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# REORGANIZATION PROCEDURE UNDER THE NEW CHANDLER ACT

HERMAN M. KNOELLER

## I.

### HISTORICAL FEATURES OF THE BANKRUPTCY ACT

THE general revision of the Bankruptcy Act or Amendatory Act of 1938 is commonly denominated the Chandler Act by reason of the fact that the Honorable Walter Chandler introduced the same in the House of Representatives. It was signed by the President on June 22, 1938, and became effective by its own terms on September 22, 1938. It embodies the new social economic concept of reorganization and the rehabilitation of the debtor and his business as a going concern, instead of the liquidation, distribution, and stoppage of business with the consequent loss to the debtor, creditors, employees, and the public generally.

The historical commentary of the Honorable George Johnson, former United States District Judge of the Northern District of Illinois, contained in the 1938 Pocket Supplement of the United States Code Annotated is so concise yet complete and illuminating as to warrant a full quotation. Thus, it is stated by this learned judge and author:

“The first Act of Congress looking toward the establishment of ‘uniform laws on the subject of bankruptcies,’ authorized by Article 1, Sec. 8, of the Constitution, was enacted in 1800, and embodied the conception of the English system, in force in the colonies at the time of the revolution, that a bankrupt debtor was dishonest. Evidencing an intent of the framers of the Constitution that Congress should exercise that power only to coerce uniformity in the States, that Act was repealed in 1803. The States laws on insolvent debtors sufficed until 1841, when the second general Bankruptcy Act was passed as a result of the commercial casualties of the Van Buren ‘economic revulsion,’ historically known as the panic of 1837. Following the lead of the reforms in England the second Bankruptcy Act adopted the theory that a debtor might be honest but unfortunate and that such debtors should, on conditions imposed, be discharged of their obligations so as to be free to pursue future activities not fettered by burdensome debts. The life of that Act was two years. From the date of its repeal in 1843, for twenty-four years, the State Insolvency Laws were in effect, their operation having been merely suspended during the period when the National Bankruptcy Act was in force and then only as to those who could, without their consent, be made subject to the provisions of the Bankruptcy Statute.

"Following the civil war, and the economic disturbances and State Moratorium Laws occasioned thereby, Congress passed the third general Bankruptcy Act of 1867, which was materially amended in 1874, following the panic of 1873, but which was repealed in 1878. The 1874 amendment was occasioned by the widespread commercial frauds.

"For twenty years after the repeal in 1878 the nation was again without a general bankruptcy system. Following the 1893 panic the National Bankruptcy Act of 1898 was enacted. Amendments in 1903, 1906, 1910, 1915, 1916, 1917, 1922, and 1926, expanded, modified, and built up a complete but complicated system of bankruptcy administration, which, like comparative systems, recognized two classes of debtors, the honest and unfortunate, and the dishonest ones. Punishments and impediments to discharge were embodied for the latter class and gradually the theory of compositions and creditor control gained a commanding position in the system.

"Following the 1929 'economic dislocation,' the amendments of 1933, 1934, and 1935, introduced the new philosophy of rehabilitation of honest debtors as the best means of serving the social and commercial needs of the nation, drastic liquidations having been found by experience to be destructive of economic balances by dumping on an already disturbed market, bankrupt stocks of goods at bankrupt prices.

"Remotely, the Amendatory Act of 1938 is the result of agitation commenced in 1929. The relaxation in the severity of creditors' remedies and the favorable policy to debtors led to numerous cases of deplorable bankruptcy frauds reflecting unfavorably upon the administration of bankruptcy estates. Under a presidential order of July 29, 1930, a nation-wide survey was made by the Department of Justice. The defects of the 1898 Act and recommendations as to measures to correct the evils were embodied in a comprehensive report of December 5, 1931.

"The extent of creditor control in bankruptcy administration, and arrangements beyond the control of the courts have, in every system, proved difficult to deal with and have caused much fluctuating and inconsistent legislation. The two questions are intermixed and throw much light on the causes of dissatisfaction with many of the features of the 1898 Act, and its amendments. The debtors' relief amendments, in extending leniency to debtors, encouraged deplorable abuses and left many unforeseen contingencies unprovided for. To clarify the confusion arising from conflicting provisions, to add omitted essentials, to perfect the system, strengthen the processes of administration, and modernize the law in accordance with a pronounced public policy for the enforcement of a greater degree of commercial honesty, the general revision was made."

The newly revised 1898 Bankruptcy Act now consists of fourteen chapters. They are as follows:

1. The first seven chapters relate to general bankruptcy.
2. Chapter 8 relates primarily to Agricultural Compositions and Extensions and also Reorganizations of railroads engaged in interstate commerce.
3. Chapter 9 pertains to Debt Readjustments for insolvent public debtors, such as municipalities and taxing districts.
4. Chapter 10 supersedes Sec. 77B of the old Act and pertains to Corporate Reorganizations involving both secured and unsecured debts. This chapter is divided into sixteen articles, and sections numbered 101 to 276, inclusive.
5. Chapter 11 supplants Sec. 74 of the old Act and provides for Arrangements primarily for individuals and partnerships and also for corporations if all the debts to be adjusted are unsecured.
6. Chapter 12 relates to Real Property Arrangements and is intended to provide relief to individuals or partnerships in the adjustments of debts secured by real estate bonds, mortgages, or chattels real.
7. Chapter 13 was enacted to relieve wage earners (an individual who works for wages, salary, or hire at a rate of compensation which, when added to all his other income, does not exceed \$3,600.00) from harassments of garnishment and attachment proceedings, and employers from trouble and expense in connection therewith. Debts secured by real estate cannot be adjusted under this scheme, but a wage earner may now adjust his debts by payments periodically out of his future earnings which are sequestered by the Court and made available for equitable distribution to creditors.
8. Chapter 14 relates to Maritime Commission Liens and the power of the Court to appoint the United States Maritime Commission as trustee to operate vessels between the United States and any foreign country.

Now considering Chapter 10 relating to corporate reorganization, it may be said that the most basic improvements in practice and procedure are:

1. The enlargement of the creditors' control in corporate reorganization matters.
2. The requirement that the court appoint disinterested trustees and disinterested counsel for such trustees in the administration of any estate involving fixed and non-contingent indebtedness of \$250,000.00 or more (Secs. 156, 158).
3. The requirement that the Judge shall refer the plans of reorganization to the Securities & Exchange Commission for its examina-

tion and advisory report, where the scheduled indebtedness of the corporation exceeds \$3,000,000.00; in smaller estates, it is within the discretion of the Court whether the plan should be submitted to the Securities & Exchange Commission (Sec. 172).

Concerning the effective date of Chapter 10, it is enacted that the provisions of the amendatory act shall apply to all 77B proceedings under the old Act if the petition in such proceedings was approved within three months before the effective date (September 22, 1938) of the Chandler Act and also to such other 77B proceedings where the petition was approved more than three months before the effective date of the Chandler Act to the extent that the Judge shall deem the application practicable.

## II.

### JURISDICTION

As to the place of filing petitions, Chapter 10 has imposed practical limitations upon "jurisdiction shopping" by deleting the provision of Sec. 77B which made the state of incorporation as such a permissible venue, and now making the proper venue the Court within whose territorial jurisdiction there is to be found the corporation's principal place of business or its principal assets for the preceding six months or for a longer portion of the preceding six months than in any other jurisdiction (Sec. 128).

After a petition has been filed, the Judge may transfer a proceeding to a Court of Bankruptcy in any other district regardless of the location of the principal assets of the debtor or its principal place of business if the interest of the parties will be best served by such transfer (Sec. 118).

The Court in which the petition is filed has the exclusive jurisdiction of the debtor and its property wherever located and may issue temporary restraining orders in respect to pending bankruptcy proceedings, mortgage lien foreclosures, or equity receiverships (Sec. 113), and upon the approval of the petition the jurisdiction of the Court is the same as in bankruptcy proceedings upon adjudication (Sec. 114), and the Court may exercise all powers which a Court of the United States would have if it had appointed a receiver in equity of the property of the debtor on the grounds of insolvency or inability to meet its debts as they mature (Sec. 115).

## III.

### CORPORATION SUBJECT TO THE ACT

The new Act provides that the term "corporation" under Chapter 10 shall mean a corporation which could be adjudged a bankrupt under

the Act and any railroad corporation except a railroad corporation engaged in interstate commerce which could file a petition under Sec. 77 of the Act (Sec. 106). From this we can conclude that a voluntary petition for reorganization under Chapter 10 may be filed by any corporation except:

1. A municipal corporation.
2. A railroad corporation which could file a petition under Sec. 77 of the Act.
3. An insurance corporation.
4. A banking corporation (4a).

We may likewise conclude an involuntary petition for corporate reorganization under Chapter 10 may be filed against any moneyed business or commercial corporation except:

1. A building and loan association.
2. A municipal corporation.
3. A railroad corporation.
4. An insurance corporation.
5. A banking corporation (4b).

#### IV.

#### PLEADING AND PRACTICE

#### UNDER CHAPTER 10

##### A. *Generally*

The nature of proceedings in the United States District Court for the reorganization of a corporation and the approval of a proposed plan has been held not to be so formal in nature as to warrant the application of the strict rules of pleading. These cases are recognized as "proceedings in bankruptcy" instead of "controversies."<sup>1</sup>

It has also been held that the Conformity Act does not have any application to proceedings for reorganization of a debtor in Federal Court, for jurisdiction over the whole matter of the estate of the bankrupt or debtor, including the claims against it, is in the Bankruptcy Court and governed by its practice and procedure.<sup>2</sup>

The new federal rules of civil procedure, effective September 1, 1938, also expressly provide that they do not apply to proceedings in bankruptcy (Rule 81a).

Thus, it seems quite clear that the primary source of authority for pleading and practice for corporate reorganization in Bankruptcy Court must be found within Chapter 10 thereof and such other law as may be incorporated therein by reference.

<sup>1</sup> *Bitker v. Hotel Duluth*, 83 F. (2d) 721 (C.C.A. 8th, 1936).

<sup>2</sup> *In re Pilsener Brewery*, 79 F. (2d) 63 (C.C.A. 9th, 1935).

*B. Resolution of the Board of Directors*

1. The Board of Directors of a corporation should authorize the filing of a petition for voluntary reorganization under Chapter 10 of the Bankruptcy Act, and a certified copy of this resolution should be signed by the president of the corporation and attached to the petition as "Exhibit A."

2. The form of this resolution is optional and may be conveniently drawn as follows:

WHEREAS, this corporation is unable to pay its debts as they mature and it has been advised by counsel that it is necessary for the corporation to reorganize and that it is advisable to proceed under the acts of Congress relating to bankruptcy and more particularly Chapter 10 of the Revised Bankruptcy Act of 1938,

THEREFORE, BE IT RESOLVED that this corporation is authorized to file a petition for reorganization under the acts of Congress relating to bankruptcy and more particularly Chapter 10 of the Revised Bankruptcy Act of 1938.

RESOLVED, that the President of this corporation is hereby authorized to execute petitions and other documents and to take or to cause to be taken such proceedings as may be desirable or necessary to secure to this corporation any and all relief that it may be entitled to under the Revised Bankruptcy Act of 1938 and particularly Chapter 10 thereof, and that counsel be employed to carry out the provisions of this resolution.

*C. Financial statement*

In view of the fact that the petition requires an allegation as to the assets, liabilities, capital stock, and financial condition of the corporation (Sec. 130), it is usual and customary to attach to the voluntary petition a financial statement marked "Exhibit B." The financial statement should group the assets into fixed assets, permanent sinking funds, current assets, and deferred charges. The liabilities should likewise be grouped into fixed liabilities, current liabilities, contingent liabilities, deferred credits, and capital. Capital should be further divided into capital stock of common, preferred, and treasury shares and surplus. There should also be attached a statement of the surplus or deficit account showing the balance at the commencement of the accounting year, the profit or loss sustained during the period, and the balance of the surplus or deficit at the close of the accounting period or at the time the petition is filed.

*D. Petition*

Of course, in case of voluntary proceedings for reorganization, the corporation by its duly authorized officers files the petition for reorganization, which is usually signed and verified by the president.

In case of involuntary proceedings, three or more creditors having claims liquidated in amount and not contingent as to liability against the corporation or its property (thus, mortgagees of corporation property held as security under a trust deed where the corporation in possession did not assume the debt) aggregating \$5,000.00 (without first deducting the value of their securities) or more, may file a petition; or an indenture trustee, where the securities outstanding under the indenture are liquidated as to amount and not contingent as to liability, may, if no other petition by or against the corporation is pending, file a petition for reorganization (Sec. 126).

The necessary allegations of a voluntary petition are:

1. That the corporation is insolvent and unable to pay its debts as they mature.

2. The applicable jurisdictional facts requisite under the Act (corporate existence and principal place of business or property of the corporation during the six month period immediately preceding the filing of the petition, and the eligibility to file a petition under Chapter 10).

3. The nature of the corporation's business.

4. The assets, liabilities, capital stock, and financial condition of the corporation.

5. The nature of all pending proceedings affecting the property of the corporation known to the petitioner or petitioners, and the courts in which they are pending.

6. The status of any plan of reorganization, readjustment, or liquidation affecting the property of the corporation pending either in connection with or without any judicial proceeding.

7. The specific facts showing the need for relief under Chapter 10 and why adequate relief cannot be obtained under Chapter 11 of the Act (dealing with arrangements applicable to persons having no secured creditors).

8. The desire of the petitioner that a plan be effected (Sec. 130).

The necessary allegations of an involuntary petition are:

1. The same allegations as are required in a voluntary petition, plus

2. That the corporation was adjudged a bankrupt in a pending bankruptcy proceeding, or

3. That a receiver or trustee has been appointed for or has taken charge of all or the greater portion of the corporation's property in a pending equity proceeding, or

4. That an indenture trustee or mortgagee by reason of default is in possession of all or the greater portion of the corporation's property, or



5. That a proceeding to foreclose a mortgage or enforce a lien against all or the greater portion of the corporation's property is pending, or

6. That the corporation has committed an act of bankruptcy within four months prior to the filing of the petition.

When drafting the petition, care should be taken to make one original and at least six copies. The original petition is filed with the Clerk of the United States District Court as part of the record of the case, one copy is retained by the Clerk for general reference purposes, another copy is sent to the Secretary of the United States Treasury at Washington, D. C., another copy is sent to the Securities & Exchange Commission at Washington, D. C., another copy is sent to the Regional Office of the Securities & Exchange Commission at Chicago, Illinois, and (in case of involuntary proceedings) a copy is served by the United States Marshal upon the debtor, together with a subpoena (Clerk's form No. 5 issued by the Clerk under seal of the Court) returnable within ten days, and at least one general office copy should be retained by the attorney who filed the petition.

*Initial cost*—When the petition is filed, a payment to the Clerk of a filing fee of \$100.00 is necessary, unless a prior bankruptcy proceeding is pending, in which case the Clerk's fee is \$70.00; also, there is the usual and customary travel and service fee that must be paid to the United States marshal.

From the time the petition is filed the estate is in *custodia legis*, but the mere filing of the petition does not put the estate in the process of administration, but an approval of the petition does.

#### E. *Answer*

In case of involuntary proceedings, within ten days after the service of the subpoena and a copy of the petition the debtor may file an answer setting forth admissions, denials, confessions, and avoidance, or any affirmative defenses it may have (Sec. 136); also, any creditor, indenture trustee, and, if the debtor is not insolvent, any stockholder may answer the involuntary petition by filing a controverting answer, but the same must be filed before the date set for the first hearing which may not be less than thirty nor more than sixty days after the approval of the petition (Secs. 137, 161).

Whether an answer is or is not filed, the Judge must determine without a jury the issues raised by the answer and the question whether the petition is filed in good faith and complies with all the requirements of Chapter 10 of the Act.

#### F. *Order of approval and good faith*

In case of voluntary proceedings, upon the filing of a petition by the debtor, the Judge enters an order approving the same if satisfied that it complies with the statute and was filed in good faith, or may dismiss it if not so satisfied (Sec. 141).

In case of involuntary proceedings, if within the statutory period of time no answer is filed by the debtor or if the answer does not controvert material allegations, the Judge may enter an order approving the petition or dismissing it, depending upon whether or not in his opinion it was properly filed under the Act and in good faith (Sec. 142).

If an answer is filed by the debtor or any other party entitled to file the same within the statutory period of time and controverts any material allegation, the Judge is required to determine the issues summarily and as soon as may be without the intervention of a jury (Secs. 143, 144), and such determination is final and conclusive, both as to the fact and as to the jurisdiction of the Court, where notice has been given to the parties in interest (Secs. 145, 149).

*Test of good faith*—The Act does not define affirmatively the term "good faith" but does so negatively (Sec. 148) by providing that a petition is not filed in good faith if any of the following facts appear:

1. The petitioning creditors have acquired their claims for the purpose of filing the petition.
2. Adequate relief is obtainable under Chapter 11 relating to the adjustment or arrangements of unsecured claims.
3. It is unreasonable to expect that a plan of reorganization can be effected.
4. A prior proceeding is pending in any Court, and the best interests of the parties can be there subserved.

Under Sec. 77B of the old Act, it was held that a petition for corporate reorganization, whether voluntary or involuntary, to have been filed in good faith as required by the Act must have been filed not for the purpose of harassing the debtor or of hindering and delaying creditors, but with the purpose and reasonable belief that the debtor was in a position to conform to the requirements and to obtain the benefits of the Act.<sup>3</sup>

Unless otherwise ordered, an order approving the petition operates as a stay of a prior pending bankruptcy, mortgage foreclosure, equity receivership proceeding, or any action to enforce a lien against the debtor's property (Sec. 148) and subjects the debtor and its property wherever located to the exclusive jurisdiction of the Court entering the order (Sec. 111).

<sup>3</sup>R. L. Witters Associates, Inc. v. Ebsary Gypsum Co. Inc., 93 F. (2d) 746 (C.C.A. 5th, 1938).

The order of approval is a judicial determination embodying both findings of fact and conclusions of law, which may be vacated upon proper showing made and is appealable.<sup>4</sup>

*Burden of proof*—The petitioners for reorganization of a corporation have the burden to establish their legal standing to institute the proceeding, their good faith, and a need for reorganization.<sup>5</sup>

*General contents of the order*—1. An approval of the petition and a finding that it has been properly filed under the Act and in good faith.

2. The appointment of a trustee upon the filing of his bond within five days for a specified amount to be approved by the Court, or that the debtor is continued in possession and permitted to operate its business pending further order of the Court.

3. Authorizing the trustee:

a. To prepare and file within a definite time a list of creditors of each class, showing the amount, character of claims, name and address of each creditor, and a list of the debtor's stockholders, their names and addresses.

b. To investigate forthwith, if and when directed by the Court, the acts, conduct, property, liabilities, and financial condition of the debtor, the operation of its business, and the desirability of the continuance thereof, and any other matter relevant to the proceeding or to the formulation of the plan, and report thereon to the Judge.

c. To examine, if and when directed by the Court, the directors and officers of the debtor and any other witnesses, concerning the foregoing matters or any of them.

d. To report to the Judge any facts ascertained by him pertaining to fraud, misconduct, mismanagement, and irregularities, and to any causes of action available to the estate.

e. To employ, subject to the approval of the Judge, such person or persons as the Judge may deem necessary for the purpose of assisting the trustee in performing the duties imposed upon him.

f. At the earliest date practicable, to prepare and submit a brief statement of his investigation of the property, liabilities, and financial condition of the debtor, the operation of its business, and the desirability of the continuance thereof to the creditors, stockholders, indenture trustees, the Securities &

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<sup>4</sup> 15 FLETCHER, CYCLOPEDIA ON CORPORATIONS 620, 621.

<sup>5</sup> In re Hudson Coal Co., 22 F. Supp. 768 (M.D. Pa. 1938).

Exchange Commission, and such other person as the Court may designate.

g. Within a definite period of time, to give notice to the debtor, its creditors, and stockholders that they may submit to him suggestions for the formulation of a plan or proposals in the form of a plan.

h. Within a definite period of time, to prepare and mail a proof of claim to the debtor and each creditor and stockholder.

i. Within a definite period of time, to prepare and file a plan of reorganization or report his reasons why a plan cannot be effected.

4. The trustee or, if the debtor is continued in possession, the debtor, is usually ordered to give notice to the creditors, stockholders, indenture trustees, the Securities & Exchange Commission, and the Secretary of the United States Treasury by mailing a copy thereof not later than a definite date and by publication of the same at least once a week for two successive weeks in a newspaper of general circulation that a hearing will be had by the Court at a definite time (not less than thirty nor more than sixty days after the approval of the petition) for the purpose of hearing any objections whether the appointed trustee should be retained or whether the debtor should be continued in possession and for the making of such other orders in the premises as may be necessary or proper.

5. That proofs of claim be filed with the Clerk on or before a definite date (usually sixty days) by all creditors and stockholders of the debtor.

6. The time and place is definitely set for a hearing before the Court for the purpose of considering the plan of reorganization to be submitted by the trustee or his report why a plan cannot be effected or any objection thereto or amendments to the plan as may be proposed by the debtor, its creditors, its stockholders, indenture trustee, etc., and the trustee is ordered to mail notices of the hearing to all parties including the Securities & Exchange Commission and the Secretary of the United States Treasury within a definite period of time.

7. Finally, a restraining order is entered against any and all parties from interfering, attaching, garnishing, levying upon, or disturbing the property in possession of the debtor or commencing any judicial proceedings to enforce any liens or suits except with the permission of the Court, and the Court specifically reserves full right and jurisdiction to make future orders as it may deem proper in respect to the debtor or the trustee, the plan of reorganization, filing schedules, claims, division of creditors into classes, etc.

The debtor is continued in possession purely in the discretion of the Court where the indebtedness amounts to less than \$250,000.00 (Sec. 156), but if the indebtedness equals or exceeds \$250,000.00 the Court must appoint a disinterested trustee (Sec. 156). Where the debtor is continued in possession, the Judge may at any time appoint a disinterested person as an examiner to prepare and file a plan and to perform the duties imposed upon the trustee. Furthermore, where the indebtedness of the debtor is less than \$250,000.00, the Judge may at any time terminate the appointment of a trustee and restore the debtor to the possession of its property, or, if the debtor has been continued in possession, terminate its possession and appoint a trustee (Sec. 159). When the debtor is continued in possession, it is vested with all the right and title and subject to all the duties and powers of a trustee appointed by the Court (Sec. 188). Furthermore, when the debtor is continued in possession, it must prepare the schedules of its property, the names and addresses of its creditors and stockholders, and the amounts and character of their claims (Sec. 163).

When a trustee is appointed, not only must he be disinterested, but also his attorney must likewise be a disinterested party (Secs. 156, 157). The trustee and/or his attorney is not deemed a disinterested party if:

1. He is a creditor or stockholder of the debtor.
2. He is or was an underwriter of any of the outstanding securities of the debtor within five years prior to the filing of the petition.
3. He is or was within two years prior to the filing of the petition a director, officer, employee, underwriter, or attorney for the debtor or its underwriter.
4. He has an interest materially adverse to the interest of any class of creditors or stockholders (Sec. 158).

When a trustee is appointed, he is required to prepare a list of the creditors and shareholders of the debtor, their addresses, claims, and stock held by each, and file the list with the Clerk of the District Court (Secs. 163, 164). The Court has exclusive jurisdictional control of the lists so prepared, whether by the debtor or by the trustee appointed (Sec. 166). The Court may also direct copies of the summaries of annual reports and may direct copies of the summaries of other reports to be mailed by the trustee to the creditors, stockholders, and indenture trustees, and may also direct the publication of any summaries of any such reports in a public newspaper (Sec. 190). Upon his appointment and qualification, the trustee under Chapter 10 of the Act is vested with the title to the debtor's property as of the date of the filing of

the petition (Sec. 70a), instead of the date of the adjudication or of the approval of the petition; the trustee is given the right to immediate possession of the debtor's property in the hands of any receiver or trustee appointed in any prior Court proceedings (Secs. 256, 257).

*G. Notice of hearing and affidavit of publication*

After the approval of the petition and the entry of the above order, a notice is given to the printer for publication; it contains substantially the following:

1. Title of the Court, case, and case number.
2. That pursuant to an order entered in the above entitled matter by the above named Court, notice is hereby given that a hearing will be held by the said Court on the\_\_\_\_\_day of\_\_\_\_\_, at\_\_\_\_\_o'clock in the Court Room of the United States District Court for the Eastern District of Wisconsin in the Government Building, to determine whether the debtor shall be allowed to remain in possession or the appointment of a trustee.

Dated at Milwaukee, this\_\_\_\_\_day of\_\_\_\_\_.

A.B.C. CORPORATION, Debtor.

By\_\_\_\_\_

President.

*H. Principal hearings*

The principal hearings before the Court on the reorganization of a debtor and in respect to which all parties are entitled to notice are as follows:

1. In case of involuntary proceedings, the first primary hearing is on the petition for determination of the question whether or not the petition complies with Chapter 10 of the Act and is filed in good faith and for the appointment of a trustee where the indebtedness of the corporation is \$250,000.00 or more (Sec. 156).

2. The second principal hearing in case of involuntary proceedings and the first hearing in case of voluntary proceedings is on any objections to the retention of the debtor in possession with or without an examiner or the retention of the trustee previously appointed.

3. The third principal hearing is on the trustee's report that no plans of reorganization are possible of formulation or for the consideration of a proposed plan and whether the same is fair, equitable, and feasible and proposed in good faith. At this time, objections to the proposed plan, amendments, and even new plans may be considered (Sec. 169). After the order of approval of a plan of reorganization and the fixing of the time when creditors and stockholders may accept a copy of the plan, a summary thereof, and a copy of the Judge's opinion of approval, the Securities & Exchange Commission report

on the plan are sent to creditors and stockholders, then and only then solicitation for acceptances of the plan may be made without consent of the Court (Secs. 175, 176). Where the debtor is continued in possession, a plan may be filed, within the time fixed by the Judge, by the debtor, any creditor, or indenture trustee, an examiner appointed by the Court, and also when the debtor is not found insolvent, by any stockholder (Sec. 170). After the hearing on the proposed plan of reorganization but before the approval thereof, the Judge must, if the indebtedness of the debtor exceeds \$3,000,000.00, submit the plan to the Securities & Exchange Commission for examination and report, which report is advisory; if the indebtedness does not exceed the mentioned figure, it is discretionary with the Court to submit it to the Securities & Exchange Commission (Sec. 172); no order of approval can be entered before the report of the Securities & Exchange Commission is filed or notification that it will not file a report or until after the expiration of a reasonable length of time for filing of such report as the Judge has fixed (Sec. 173). After the hearing and the submission of the plan to the Securities & Exchange Commission and the receipt of its report thereon, the Judge is required to enter an order approving the plan if the same complies with Sec. 216 (covering specific provisions that the plan must contain) and is fair, equitable, and feasible; whereupon, a time is fixed within which creditors and stockholders affected may accept the same (Sec. 174). The order of the Judge approving the plan does not affect the right of the debtor or any creditor, indenture trustee, or stockholder to object to the confirmation of the plan (Sec. 180).

4. The fourth principal hearing is held for the confirmation of the plan or disposition of objections thereto or for an order of dismissal or liquidation of the debtor. After the plan has been accepted in writing, filed in Court by or on behalf of the creditors holding two-thirds of the amount of the claims filed and allowed of each class and also, if the debtor has not been found insolvent, by or on behalf of the stockholders holding a majority of the stock of which proofs have been filed and allowed of each class, exclusive of those creditors and stockholders not affected by the plan or whose claims have been disqualified or for whom payment and protection have been provided, the Judge is required to fix a hearing for the consideration of the confirmation of the plan and such objections as may be made to the confirmation; notice of this hearing must be given to the debtor, the creditors, stockholders, indenture trustees, the Secretary of the Treasury, the Securities & Exchange Commission, and such other persons as the Judge may direct (Sec. 179). The Act specifically provides that the Judge shall confirm the plan (Sec. 221) if satisfied:

- a. It complies with the provisions of the law and Chapter 10 of the Act.
- b. It is fair, equitable, and feasible.
- c. The proposal of the plan and its acceptance are in good faith and not obtained by means of promises forbidden by the Act.
- d. All payments made or promised for services and costs and expenses of the reorganization which have been fully disclosed to the Judge are reasonable or if fixed after confirmation will be subject to the approval of the Judge.
- e. The identity, qualifications, and affiliations of the directors, officers, or voting trustees upon consummation of the plan have been fully disclosed and their appointment is equitable and compatible with the interest of all parties. The plan accepted may be altered or modified with the approval of the Judge where the alteration or modification does not materially and adversely affect the interest of creditors or stockholders; if it does, a notice and hearing on the modifications must be had (Sec. 222). Upon the confirmation of the plan, its provisions are binding upon the debtor and all parties interested, and the debtor is directed to comply with its provisions and take all action necessary to carry out the plan, including, in case of a public utility corporation, the procuring of authorization, approval, or consent of each commission having regulatory jurisdiction over the debtor.

Where there is a failure to propose a plan, or insufficient acceptances have been received to the proposed plan, or if the plan is not confirmed or approved, then a hearing is had to consider the final report of the trustee and the question whether an order of dismissal should be entered or an adjudication that the debtor is a bankrupt and direction that bankruptcy be proceeded with pursuant to the provisions of the Act. If a dismissal of the proceedings and/or a direction for bankruptcy is entered, the Judge enters a final decree discharging the trustee and closing the estate subject to the payment of reasonable costs and expenses connected with the proceedings (Secs. 237, 259).

5. The fifth principal hearing, which is usually after the confirmation of the plan or order of dismissal or bankruptcy, is to consider the application by parties in interest and their attorneys for compensation for services rendered and reimbursement for expenses incurred. Notice of the above hearing must be given to the applicant, the trustee, the debtor, the creditors, the stockholders, the indenture trustees, the Securities & Exchange Commission, and such other persons as the Judge may direct (Sec. 247). It is clear from a reading of the new



Act that allowances are spread among a larger group of persons than under Sec. 77B of the old Act. The costs and expenses for which allowances may be made may be incurred in the proceedings in connection with the administration of the estate, in connection with the plan approved by the Judge, even though not eventually accepted by the creditors or confirmed by the Judge, or in connection with the submission of suggestions for a plan or objections thereto (Secs. 241, 242, 243). The statutory rule now is that in fixing any allowances the Judge is required to give consideration only to the services which contributed to the plan confirmed, or to the refusal of confirmation of the plan, or which were beneficial in the administration of the estate, and to the proper costs and expenses incidental thereto (Sec. 243). Every applicant for an allowance must, in addition to the usual affidavit against fee splitting, file with the Court a statement under oath showing what claims against, or stock of, the debtor he purchased, acquired, or transferred after the initiation of the proceedings, and if such acts have occurred without the consent of the Court, no allowance for compensation for services rendered nor even for reimbursement of expenses may be allowed him (Sec. 249).

6. The sixth principal hearing relates to the execution and accomplishment of the confirmed plan of reorganization and for a final decree. The debtor, pursuant to the order of confirmation, files a report of the complete execution and accomplishment of the confirmed plan of reorganization showing what new corporations have been organized, the disposition of claims, costs of administration, provisions for stockholders and creditors of the debtor corporation. The report is usually attached to a petition for the entry of an order approving the report, finding and decreeing that the plan of reorganization has been fully and legally executed, accomplished, and consummated, discharging the debtor from all its debts, claims, and liabilities, excepting such debts as are by law or the plan of reorganization excepted from a discharge, restraining and enjoining all creditors and stockholders from pursuing or commencing any suits at law or in equity against the new corporation or any of its property on account of any claim which said creditor or stockholder may have had against the debtor, except such liabilities and claims as the new corporation expressly assumed or agreed to pay pursuant to the terms and provisions of the plan of reorganization, and terminating and finally closing the corporate reorganization proceedings in the said Court properly entitled and case numbered. If there be no objections to the report or the entry of the final decree, an order is accordingly made; otherwise, a hearing is had upon any objections filed and a final disposition made by the Court.

7. *Sundry hearings*—In the course of the proceedings there may be many other special hearings, such as:

- a. Petitions for intervention.
- b. Reclamation petitions.
- c. Petitions for withdrawal of acceptances.
- d. Petitions for stays or extensions.
- e. Petitions for an order setting the manner and time for proving claims.
- f. Petitions for an order classifying claims.
- g. Petitions for an order of insolvency.
- h. Petitions for an order for appraisal.
- i. Petitions for an order to scrutinize deposit agreements or disqualify certain claims.
- j. Petitions for an order requiring the debtor to report, execute, or consummate the plan.

### *I. Representation*

1. The debtor, the indenture trustee, and any creditor or stockholder has the right to be heard in all matters arising in a proceeding under Chapter 10, and the Judge for cause shown may permit a labor union or employees' association to be heard on the economic soundness of a plan of reorganization (Sec. 206). The Act specifically provides for a petition and order of intervention, either generally or in respect to any specified matter in which a party in interest may seek intervention (Sec. 207).

2. Every person or committee representing more than twelve creditors or stockholders, and the indenture trustee must file a verified statement with copies of their employment contract or instrument of authority to act, showing the claims represented and the time of their acquisition, if acquired within one year before the filing of the petition for reorganization (Sec. 211).

3. An attorney for creditors or stockholders cannot be heard unless he has first filed with the Court a statement setting forth the names and addresses of the creditors or stockholders he represents, the nature and amounts of their claims, and the time of acquisition thereof, if acquired within one year prior to the filing of the petition (Sec. 210).

4. A "creditor" is defined as the holder of any claim, and "executory contracts" expressly includes unexpired leases of real property (Sec. 106), but damages by reason of the rejection of a lease is limited to three years' rent (Sec. 202). A "claim" is defined as including all claims of whatever character against the debtor or its property, except stock, whether or not such claims are provable under Sec. 63 of the Bankruptcy Act and whether secured or unsecured, liquidated or unliquidated, fixed or contingent. Under Sec. 77B of the old Act it was

held that if the mortgage or trust indenture does not authorize the trustee to vote, he is not a creditor entitled to vote upon the plan of reorganization to the exclusion of the bondholders.<sup>6</sup> The new Act provides (Sec. 198) even if the language of the trust indenture would otherwise be inadequate, the indenture trustees may file claims for all known and unknown holders of securities issued under the trust indenture who have not themselves filed claims; however, in computing the majority necessary for the acceptance of a plan of reorganization, only the claims filed by the holders thereof and allowed are included. Every claim filed must be proved and the burden to do so is on the claimant; the claims are not allowed as a matter of course, and any party in interest may object to the allowance of any claims.

5. *The Securities & Exchange Commission*—The Securities & Exchange Commission may become a party to the proceedings by filing a notice of appearance and be entitled to be heard on all matters, but it may not appeal from any matter (Sec. 208), and the attorneys or agents of the Securities & Exchange Commission are not entitled to compensation or reimbursement (Sec. 242). The Clerk of the District Court is required to forward copies of all pleadings to the Securities & Exchange Commission by registered mail (Sec. 265). As heretofore stated, if the indebtedness of the debtor corporation exceeds \$3,000,000.00, the plans of reorganization must be first submitted to the Commission for examination and report; if less than \$3,000,000.00, the plans may be submitted in the discretion of the Court (Secs. 172, 173).

6. *United States Treasury Department*—The Secretary of the United States Treasury must be given copies of all papers and notices of hearings under Chapter 10 of the Act, together with the plans of reorganization proposed (Sec. 266).

7. *Public Utility Commission*—A plan of reorganization involving a public utility corporation under the jurisdiction of a public utility commission must be first submitted to that Commission before it is approved by the Court, and a certificate of approval must be obtained or at least an adequate time must be given to the Commission to certify its approval or disapproval (Sec. 177).

#### *J. Plan of reorganization*

1. The preparation and proposal of a plan is imposed upon the trustee, if appointed, but the debtor and any of its creditors or stockholders may propose amendments or complete new plans to the trustee and they are not required to secure any percentage of the creditors or stockholders for cooperation in the submission of a proposed plan before doing so; if the debtor is continued in possession a plan may be

<sup>6</sup>In re Allied Owners Corporation, 74 F. (2d) 201 (C.C.A. 2d, 1934).

filed by the debtor, any creditor, indenture trustee, and, if the debtor is not found insolvent, by any stockholder; an examiner if appointed by the Court may likewise prepare and propose a plan of reorganization (Secs. 169, 170).

2. The trustee in the formulation of plans acts as the focal point in assembling facts and negotiating for various plans; he is the clearing house for suggestions, the driving force for the prompt preparation and submission of the best plan.

3. The basic requirement of a plan is that a reorganization plan *shall* include in respect to creditors and *may* in respect to stockholders provisions altering or modifying their rights, either through the issuance of new securities or by other means (Sec. 216).

4. It is specifically provided that the plan of reorganization shall include provisions prohibiting the debtor corporation from issuing non-voting stock, and in case the debtor has liabilities of \$250,000.00 or more, at least annual periodic reports must be given to the security holders, including profit and loss statements and balance sheets prepared in accordance with sound business and accounting practice (Secs. 216 [12a and b]).

5. The four methods of protecting dissenting classes of creditors which existed under Sec. 77B of the old law still exist under the new Act, to-wit:

a. By the transfer, sale, or retention by the debtor of the property subject to such claims.

b. The sale of such property free of such claims at not less than a fair upset price, and the transfer of such claims to the proceeds of such sale.

c. By the appraisal and payment in cash of the value of such claims.

d. By such method as will, under and consistent with the circumstances in the particular case, equitably and fairly provide protection.

6. The three methods of protecting dissenting classes of stockholders that existed under Sec. 77B of the old law still exist under the new Act, that is:

a. By the sale of the debtor's property in which they have an equity at not less than a fair upset price.

b. By the appraisal and payment in cash of the value of their stock.

c. By such method as shall, under and consistent with the circumstances in the particular case, equitably and fairly provide protection.

If, however, the method employed in regard to protecting dissenting classes of creditors or stockholders is that of paying in cash the appraised value of their claim, the dissenters no longer have the election of receiving in cash the appraised value of the securities allotted their class of creditors under the plan of reorganization.

7. The Court may direct the debtor, its trustee, any mortgagees, indenture trustees, and other necessary parties to execute and deliver or join in the execution and delivery of such instruments as may be requisite to effect a retention or transfer of any property dealt with by the plan, which has been confirmed, and to perform such other acts, including the satisfaction of liens, as the Court may deem necessary for the consummation of the plan (Sec. 227). Upon the disposition of the estate, after confirmation of the plan, the Judge, upon notice, may fix a time, to expire not sooner than five years after the final decree, within which the creditors shall transfer or release their claims, and the holders of securities shall present or surrender their securities (Sec. 204).

#### *K. Appeals*

1. *Referee orders*—Within ten days after the entry of an order by a Referee, a petition for review by the United States District Judge may be filed with the Referee and a copy served on the adverse party, and the Referee must thereupon promptly prepare and transmit the record to the Clerk of the District Court (Secs. 29a, 29c); the Court may suspend the enforcement of a Referee's order pending the hearing of a petition for review upon such terms as will protect the rights of all parties interested (Sec. 39c).

#### 2. *Appeals to the Circuit Court of Appeals*—

a. Such appeals must be taken within thirty days after the written notice of the entry of judgment, order, or decree and proof of the service of the notice of entry of judgment, order, or decree should be filed within five days after the service of the notice; if no notice of entry of judgment, order, or decree is served, the appeal must be taken within forty days from the entry of the judgment, order, or decree (Sec. 25).

b. Interlocutory as well as final orders, arising in any type of "proceedings in bankruptcy," are appealable, but only final orders in "controversies arising in bankruptcy proceedings" may be appealed to the Circuit Court of Appeals (Sec. 24a). It thus becomes necessary to distinguish between "proceedings in bankruptcy" and "controversies arising in bankruptcy proceedings." "Proceedings in bankruptcy" are defined as the usual steps common in the administration of the bankrupt's estate and

within the summary jurisdiction of the Bankruptcy Court, such as adjudication of bankruptcy, allowance of claims, costs and expenses of administration, sale of assets, declaration of dividends, discharge of bankrupt, setting aside exempt property, etc. "Controversies arising in bankruptcy proceedings" are ordinary suits in equity or actions at law between the trustee and adverse claimants, and are always plenary actions in the absence of consent, whether brought in the state, federal, or bankruptcy court.

c. Facts may now be reviewed on appeals from all types of proceedings as well as from controversies, with the exception that only matters of law may be reviewed when the appeal is from a judgment on a verdict rendered by a jury (Sec. 24a).

d. An allowance of an appeal by the Circuit Court of Appeals is no longer necessary in order to take an appeal from any kind of a proceeding or controversy unless the order, judgment, or decree involves less than \$500.00 in amount (Sec. 24a).

e. Appeals from allowances or disallowances of applications for compensation or reimbursement under Chapter 10 of the Act may be taken and allowed by the Circuit Court of Appeals, independently of other appeals in the proceeding, and are summarily heard upon the original papers (Sec. 250).

3. *Appeals to the Supreme Court*—The only bankruptcy cases now referable to the United States Supreme Court are such cases as the United States Supreme Court may choose to review by granting a writ of certiorari; the petition for writ of certiorari to review the judgment or decree of the Circuit Court of Appeals must be presented to the United States Supreme Court within three months from the date of the judgment or decree sought to be reviewed.<sup>7</sup>

#### L. *Miscellaneous tax features*

1. *Stamp taxes*—The issuance, transfer, or exchange of securities or the making or delivery of instruments of transfer under any plan of reorganization confirmed under Chapter 10 of the Act are exempt from any stamp taxes now or that may hereafter be imposed under the laws of the United States or of any state (Sec. 267).

2. *Securities Act*—Reorganization securities are exempt from the registration requirements of the Securities Act of 1935, if issued in exchange, in whole or part, for securities of or claims against the debtor, pursuant to the plan of reorganization (Sec. 264).

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<sup>7</sup> 8 REMINGTON, BANKRUPTCY §§ 3878, 3882.

3. *Income taxes*—

a. No profit within the meaning of the federal or state income tax or profit taxes is deemed to have been realized by reason of a reduction in the indebtedness of the debtor under a plan of reorganization, but the basis used in taxing any later disposition of the property of the debtor must be the original basis decreased to the extent to which the indebtedness of the debtor is reduced in the reorganization proceedings (Sec. 270).

b. Where it appears that a plan has for one of its principal purposes the avoidance of taxes, objections to its confirmation may be made on that ground by the Secretary of the Treasury, or, in the case of a state, by the corresponding official, and such objections shall be heard independently of other objections to the confirmation of the plan (Sec. 269).

c. All taxes found to be owing to the United States or any state from the debtor within one year from the date of the filing of a petition and which have not been assessed prior to the date of the confirmation of the plan and all such taxes which may become owing from a receiver or trustee or debtor in possession are assessed against and paid by the debtor or the corporation organized for effectuating the plan, unless the United States or any state in writing accepts the provisions of the plan (Sec. 271).

In summarizing and closing, it may be said that the most basic improvements in practice and procedure under Chapter 10 are:

1. The enlargement of the creditors' control in corporate reorganization matters.

2. The requirement that the Court appoint disinterested trustees and disinterested counsel for such trustees in the administration of any estate involving fixed and non-contingent indebtedness of \$250,000.00 or more.

3. The requirement that the Judge shall refer the plans of reorganization to the Securities & Exchange Commission for its examination and advisory report, where the scheduled indebtedness of the corporation exceeds \$3,000,000.00; in smaller estates, it is within the discretion of the Court whether the plan should be submitted to the Securities & Exchange Commission.

The new Bankruptcy Act and, in fact, the entire history of Bankruptcy legislation indicates that law is a dynamic and living science—stable but not stationary—always dealing and ever competing with the

variable factors of time, place, and man in his multitudinous relations to his fellow man. There can be no question that the New Act:

1. Perfects the Bankruptcy system.
2. Strengthens the processes of administration.
3. Modernizes the law, and
4. Leads to greater commercial honesty.

But there is a great question as to the timeliness of its enactment. Most corporations which have been in financial distress have already reorganized or are now favorably weathering the storm of the Depression. The Clerk of the United States District Court in Milwaukee reports that very few petitions have been filed under the New Act. So, it may be said in conclusion that from a short range point of view, the New Act may not be of any great practical importance, but over a long period of time it is bound to fortify creditors' rights in corporate reorganizations.

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