is of great importance in determining whether there is good faith.

²⁴⁰ *In re* Cosgrave, 10 F. Supp. 672 (Cal. 1935).

surmountable bar to the good faith requirement.²⁴¹ But the Supreme Court has now held that a dissolved corporation may not file under 77B.²⁴² It left undecided, however, the question whether creditors might not file in good faith against such corporation.²⁴³ The result of the Supreme Court case, although distinctions may be made, makes it at least probable that in the case of special incorporation, and in the cases of the dissolved corporation, both debtor and creditor petitions will be held lacking in good faith.

Plan. Plans of reorganization may be proposed under 77B by the debtor, by creditors holding 10% of all claims and 25% of the claims of one class of affected creditors, and by stockholders, if the debtor is not insolvent in the bankruptcy sense, having 5% of the outstanding shares and 10% of the shares of one class. Under section 77, the filing of a plan by the debtor seems mandatory. And under this section the trustees appointed by the court, creditors having 10% of the claims of one class, stockholders having 10% of the shares of any one class of shares, and any party in interest, having obtained the consent of the Interstate Commerce Commission, may file a proposed plan. Apparently neither section 74 nor 75 contemplates the proposal of a plan of reorganization by a creditor. Section 74 distinguishes between a plan of extension and a plan of composition; section 75 speaks of "a composition or extension proposal" but does not distinguish between them. Sections 77 and 77B speak only of plans of reorganization. Under section 74, an extension supposedly extends the time of payment only; a composition reduces the claims. When the plan under section 74 is an extension plan, claims of all characters are provable and affected. Theoretically when the plan is a composition plan only claims provable in bankruptcy may be affected. Sections 77 and 77B allow claims of all character to be proved. Section 75 is silent on the subject and presumably adopts the bankruptcy classification of provable claims.²⁴⁴

The reorganization acts have attempted to deal with the rather difficult problem of landlord's claims. Prior to the reorganization acts, landlords were unable to prove in bankruptcy proceedings by asserting that bank-

²⁴¹ Old Fort Improvement Co. v. Lea, 89 F.(2d) 286 (C.C.A. 4th 1937); *In re* Loeb Apartments, 89 F.(2d) 461 (C.C.A. 7th 1937).

²⁴² Chicago Title & Trust Co. v. Forty-One Thirty-Six Wilcox Bldg. Corp., 58 S.Ct. 125 (1937).

²⁴³ See *In re* 211 East Delaware Place Bldg. Corp., 76 F.(2d) 834 (C.C.A. 7th 1935) where it was held creditors might file in good faith against a dissolved corporation.

²⁴⁴ Thus, for instance, excluding tort claims which have not been litigated.

ruptcy was an anticipatory breach of the contract to pay future rent.²⁴⁵ And this was in general also true in equity receiverships.²⁴⁶ The result was that in depression days, high rent charges were avoided by some debtors who reorganized and left the landlord with practically no compensation for the loss of his lease. On the other hand, landlord's claims might prove to be of great value in that the owner of such a claim might succeed in having the doctrine of the Boyd case applied, and this threat might prove to be of at least considerable nuisance value.²⁴⁷ While the denial to the landlord of a claim based on an anticipatory breach by the tenant seems to be unfair, nevertheless the allowance of the landlord's claim in toto would work a hardship on other creditors, and on the debtor. The reorganization acts were passed at a time when there was both agitation for more liberal treatment of landlords, and that landlord's claim be not used for their nuisance value or to prejudice unduly other creditors.

It is impossible to deal at all adequately with the problem of landlord's claim in a short general survey of the entire reorganization field. It may be pointed out, however, that the reorganization acts had three problems to face. The first problem was whether the landlord would be allowed to prove for an anticipatory breach of a contract to pay future rent. The second problem was whether, a claim for anticipatory damages having been allowed, the landlord's claim for future rent damages would be limited so as not to prejudice unduly other creditors, and the debtor. The third problem was whether other limitations on the right of the landlord to claim damages for failure to pay future rent would be operative. The doctrine in some states that a re-entry by the landlord would bar his claim for damages was the chief limitation which had to be met.²⁴⁸

In general the reorganization acts, with the possible exception of section 75, make claims for future rent provable. Such claims are expressly provable under an extension proposal in section 74. Under a composition proposal under section 74, claims for future rent are provable by application of section 63 of the ordinary bankruptcy act, as amended, which, however, limits the claim to an amount not to exceed one year's rent. It is problematical whether any such limitation is operative under an extension proposal in section 74. Under section 77 claims for future rent would seem to be provable to some extent at least, because its definition of claims is broad enough to include a claim for future rent, and also

²⁴⁵ *Manhattan Properties v. Irving Trust Co.*, 291 U.S. 320 (1934).

²⁴⁶ *Wake Development Co. v. Auburn-Fuller Co.*, 71 F.(2d) 702 (C.C.A. 9th 1934).

²⁴⁷ *Douglas and Frank, Landlords' Claims in Reorganizations*, 42 Yale L. J. 1003 (1933).

²⁴⁸ See 2 Univ. Chi. L. Rev. 629 (1935).

because it is provided that "in case an executory contract or unexpired lease of property shall be rejected . . . any person injured by such . . . rejection . . . shall be deemed to be a creditor of the debtor to the extent of the actual damage or injury determined in accordance with principles obtaining in equity proceedings."²⁴⁹ The only decision on the point so far has proceeded on the theory that future rent claims are provable under section 77 only to the extent that the claim has accrued to the date of the hearing on the plan.²⁵⁰ Section 77B, on the other hand, which makes claims for future rent provable, limits the claim to an amount not to exceed three years' rent. It is difficult to know why there should be a more stringent limitation under section 77 than section 77B (assuming the one decision on section 77 is to be followed) unless the near certainty that the landlord under section 77 will be able to negotiate a new lease with the tenant railroad is in itself some compensation to the landlord. It is also exceedingly hard to justify a one year's limitation applicable in some proceedings under section 74, as against the more liberal treatment under section 77B. Section 75 does not expressly define claims, but the application of the ordinary bankruptcy act might make claims for future rent provable, but with damages for future rent limited to one year.

The discrepancy in the amount of provability between the various reorganization acts makes it certain that for some time it will be argued that the principle of the *Boyd* case may be invoked by landlords in reorganizations, except in those under 77B. For one explanation of what is, from one point of view, the more liberal treatment of landlords under 77B is that under it the landlord cannot obtain additional compensation ahead of stockholders and the debtor, although in subordination to creditors, whereas under the other acts there is the possibility that such compensation may be required, under the doctrine of the *Boyd* case. Indeed it was arguable even under section 77B, that the landlord, having collected only a partial amount on what is an admittedly good claim, might recover the additional amount ahead of stockholders, but this relief has been denied him by the Supreme Court.²⁵¹ Difficulties of evaluation being what they are, the decision does not cause great excitement, but it also does not allay the ghost of the *Boyd* case insofar as the other reorganization sections are concerned.

Somewhat more startling is the holding of the Supreme Court that

²⁴⁹ § 77(b).

²⁵⁰ *Matter of New York, N.H. & H. R.R.: Claims of Connecticut Ry. & Lighting Co., U.S. Dist. Ct. Conn. Sept. 1, 1937; see 47 Yale L. J. 272 (1937).*

²⁵¹ *Kuehner v. Irving Trust Co., 299 U.S. 445 (1937).*

the rent claim provision of section 77B provides for claims which would not be provable under state law because of the re-entry of the landlord.²⁵² While this seems to be a workable construction of the act and an entirely commendable one, it is apparently the only example under the bankruptcy law wherein a creditor has a claim under federal law, but not under state law. The reliance of the court on words peculiar to the provision under section 77B again makes it doubtful whether a similar construction will follow under the other reorganization acts.

Section 77 preserves the priority for the so-called six months' claims. Receiver's certificates may be issued as prior lien securities under section 77 as formerly, and now also under section 77B, by somewhat doubtful construction of ambiguous language.²⁵³

The provisions in the four acts with respect to binding creditors to a plan of reorganization differ. Under section 74 secured claims may be extended, but not scaled down. In addition, section 74 requires the deposit of money or security sufficient to pay off all prior claims before a proposal may be confirmed. Section 75 was similar in its original form, but it has now been amended to allow the reduction of a secured claim, provided the lien is preserved at the fair and reasonable market value of the security, except that interest rates may be reduced regardless of the market value of the property. The deposit of money to pay prior claims is no longer required. Under both section 74 and section 75 a plan approved by a majority in number and amount of creditors and approved by the court becomes binding on all creditors. But in neither act is there any provision for class voting. This apparently makes it possible for unsecured creditors to force an extension onto a secured creditor, but it also allows a secured creditor having a majority in amount of the claims to prevent any extension. The court may confirm a proposal under section 74, however, even though a majority of the creditors do not approve of it, if the court finds the proposal fair. The constitutionality of this provision has not been passed upon. The analogous provision in section 75 is the famous Frazier-Lemke act. In its original form it provided that a farmer who had been unable to obtain a composition or extension, or who felt "aggrieved" by the one which had been approved by creditors, might be adjudged a bankrupt on his own petition, have his property appraised at its reasonable market value, and then either repurchase the property

²⁵² *City Bank Farmers Trust Co. v. Irving Trust Co.*, 299 U.S. 433 (1937). This apparently will be true of the lease provision amendment to section 63 of the ordinary bankruptcy act; cf. *Schwartz v. Irving Trust Co.*, 299 U.S. 456 (1937).

²⁵³ *In re Prima Co.*, 88 F.(2d) 785 (C.C.A. 7th 1937).

in installments over a six year period, or, if creditors demanded, pay a reasonable rental for five years and then repurchase the property at its value at that time. During the five or six year period, the farmer was allowed to remain in possession. In this form the provision was held to be unconstitutional as taking property without due process of law.²⁵⁴ In its present form the rights of the creditor are safeguarded by providing for a three year moratorium or less at the court's discretion, and by allowing the creditor to insist upon sale at a public auction at the end of that period. The debtor is only allowed to remain in possession if he pays a reasonable rental, and, if the court so requires, payments on the principal. The Supreme Court has held the present provision constitutional.²⁵⁵

In reference to the approval of a plan section 77 differs materially from the other three sections. It provides that the plan be submitted to the Interstate Commerce Commission before it may be submitted to the security holders for their approval. If the Interstate Commerce Commission disapproves, it can refuse to certify the plan to the court, and may, in addition, certify a plan of its own to the court. If a plan is certified, the court may then either approve or disapprove that plan. If the court approves, the Commission then submits the plan to the security holders. In the ordinary case a two-thirds majority in amount of those voting in each class of security holders and of affected stockholders is required, but if the plan fails to secure the necessary majority, it may nevertheless be confirmed by the court if the court finds that the plan treats fairly those who have rejected it, and that the rejection was not reasonably justified. Section 77B follows sections 74 and 75 in requiring submission to the security holders before the court has passed upon the plan and does not involve the use of any such agency as the Interstate Commerce Commission. Further, the assents required are two-thirds of the allowed claims of each class of security holder, and a majority in amount of each class of stockholder rather than, as under section 77, a stated majority of votes actually cast. If the necessary assents have been obtained the court may then confirm the plan if it finds it to be fair.

Thus in contradistinction to sections 74 and 75, sections 77 and 77B both employ class voting. Neither section is very specific as to how the classification of claims is to be made, although section 77 does state that no separate class shall be made unless there is a substantial difference.

²⁵⁴ *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935).

²⁵⁵ *Wright v. Vinton Branch of Mountain Trust Bank of Roanoke, Va.*, 57 S.Ct. 556 (1937), commented on in 32 Ill. L. Rev. 239 (1937), 35 Mich. L. Rev. 1130 (1937), 22 Minn. L. Rev. 102 (1937).

Four criteria for the division into classes have been suggested: the legal rights of the creditors as in an equity receivership, the rights in bankruptcy as on liquidation, the economic status of the claims, and the treatment given the claims under the proposed plan of reorganization.²⁵⁶ Under section 77B it has been said that those creditors who agreed to take new securities in a plan of reorganization and did so before the 77B proceedings began must be treated as a separate class for the purpose of voting.²⁵⁷ Section 77 differs from the other sections in requiring its stated majority of votes on a basis of claims actually voting as distinguished from the allowed claims. The trustee under the indenture is expressly authorized to file claims for the bondholders under section 77. There is no legislation to that effect under the other section, but under section 77B it has been held that the trustee may file, although he may not vote in the place of the bondholders where there is no express authorization to that effect in the indenture.²⁵⁸

Both 77 and 77B have provisions, not present at all in sections 74 and 75, whereby it may be unnecessary to secure the assent to a particular class, although the general provisions allowing the court to confirm a plan without the necessary assents in sections 74, 75, (and 77 also), may have the same effect. Under sections 77B and 77 assents of stockholders need not be secured if the court has found the corporation to be insolvent, or that the interests of the stockholders will not be adversely affected by the plan. Section 77 adds "or if the debtor has by proper corporate action accepted the plan and the stockholders are bound by this acceptance." Under section 77B a plan may be confirmed with less than a majority of stockholder approvals if the plan calls for the sale of the property at not less than a fair upset price, or calls for the appraisal of the interest of stockholders and the payment in cash of either the value of their stock, or at the stockholder's election, of the value of the securities allotted to the stockholders under the plan, if any are allotted. This last provision thus enacts into statutory law as to stockholders, the dictum as to creditors in *Coriell v. White*.²⁵⁹ In addition a general provision allows confirmation without the consent of the majority of the stockholders if their equity is preserved "by such methods as will do substantial justice to such stockholders under and consistent with the circumstances of the

²⁵⁶ For the best discussion of the problem see Friendly, Some Comments on the Corporate Reorganization Act, 48 Harv. L. Rev. 39, 70 (1934).

²⁵⁷ *In re Nine North Church Street*, 82 F. (2d) 186 (C.C.A. 2d 1936).

²⁵⁸ *Matter of Allied Owners Corp.*, 74 F. (2d) 201 (C.C.A. 2d 1934).

²⁵⁹ 54 F. (2d) 255 (C.C.A. 2d 1931) discussed previously, see note 160 *supra*.

particular case." The similar provision under section 77 omits any mention of a sale at not less than an upset price, but provides for the payment in cash "of an amount not less than the value of their equity."

Sections 77 and 77B both allow confirmation of a plan without the necessary amount of creditor approvals. Under section 77 the commission must have found and the judge affirmed a finding that the interests of the class will not be materially affected, or have no value, or that the plan provides for payment in cash of not less than the value of their interests. Section 77B, in addition to the court's finding that the class will not be affected or that there is payment in full, allows the use of the upset price, and the *Coriell v. White* device, together with a general provision "by such method as will in the opinion of the judge, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection."

All four acts require a finding that the plan is fair or equitable and feasible. There has been some controversy as to whether the statutes thus enact the rule in the *Boyd* case; there is dictum both ways.²⁶⁰ At one time it was thought that no plan might be fair which excluded stockholders completely, but the Supreme Court has ruled otherwise.²⁶¹ The constitutionality of the provisions which allow confirmation of a plan without the approval of the required number of security holders remains in doubt. It may be that any plan which does not meet the approval of the required amount of senior lien holders will be adjudged unfair.²⁶²

Officers and Committees. All four acts provide for the appointment of an official who will generally supervise the debtor's affairs in connection with the reorganization proceedings. Section 74 makes the appointment of a receiver permissive; section 75 provides for the appointment of a conciliation commissioner for each county. He is to aid the farmer in the preparation of the necessary papers and to supervise the farming operations if the creditors request. Sections 77 and 77B provide for the appointment of a trustee to manage the property, to report on the plan to the court, and to prepare a list of the creditors. The appointment of the trustee is mandatory under section 77; discretionary under section 77B. Further, under section 77 the trustee is to be directed by the court to report charges of misconduct which may give the debtor a cause of action. In addition, the appointment of the trustee is subject to confirma-

²⁶⁰ *Matter of New York Railways Corp.*, 82 F. (2d) 739 (C.C.A. 2d 1936); *Downtown Investment Assn. v. Boston Metropolitan Buildings*, 81 F. (2d) 314 (C.C.A. 1st 1936).

²⁶¹ *In re 620 Church Street Bldg. Corporation*, 57 S.Ct. 88 (1936).

²⁶² *Tennessee Publishing Co. v. American Nat. Bank*, 57 S.Ct. 85 (1936).

tion by the Interstate Commerce Commission, and if the trustee appointed has had connections in an official capacity with the debtor during the past year, it is necessary to appoint another trustee who has not had such connections, unless the operating revenues of the road during the past year were less than \$1,000,000. Section 77, when it was first passed, required the court to select the trustees from a panel drawn up by the Interstate Commerce Commission. The present provision which gives the right of ratification is somewhat open to question in that it may be said to give judicial functions to the commission. Section 77B has no such limitations on the appointment of a trustee. The sections give the judge the power to have the receiver, conciliation commissioner, trustee or debtor prepare a list of security holders. The exercise of this power is apparently mandatory under sections 77 and 75, discretionary under section 77B, and mandatory under section 74 insofar as listing secured creditors and the 15 largest unsecured creditors is concerned. Section 77 also makes it the duty of anyone having information as to the addresses and names of the security holders to divulge such information. There is no similar provision under sections 77B and 74 and as a result the house of issue usually cannot be required to reveal its list of bondholders.²⁶³

Bondholders' committees are not mentioned under sections 74 and 75. They are treated differently under sections 77 and 77B. Section 77B recognizes the existence of these committees during the prior stages of the reorganization. Thus assents secured to a plan of reorganization prior to the 77B proceeding will be valid. Further, a plan of reorganization may not be proposed by any one other than the debtor under section 77B unless a certain number of assents have already been secured for it. The committee is to be compensated for work done towards the reorganization, although done prior to the filing of the petition. Under section 77, on the other hand, bondholders' committees with more than twenty-five depositors are prohibited, save with the special permission of the Interstate Commerce Commission. The commission is further authorized to make rules governing committees. One result of this is to give the Commission more effective control over the proceedings, but another result is to favor the large institutional investors²⁶⁴ who may join together effectively and still have not more than twenty-five depositors. Under sections 77 and 77B, the trustee is authorized to scrutinize and if necessary disregard provisions in deposit agreements. Section 77B in addition

²⁶³ Where the house of issue is the trustee it could be required.

²⁶⁴ The potential danger of doing this is pointed out in *Brandeis, Other People's Money* (1914).

authorizes the court to limit the claim filed by any committee member to the actual consideration paid therefor. This is somewhat similar to the power given under section 77B to limit the claim of an assignee of a partial rent claim to the actual consideration which he has paid.²⁶⁵

Jurisdiction. The jurisdiction given the bankruptcy court under all of the acts is extremely broad. Under section 74, the court has jurisdiction over property of the debtor even though it is in the possession of a receiver, state or federal, or of a trustee under a mortgage, unless a final decree has been entered. This power is implemented by the ability to stay proceedings by secured creditors. The act does not define what a final decree is, and apparently this is left to the state law to determine. Under section 75 the court has jurisdiction until the creditor has obtained a final deed to the property, the sale confirmed, or the period of redemption has expired. This is somewhat broader than under section 74.²⁶⁶ Sections 77 and 77B confer upon the court the powers of both a bankruptcy court and an "equity receivership court," but the powers granted as to jurisdiction are greater than possessed by either of these. The court is given jurisdiction over the debtor's property wherever located, and it is unnecessary to show that this property was in the debtor's actual or constructive possession at the time of filing of the petition. If it is clear that it is the debtor's property, then the court may deal summarily with that property. For the protection of its jurisdiction over the debtor's property the court may issue stay or turn-over orders. It may thus stay a non-judicial sale of collateral given by the debtor when the sale of collateral would increase the total indebtedness of the debtor and delay the reorganization.²⁶⁷ The court may also stay suits brought against the debtor, although it may be an abuse of discretion to do so when suit was begun before the petition was filed, and the plaintiff through the stay provisions will be deprived of his right to jury trial.²⁶⁸

In defense of its jurisdiction over the property, the court's process runs throughout the land. Section 77 is specific on the point; the inference

²⁶⁵ 77B (b) (10).

²⁶⁶ Under § 74, the bankruptcy court has no jurisdiction where a foreclosure decree has already been entered, even though the debtor still has a right of redemption. See *Matter of Sorenson*, 77 F. (2d) 166 (C.C.A. 2d 1935).

²⁶⁷ *Continental Illinois Nat. Bank and Trust Co. v. Chicago R.I. & Pac. Ry.*, 294 U.S. 648 (1935). On the wisdom of enjoining secured security see Howland, *The Enforcement of Secured Creditors' Claims Under 77 and 77B: A Functional Analysis*, 46 Yale L. J. 1109 (1937); Alley, *An Appraisal of Some Phases of the Corporate Reorganization Statutes*, 23 Va. L. Rev. 503 (1937).

²⁶⁸ *Foust v. Munson Steamship Lines*, 57 S.Ct. 90 (1936).

is clear that this is the case as well under section 77B. As a matter of fact there are provisions under the ordinary bankruptcy act which would have allowed such a construction, and prior to the enactment of the new reorganization sections, the clear trend was towards allowing such extended jurisdiction.²⁶⁹ Under ordinary bankruptcy, however, the court obtained jurisdiction only of the property in the possession of the debtor. If a third person was in possession of property under a claim of title, more than colorable, a plenary suit was necessary to gain possession of the property. When a plenary suit was brought, the bankruptcy court's jurisdiction was merely that of any federal district court, subject to certain stated exceptions.²⁷⁰ Under sections 77 and 77B, a plenary suit is unnecessary unless the title of the debtor, as distinguished from possession, is in real dispute.²⁷¹ But if a plenary suit is necessary, it would seem that the suit would be subject to the same rules governing a plenary suit in ordinary bankruptcy, and that the process of the court would be as limited as in other plenary suits, despite subdivision *a* of section 77 which, in general, allows process to run throughout the country.²⁷²

²⁶⁹ *In re Eckleaus*, 14 F. (2d) 471 (E.D. N.Y. 1926); *In re J. Small Shoe Co.*, 4 F. (2d) 618 (D. Conn. 1924). Note § 2 (15) of ordinary bankruptcy act.

²⁷⁰ Section 23(b) of the Bankruptcy Act provided: "Suits by the trustee shall be brought or prosecuted only in the courts where the bankrupt, whose estate is being administered by such trustee, might have brought or prosecuted them if proceedings in bankruptcy had not been instituted, unless by consent of the proposed defendant, except suits for the recovery of property under section sixty, subdivision b [to set aside preferential transfers or judgments made or obtained within 4 months]; section sixty-seven, subdivision e [to set aside fraudulent conveyances made within 4 months]; and section seventy, subdivision e [to set aside transfers voidable as to any creditor even though the transfer was made prior to the 4 months period]."

For good general discussion of jurisdiction see Ross, *Federal Jurisdiction in Suits by Trustees in Bankruptcy*, 20 Iowa L. Rev. 565 (1935); Gerdes, *Jurisdiction of the Court in Proceedings under Section 77B*, 4 Brooklyn L. Rev. 237 (1935); see also Wright, *Federal Jurisdiction in Suits by Trustees in Bankruptcy as Affected by the Consent of the Defendant Under Section 23 (b) of the Bankruptcy Act*, 18 Va. L. Rev. 510 (1932); Schumacher v. Beeler, 293 U.S. 367 (1934), approved in 21 Va. L. Rev. 698 (1935).

²⁷¹ See Gerdes, *Jurisdiction of the Court in Proceedings Under Section 77B*, 4 Brooklyn L. Rev. 237 (1935).

²⁷² *Bovay v. Byllsby*, 88 F. (2d) 990 (C.C.A. 5th 1937), where it was held that the trustee of the debtor corporation could not sue in the federal district court of Mississippi to recover property allegedly taken from the debtor corporation by defendants, residents of Illinois and Delaware; see also *U.S. v. Tacoma Oriental S.S. Co.*, 86 F. (2d) 363 (C.C.A. 9th 1936) for a similar limitation. While § 77 is explicit as to the extraterritorial service of process, § 77B is explicit as to the "exclusive jurisdiction" of the reorganization court. Where a plenary suit is required, it would seem that there might well be limits to both powers; these powers were given to assist the reorganization court control the entire reorganization proceedings in one court. But where the hardship on the defendants would be great, and the title of the debtor is itself in dispute, these powers, even though express, would seem limited.

Under subdivision (i) of both sections, there is an automatic turn-over provision where the property is in the hands of a receiver or trustee of a federal or state court. The Supreme Court has stated, however, that this provision is not operative where the receiver has been appointed as a part of foreclosure proceedings,²⁷³ and it has been held that where a trustee under a mortgage is in possession and has the legal title, the reorganization court may not compel the trustee to turn the property over to the reorganization trustees.²⁷⁴ This is contrary to an express provision of section 74, which is applicable when a trustee under a mortgage is in possession.²⁷⁵ If a reorganization plan were confirmed by the reorganization court, however, the claim under which the mortgage trustee holds may be considered paid, and his right to the property will then vanish.

The jurisdiction of the court under any of the sections in an *in personam* action outside the district is doubtful. It would seem that it should have no jurisdiction where the suit is not necessary to the protection of the debtor's property. Even with jurisdiction, where the inconvenience is great, it may be an abuse of discretion for the court to exercise its jurisdiction.²⁷⁶

Fees. Both 77 and 77B make provisions for the limitation of fees to be allowed to attorneys, reorganization managers, officers, depositaries and other parties in interest. Under section 77, the Commission fixes the maximum amount to be allowed, and the judge makes the allowance, whereas under section 77B the court fixes the reasonable allowance. Under both sections, a summary appeal is allowed to the proper Circuit Court of Appeals on the question of allowances. Section 77 specifically includes the fees of trustees under mortgage indentures; section 77B does not, and this may cause difficulty. Under subdivision (i) in both sections the court is authorized to make an order for the payment "of such reasonable administrative expenses and allowances in the prior proceedings as may be fixed by the court appointing such receiver or trustee." If the dictum of the Supreme Court that "prior proceedings" refers to prior general equity receiverships and not to equity receivers obtained as a part of a foreclosure bill, the power of the reorganization court to control

²⁷³ *Duparquet, Huot & Moneuse Co. v. Evans*, 297 U.S. 216 (1936).

²⁷⁴ *Tuttle v. Harris*, 297 U.S. 225 (1936).

²⁷⁵ 74(m).

²⁷⁶ See *Thomas v. Winslow*, 11 F. Supp. 839 (N.Y. 1935); *U.S. v. Tacoma Oriental S.S. Co.*, 86 F. (2d) 363 (C.C.A. 9th 1936); *Bovay v. Byllsby*, 88 F. (2d) 990 (C.C.A. 5th 1937). These courts did not talk in terms of "abuse of discretion." But a reconciliation between the *Thomas* case, where extraterritorial jurisdiction was good, and the *Tacoma* and *Bovay* cases, where it was not good, seems based on such a rationale. See also *In re Greyling Realty Co.*, 74 F. (2d) 734 (C.C.A. 2d 1935). The arguments are set forth in a note, 5 *Univ. Chi. L. Rev.* 139 (1937).

fees is somewhat hampered. There is apparently no other provision which grants the court power to control fees allowed receivers in prior foreclosure proceedings. But apparently the dictum is not to be followed.²⁷⁷

As to committees, section 77 is more strict in its fee provision than section 77B. Section 77 allows the court to grant committees actual and reasonable expenses, whereas section 77B allows, in addition, reasonable compensation. It is not clear, however, whether under section 77 the Commission and the court may pass upon the amount the committee collects as its fee from individual security holders.²⁷⁸ Subdivision (f) of section 77B apparently does give this power to the court. The lack of a reasonable compensation award under section 77 then may be based on the idea that it will be collected from the bondholders individually outside the jurisdiction of the court. This would be in line with a holding by the Supreme Court that the Commission could not control fees paid by individual security holders since that was a matter of private contract.²⁷⁹ If this is indeed the case, the effectiveness of section 77 is impaired. Under section 77B some courts have refused to allow any fees to committee members who have made a profit out of the buying and selling of claims.²⁸⁰

Summary. A comparison of the sections would indicate that section 74 is the weakest because of its inability to affect secured claims and the necessity to deposit cash to pay off prior claims. It utilizes an unworkable distinction between compositions and extensions, and insofar as compositions are concerned it apparently adopts the bankruptcy definition of provable claims, thus eliminating certain claims, such as tort claims not reduced to judgment, which ought to be provable if a complete readjustment is to be attained.^{280a} While it allows a plan to become binding on unsecured creditors when approved by a majority in number and amount, and upon secured creditors as well, when an extension is concerned, it contains no provision for class voting. It does not require the appoint-

²⁷⁷ See *Shulman v. Wilson-Sheridan Hotel Co.*, 57 S. Ct. 680 (1937), 47 Yale L. J. 262 (1937).

²⁷⁸ See *Friendly*, The 1935 Amendment of the Railroad Reorganization Act, 36 Col. L. Rev. 27, 41 (1936). This, of course, is not a matter of indifference; see *Rodgers and Groom*, Reorganization of Railroad Corporations under Section 77 of the Bankruptcy Act, 33 Col. L. Rev. 571, 587 (1933).

²⁷⁹ *United States v. Chicago, M. & St. P. R. Co.*, 282 U.S. 311 (1931).

²⁸⁰ *In re Paramount Publix Corp.*, C.C.A. 2d C.C.H. Dec. Par. 3987 (1936); *In re Republic Gas Corp.* S.D. N.Y., C.C.H. Par. 4104 (1936).

^{280a} See *Underlay*, Tort Claims in Receiverships and Reorganizations, 22 Iowa L. Rev. 60 (1936).

ment of a receiver, nor are the duties of a receiver clearly set forth. Further it provides no method for the control of committees.

Section 77 seems superior to section 77B in that it makes the appointment of a trustee mandatory and sets forth the qualifications of the trustee as well as the duty of the trustee to report charges of misconduct on which the debtor has a cause of action. It is superior in that it requires approval of a plan before security holders vote, thus insulating the Commission and the court from the temptation of weighing heavily on the result of the vote. On the other hand, neither it nor section 77B indicates on what basis the Commission and court are to determine the fairness of the plan. While section 77 seems an advance over section 77B in the control it exercises over committees, the attitude of section 77 on committees is ambiguous. It seems clear that the framers of the act weighed the advantages and disadvantages of committees and came to no decision.²⁸¹ Section 77 is an advance in the greater control which it gives the court over the lists of security holders. The jurisdiction of the court under both section 77 and section 77B remains to be clarified and is open to abuse. The dependence upon acts of bankruptcy or upon a pending bankruptcy or equity receivership proceeding has caused difficulty under section 77B because of the narrow construction as to what constitutes an equity receivership. The whole provision seems unnecessary. The dependence of both sections upon insolvency in the bankruptcy or equity sense, even on a debtor's petition, is actually more strict than the ordinary bankruptcy act where on a debtor's petition no insolvency need be proved. Neither act has solved some of the main problems of reorganization; both go a long way.²⁸²

²⁸¹ This is a problem like many other reorganization problems, where a rule of thumb applicable to all situations is inappropriate. Cf. the words of the court in *Jameson v. Guaranty Trust Co.*, 20 F. (2d) 808 (C.C.A. 7th 1927) where the court weighed objections to a plan of reorganization and was similarly bewildered.

²⁸² Non-statutory changes during the depression and the proposed federal legislations will be dealt with in a third article to be printed in the next issue of the *Review*.