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A Fair and Equitable Plan Under Section 77B

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A FAIR AND EQUITABLE PLAN UNDER SECTION 77B

After the requisite consents of the various security holders and stockholders are obtained,[1] section 77B of the Brankruptcy Act provides that the plan of reorganization shall be confirmed by the judge if he be satisfied that "it is fair and equitable and does not discriminate unfairly in favor of any class of creditors or stockholders * * *."[2]

No all-inclusive tests of such fairness and equitableness as will satisfy the above requirement have yet been stated by the courts. They have variously said that "77B doesn't require that every plan approved as fair and equitable shall withstand attack by non-assenting creditors asserting their strict legal rights, unaffected by any principles of the Bankruptcy Act,"[3] and "that the courts will scrutinize with care all plans of reorganization * * * to make certain that assets belonging to creditors are not by indirection being diverted to stockholders."[4] A more helpful test is that suggested in *In re Dutch Woodcraft Shops*,[5] under which "a plan of reorganization must meet two requirements: (1) it should give to each creditor and stockholder the value of his interest in the debtor's assets, and (2) it should fully recognize the priority of claims. The omission of any group while a lower ranking group, either of stockholders or creditors, is included will render the plan unfair and inequitable." This definition of fairness suggests two questions: (1) Shall we determine the value of the security holder's or stockholder's interest in the debtor's property on the basis of such property's liquidation value, or with a view to the business future of the debtor as a going concern?[6] and (2) In what manner must these old priorities be recognized in reorganization?

1. (1934) 48 Stat. 918, (1937) 11 U. S. C. A. 207 (e) (1), which requires that each plan be approved by two-thirds in interest of each class of creditors and a majority in interest of stockholders.
2. (1934) 48 Stat. 919, (1937) 11 U. S. C. A. 207 (f) (1).
3. Downtown Inv. Ass'n v. Downtown Metropolitan Bldgs., Inc., (C. C. A. 2, 1936) 81 F. (2d) 314; In re Peyton Realty Co. (D. C. E. D. Pa. 1936) 18 Fed. Supp. 822. It is submitted that this test is not very helpful since 11 U. S. C. A. 207 (b) (1) provides that a plan of reorganization within the meaning of this section "shall include provisions modifying or altering the rights of creditors generally," and 11 U. S. C. A. 207 (b) (2) provides that such plan "may include provisions altering or modifying the rights of stockholders generally."
4. In re New York Railways Corporation (C. C. A. 2, 1936) 82 F. (2d) 739,744.
5. (D. C. W. D. Mich. 1935) 14 Fed. Supp. 467.
6. In re Witherbee Court Corporation (C. C. A. 2, 1937) 88 F. (2d) 251. The property valued as that of the going concern has been held the true basis.

I. FAIRNESS AS BETWEEN JUNIOR AND SENIOR SECURITY HOLDERS

There are two main schools of thought concerning the proper preservation of priorities in reorganization.[7] One maintains that the priority of any class as to (a) its rights on dissolution and (b) its claims on the earnings of a concern must either be completely maintained or, to the extent that they are invaded, must be represented by some *quid pro quo*.[8] Thus old six percent debentures would be entitled to new six percent preferred stock, par for par, including of course any unpaid interest, if the old common stock is to receive all the new common stock; or the old debenture holders might accept one-half of their claim in new preferred stock, giving up the other half in exchange for an unlimited participation in assets and earnings, to be represented by a fair share of the new common stock as the *quid pro quo* for the invaded priority. The second view does not require that invaded priorities be compensated for to render a plan fair. All that is necessary is a relative reduction in the rights of inferior security holders and stockholders to the debtor's income and property.[9]

In determining which theory the courts have followed in their interpretation of 77B, comparison with section 77, the Railroad Reorganization Act, may afford a useful analogy. Section 77 provides that a plan of reorganization shall be approved which is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, and does not discrimi-

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7. Bonbright and Bergerman, Two Rival Theories of Priority Rights of Security Holders in a Corporate Reorganization (1928) 28 Col. L. Rev. 127.

8. In Finletter, *Principles of Corporate Reorganization* (1937) 390, the author suggests other possible views. (A) An old class might be entitled to receive new securities having a market value equal to the face amount of their old claim before any Junior Class could be given anything; this would, however, treat a reorganization as a liquidation and has never been adopted by the courts. (B) Any plan which gives an old senior class something more either in market value, or in priority of position, than the class junior to it, might be approved if on the whole the result is not offensive to a sense of fairness. It is suggested that this latter view probably has a practical appeal, but the author believes that the cases do not sustain this view, and that it is in conflict with an appreciation of a judicial reorganization. "Reorganization is not a general scrapping of vested rights. It is a readjustment of the capital structure of a continuing enterprise at a given point of its career." But see Note (1935) 35 Col. L. Rev. 547, 562.

9. Swaine, Reorganization of Corporations: Certain Developments of the Last Decade (1927) 27 Col. L. Rev. 901,914. "The test of fairness is whether each class of security holders, which retain any interest in the property retain approximately its relative position with respect to the other security holders." Cf. Foster, Conflicting Ideals for Reorganization (1935) 44 Yale L. J. 923.

nate unfairly.[10] This "due recognition" clause is not present in section 77B.[11] A possible implication from this omission is that a plan of reorganization pursuant to section 77B need not invariably preserve old priorities, but that a plan might be approved as fair which invades priorities, giving no compensating *quid pro quo,* provided that similar rights of inferior security holders and stockholders suffer a corresponding reduction to satisfy the requirement that the plan be non-discriminatory.[12]

The cases which have arisen to date substantiate the relative priority theory. They hold in effect that a plan of reorganization is fair and equitable which invades old priorities without giving in return a compensating *quid pro quo* if a like reduction is made in rights of inferior holders[13] and if such reductions are necessary for successful rehabilitation of the debtor.[14] *In re Anchor Post Fence Company*[15] illustrates admirably a plan of this type approved by the court as complying with section 77B. In that case bond maturities were extended and interest thereon reduced from 6½% to 5%, payable only out of available earnings; unsecured claimants were given non-negotiable and non-interest bearing long-term notes; preferred shareholders' interest rates were reduced from 8% cumulative to 6% cumulative, retroactive as to accumulated interest, with no dividends to be paid until the outstanding bonded indebtedness was reduced 50%, and the notes given trade creditors paid in full; common stockholders retained their old status, except that no dividends were to be paid thereon until the outstanding bonded indebtedness was reduced 75% and the notes given unsecured creditors were paid in full. The debtor was solvent in the brankruptcy sense, but met the insolvency requirements of section 77B by virtue of inability to meet maturing debts.[16] Hence, although the debtor's assets were appraised by the court at a figure in excess of outstanding liabilities, the creditors were forced

10. (1935) 49 Stat. 918, (1937) 11 U. S. C. A. 205 (e) (1).
11. (1934) 48 Stat. 919, (1937) 11 U. S. C. A. 207 (f) (1).
12. It is not suggested that sec. 77 requires an absolute preservation of priorities in reorganization or that a plan under 77 might not be sustained which did not provide *quid pro quo* for invaded priorities.
13. There would seem to be room for doubt as to the constitutionality of such a doctrine, since it appears to involve the taking of a substantial property interest with no compensation given therefor. This may well be inconsistent with the requirement of due process.
14. In re Pressed Steel Car Co. of New Jersey (D. C. W. D. Pa. 1936) 16 Fed. Supp. 329; In re New York Railways Corporation (C. C. A. 2, 1936) 82 F. (2d) 739.
15. (D. C. D. Md. 1936) 14 Fed. Supp. 801.
16. (1934) 48 Stat. 912, (1937) 11 U. S. C. A. 207 (a).

through the plan to suffer an impairment of security, with no return therefor.[17]

In *In re New Rochelle Company*,[18] involving a debtor, solvent but unable to meet maturing obligations, old first mortgage interest rates were reduced from 6% to 4%, while unsecured creditors were given the option to take either one-third the face value of their claims in bonds or full payment in non-interest bearing notes maturing within two years. Each note contained a cancellation clause, whereby upon default in the payment of any, all notes should become due immediately, and all noteholders be forced to take a *pro rata* part of the bonds not taken under the options, in full satisfaction. Though it was clear that such remaining bonds might not equal the face value of the outstanding notes, the plan was approved. Here again, although the debtor's assets were appraised at a sum sufficient to satisfy all claimants, dissenting bondholders were forced to accept a decrease in interest, while objecting unsecured creditors were compelled to take bonds of a face value much less than that of their claims or full payment in non-interest-bearing, later maturing notes, payment of which was uncertain. The court, in approving the plan,

17. Note the detailed manner provided for the application of net earnings under the plan. 15% was to be used for working capital, and such part of the remainder as might be required, for the payment of interest, accumulated and future on 5% bonds; the balance, if any, was to be applied to the reduction of notes issued for unsecured claims. After the notes were retired, 15% of the net earnings were to be applied to working capital, such of the balance as might be necessary for the payment of interest on the 5% bonds, and 50% of the remainder toward a sinking fund for the payment of bonds. Furthermore a committee of six bondholders, or their nominees, appointed initially by the court, with power in said committee to fill vacancies, was to have a veto power over the sale of any of the company's mortgaged property free from the lien. This committee was to function until the debtor's bonded indebtedness was reduced from $349,000 to $100,000. In re Anchor Post Fence Co. (D. C. D. Md. 1936) 14 Fed. Supp. 801. In determining the extent of a security holder's priority and the amount of claim he had in reorganization, unpaid interest is to be included. In re 333 North Michigan Ave. Building Corporation (C. C. A. 7, 1936) 84 F. (2d) 936, involving a plan, held fair and equitable, for a solvent debtor whereby first mortgage bondholders received no-par preferred stock and certain common stock, while inferior security holders and shareholders received new common stock; cf. Security First National Bank of Los Angeles v. Rindge Land and Navigation Co. (C. C. A. 9, 1936) 85 F. (2d) 557, 107 A. L. R. 1240; In re Tennessee Publishing Co. (C. C. A. 6, 1936) 81 F. (2d) 463; Francisco Building Corporation v. Battson (C. C. A. 9, 1936) 83 F. (2d) 93, holding that, if the requisite number of creditors fail to assent to a plan, such plan does not provide adequate protection as required by 11 U. S. C. A. 207 (b) (5), when it gives such creditors only a fraction of the face value of their holdings. It is to be noted that the last three cases involved the treatment of non-assenting classes of creditors, as to which the requirements differ from those for assenting classes.

18. (C. C. A. 2, 1935) 77 F. (2d) 881.

stressed the fact of its approval by a large number of unsecured creditors and the reasonable certainty of ultimate successful rehabilitation of the debtor.[19]

In the cases so far discussed, the debtors were solvent in the bankruptcy sense. Since creditors and stockholders alike held a valuable interest in the debtor's property, these rights were necessarily recognized by some participation in the reorganized debtor.

A different problem is presented when creditors or stockholders with no equity in the old debtor are recognized in reorganization. Any such recognition which does not first provide for making the equity interest whole might be thought a violation of due process as involving, in effect, a direct taking of priority rights and giving them to the inferior interests. The courts, however, have allowed this to be done over the objections of dissenting priority holders. For example, in *Downtown Investment Association v. Boston Metropolitan Buildings, Inc.*,[20] a debtor's assets were sufficient to cover outstanding first mortgage bonds but insufficient to pay second mortgage bondholders in full, leaving no equity in the old stockholders. A reorganization plan was sustained which extended the maturity of first mortgage bonds and released unpaid interest thereon up to a certain date, while second mortgage bondholders suffered similar reductions, and new common stock was allocated between the first and second mortgage bondholders and old stockholders. The court said that the participation by the stockholders, who had no equity in the debtor's property, and that of the second mortgage bondholders, over and above the extent of their interest, would have been held unfair under the rule of the old equity receivership cases,[21] but to hold that the phrase "fair and equitable" has the same meaning when applied to a reorganization under 77B as it had in equity receiverships, is to eliminate from it, to a certain degree, the rights of creditors and stockholders to adjust their respective rights by contract, and nullify provisions of the act which was

19. Ibid. The court stressed the fact that the debtor had been operated at a profit by a receiver pending reorganization, and in all likelihood would be able to pay the notes given trade creditors as they matured. The opinion does not indicate what was given old common shareholders. Cf. Horn v. Ross Island Land and Gravel Co. (C. C. A. 9, 1937) 88 F. (2d) 64, holding unfair a plan by which a solvent corporation proposed to pay its bondholders one-fourth on the face value in cash as full satisfaction.

20. (C. C. A. 1, 1936) 81 F. (2d) 314.

21. Cf. Northern Pacific Railroad Co. v. Boyd (1913) 228 U. S. 482, 33 S. Ct. 554, 57 L. ed. 931, and comment thereon in Finletter, *Principles of Corporate Reorganization* (1937) 391.

passed to facilitate corporate reorganization.[22] Thus, over the objections of dissenting bondholders, stockholders with no equity in the debtor's property were given common stock in the reorganized debtor, without giving any *quid pro quo,* monetary or otherwise, to the holders of the equity. Similarly in *J. S. Farlee & Co. v. Springfield-South Main Realty Co., Inc.,*[23] involving an insolvent debtor, a plan which left stock ownership intact and provided for a reduction on the bonded interest from 7% to 5% was held fair and equitable. The opinion stressed the inability of the debtor to pay more than 5% interest on the bonds and argues that the number of objecting bondholders was highly indicative of the inherent fairness of the plan.[24] The case may be criticized in that, should the reorganized business prove successful, the old bondholders have suffered an irreparable loss of interest, while the common shareholders, who would have realized nothing from a liquidation at the time of reorganization,

22. In In re Peyton Realty Co. (D. C. E. D. Pa. 1936) 18 Fed. Supp. 822, 823, the court said that sec. 77B creates an entirely new procedure designed to facilitate corporate reorganization, and in particular to remove the difficulties which arose from the emphasis which the courts had previously placed upon the position of non-assenting minorities; and that Congress is using the term "fair and equitable" in a new, broader sense than the courts had in equity receiverships.

23. (C. C. A. 1, 1936) 86 F. (2d) 931.

24. Cf. In re Burns Bros. (D. C. S. D. N. Y. 1936) 14 Fed. Supp. 910, which involved a reorganization of an insolvent debtor. Old class A common shareholders with certain priorities in voting and income received one share of new common stock for each ten old shares held, and class B common stock received one share of new common stock for each fifty shares held. The plan recognized old priorities between the stockholders in reorganization although neither class of stockholders had an equity in the debtor's property. A reasonable inference would seem to be that recognition of any such interest in reorganization necessitates a participation of all old interest prior thereto, though such old priority interests had no equity in the debtor's property at the time of reorganization. This apparently is true, although it has been held by the United States Supreme Court in In re Church St. Building Corporation (1936) 299 U. S. 24, 57 S. Ct. 88, 81 L. ed. 16 that any creditor, bondholder, or shareholder with no equity in the dedtor's property at the time of reorganization, as determined by the court at that time, may be excluded from a plan of reorganization without violating the due process clause. See also In re Georgia Hotel Corporation (C. C. A. 7, 1936) 82 F. (2d) 917; In re Donohoe's, Inc., (D. C. D. Del. 1937) 19 Fed. Supp. 441; In re Parker Young Co. (D. C. D. N. H. 1936) 15 Fed. Supp. 965. But see In re Consolidation Coal Co. (D. C. D. Md. 1935) 11 Fed. Supp. 594, in which the court said, concerning the subscription warrants to new common stock, given old common stockholders having no equity in the debtor's property at the time of reorganization: "The bondholders' committee have urged, and not without force, that it would not have been unreasonable to have provided in the plan that the old common stockholders be required to pay $40 in place of $25 for the new common stock," thus indicating that the courts will not sanction every type of participation of non-equity interests without contributions on their part.

have the "gravy." The courts, while confining the allocable participation of these non-equity interests to common stock, have failed to recognize that, in effect, a diversion of priority interests to the inferior security or stockholders, which is seemingly unfair and possibly a taking of property without due process of law, is involved. As has been indicated, they have regarded such plans as a valid exercise of composition, given by Congress pursuant to its bankruptcy power;[25] and the question has never been passed upon by the Supreme Court.

A related problem is involved when old inferior security hlodders are allowed a participation in the reorganized debtor, senior to that given old senior priorities. Such a plan was sustained in *In re Consolidation Coal Co.*,[26] in which the solvent debtor had outstanding promissory notes, refunding 4½% bonds, and first and refunding 5% bonds, all of which the assets were more than sufficient to pay in full. The approved plan, held fair and equitable, and not unduly discriminatory in favor of any class of creditors, gave 4½% bondholders, whose lien on the debtor's property and income was inferior to that of the 5% bondholders, bonds of $500 par value, along with three shares of par $100 preferred stock, plus nine shares of $25 par value common stock. Holders of each 5% bond received identical bonds of $400 par, preferred stock, and twelve shares of $25 par common stock. Thus the old inferior bondholders were given a lien of like strength with that given the old priority bondholders, but $100 greater in par value. On the other hand the common stock interest given the latter was greater than that given the former. The opportunity for increased participation in earnings, by way of the greater number of common shares given the old senior bondholders, was regarded as a fair bargain for the invaded prior-

25. The Bankruptcy Act (1898) 30 Stat. 459, (1927) 11 U. S. C. A. 30 (b) provides that the judge shall confirm a composition if he is satisfied that "(1) it is for the best interest of the creditors * * *." It has been held under this section that if it can be shown that a liquidation of the bankrupt's property in the course of ordinary bankruptcy procedure will yield substantially more than the offered composition, the proposal will not be confirmed over objection. In re Spiller District Court (D. C. D. Mass. 1916) 230 Fed. 490; Fleischmann and Devine, Inc., v. Saul Wolfsom Dry Goods Co., Inc., (C. C. A. 5, 1924) 299 Fed. 15. It may be argued that the requirements of "fair and equitable" under sec. 77B were intended to mean substantially the same as the above indicated interpretations of sec. 12 (b) of the Bankruptcy Act, and hence if the reorganization plan does not provide a creditor some type of security of a reorganized debtor equivalent in value to that which would be received on a liquidation, such plan is necessarily unfair.

26. (D. C. D. Md. 1935) 11 Fed. Supp. 594. Note that on each $1,000 4½% bond, $175 accrued interest was outstanding, and $150 on each $1,000 5% bond.

ity.[27] The excellent business prospects of the debtor, reflecting the potential value of the common stock, and the large majorities assenting to the plan were held highly indicative of fairness. The case indicates that old priorities may be surrendered to old inferior security holders, provided the relinquishing priority holders are recompensed by some compensating participation in the reorganized debtor sufficient to protect them adequately.[28]

Another phase of the problem of fairness arises where, because of practical considerations, unsecured creditors are paid in cash while secured creditors are given new securities, or suffer impairment of their old ones. So long as such cash payments are not execessive, such provisions will not be disapproved as unfair or discriminatory.[29] The position of the courts is that the expense, necessarily entailed in requiring a security allot-

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27. Kansas City Terminal Ry. v. Central Union Trust Co. (1926) 271 U. S. 445, 46 S. Ct. 549, 70 L. ed. 1028 supports the doctrine of the principal case. The plan in that case allowed an identical participation of old stockholders and debenture holders, the former paying a greater assessment than the latter. The Court held that the plan afforded adequate protection to the old debenture holders.

28. A reorganization plan may provide for reduction of interest rates on old securities and stock. In re Parker Young Co. (D. C. D. N. H. 1936) 15 Fed. Supp. 965; J. S. Farlee Co., Inc., v. Springfield-South Main Realty Co., Inc., (C. C. A. 1, 1936) 86 F. (2d) 931; In re Anchor Post Fence Co. (D. C. D. Md. 1936) 14 Fed. Supp. 801. Maturities of old securities may be extended. In re Georgian Hotel Corporation (C. C. A. 7, 1936) 82 F. (2d) 917; In re Anchor Post Fence Co. (D. C. D. Md. 1936) 14 Fed. Supp. 801; but see In re Ogden Park Post Office Bldg. Corp. (D. C. N. D. E. D. Ill. 1936) 14 Fed. Supp. 413, holding that where the debtor had paid no interest on its bonds since 1931, a maturity extension of such bonds for 15 years was unreasonable; and Provident Mutual Life Ins. Co. of Philadelphia v. University Evangelical Lutheran Church of Seattle (C. C. A. 9, 1937) 90 F. (2d) 992, where it was held that a plan which left bondholders unpaid as to principal in 25 years was unfair. In the foregoing cases the financial condition of the debtor was poor, and the outlook for payment dubious. Cumulative interest may be made non-cumulative. In re Anchor Post Fence Co. (D. C. D. Md. 1936) 14 Fed. Supp. 801; In re Georgian Hotel Corp. (C. C. A. 7, 1936) 82 F. (2d) 917. Sinking fund requirements may be surrendered or altered. Downtown Inv. Ass'n v. Boston Metropolitan Bldgs., Inc., (C. C. A. 1, 1936) 81 F. (2d) 314. Accrued interest may be forfeited. In re Anchor Post Fence Co. (D. C. D. Md. 1936) 14 Fed. Supp. 801; Downtown Inv. Ass'n v. Boston Metropolitan Bldgs. Inc., (C. C. A. 1, 1936) 81 F. (2d) 314. No definite rule can be laid down as to the extent to which the above-mentioned rights may be invaded in reorganization. The limitation, established by the decided cases, appears to be that such impairment of securities be necessary for the rehabilitation of the debtor, and other inferior security holders suffer comparable impairment of security. The courts are prone to declare these alterations unfair or discriminatory. The number of assents to the plan is given great weight in the determination of the fairness of reductions. See (1934) 48 Stat. 914, (1937) 11 U. S. C. A. 207 (b) (9).

29. Brocket v. Winkle Terra Cotta Co. (C. C. A. 8, 1936) 81 F. (2d) 949.

ment to small claimants rather than cash, more than outweighs any apparent discrimination caused by cash distribution.[30]

The problem of the control of a reorganized corporation is of prime importance to all parties concerned, and provisions in regard to it are carefully scrutinized by the courts.[31] Thus in the reorganization of a solvent debtor approval of the plan was conditioned on giving old bondholders and creditors adequate representation in the corporate directorate.[32] In the case of an insolvent debtor there would appear to be still more reason, because of the financial status of the debtor, often the result of poor management, and because reorganization always invades priorities, for requiring that parties interested share in the control of the debtor. The courts generally insist on adequate representation in these situations[33] and have even continued

30. Brocket v. Winkle Terra Cotta Co., supra, note 29; In re New Rochelle Coal and Lumber Co. (C. C. A. 2, 1935) 77 F. (2d) 881; cf. Provident Mutual Life Insurance Co. of Philadelphia v. University Evangelical Lutheran Church of Seattle (C. C. A. 9, 1937) 90 F. (2d) 992, which involved a debtor church with liabilities of $63,808 and assets of $53,000 and where a proposed plan of reorganization which contemplated payment of unsecured indebtedness of $140 while the first mortgage interest rate was reduced from 6½% to 2%, with a payment on the principal at a rate which would leave an amount owing after 25 years and the payments were not certain, was held unfair and a violation of due process of law as to bondholders; cf. also In re McCrory Stores Corporation (D. C. S. D. N. Y. 1935) 12 Fed. Supp. 267, holding that a plan of reorganization which provided for participation by a creditor, who obtained his claim by means of a trust relation with the debtor at a reduced price and just prior to reorganization, was unfair to other participants when such creditor was allowed to participate at the par value of his claim. Sec. 77B (b) (3) provides that a plan of reorganization shall provide for the payment in cash of all costs of administration.

31. In re Consolidation Coal Co. (D. C. Md. 1935) 11 Fed. Supp. 594, 598: "Although there has been no serious objection raised to this aspect of the plan [control], it is a vital one in all such reorganizations and therefore should not be approved by the court, even though not objected to by any party in interest, if not believed by the court to be fundamentally sound."

32. In re Anchor Post Fence Co. (D. C. Md. 1936) 14 Fed. Supp. 801, where the shareholders were forced to change the personnel of the directorate to give bondholders and creditors representation.

33. In re Burns Bros. (D. C. S. D. N. Y. 1936) 14 Fed. Supp. 910; In re United Railways and Electric Co. of Baltimore's Reorganization (D. C. D. Md. 1935) 11 Fed. Supp. 717; In re 333 North Michigan Ave. Bldg. Corp. (C. C. A. 7, 1936) 84 F. (2d) 936. Cf. In re Barker Young Co. (D. C. D. N. H. 1936) 15 Fed. Supp. 965, which involved an insolvent debtor. Under the plan of reorganization here, preferred shareholders surrendered three-fourths of their shares and accumulated interest, and the interest rate on the shares retained was reduced, while common shareholders retained their old status. Before reorganization preferred shareholders, on default in any four consecutive quarterly interest payments were to have absolute voting control. Under the new plan such control was to vest in them only after default on six consecutive quarterly interest payments. The court said

jurisdiction over the management of the debtor, after reorganization has been completed, by requiring court approval of corporate acts.[34] Under special circumstances, even in the case of an insolvent debtor, a plan may be approved whereby old stockholders retain control. Thus, where preferred shareholders surrendered 75% of their stock, the common shareholders retaining their stock, and no other securities were outstanding, such a plan was approved, inasmuch as the insolvency was not due to mismanagement, and the underwriters of new security, from which necessary new capital was to be obtained by the debtor, insisted that control remain in the old common shareholders.[35]

Another important element bearing on the fairness of a reorganization plan is the right of the various security holders and stockholders *inter se* to participate in securities to be issued to obtain new working capital. The problem becomes particularly acute where the new security to be sold is superior to that given the various old securities holders. The courts have generally held that there is no objection to selling senior security to outsiders before offering it to a particular class.[36] On principle it would seem that subscription rights to new security, senior to that given an old priority holder, should not be sustained without a prior offering to the old senior group.[37] However, if the old equity receivership precedents are to be followed,

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that it was neither fair nor equitable for preferred shareholders to surrender voting privileges, particularly since the plan authorized an unlimited right to mortgage the property for such sums as the directors should decide. In re Ogden Park Post Office Building Corporation (D. C. N. D. C. D. Ill. 1936) 14 Fed. Supp. 413, 414 involved a debtor whose common stock was completely held by a corporation which was going through reorganization. The court said, "The court cannot approve a plan in which the management of a property is definitely committed to a debtor, the control of whose affairs is dependent upon the result of another court proceeding." But see J. S. Farlee & Co., Inc., v. Springfield-South Main Realty Co., Inc., (C. C. A. 1, 1936) 86 F. (2d) 931, where the old stockholders retained their interest in the debtor as well as the control, the court declaring that the management of the property was in reality a burden and approving the plan.

34. In re Clark Co. (C. C. A. 7, 1935) 79 F. (2d) 681. This view has been criticized on the theory that while the most complete control by the court over the debtor until the plan is finally approved is proper, any reservation by the court of operating control after the plan is effected seems to go beyond the purpose of the act. Finletter, *Principles of Corporate Reorganization* (1937) 452.

35. In re Donahoe's Inc. (D. C. D. Del. 1937) 19 Fed. Supp. 441.

36. In re McCrory Stores Corporation (S. D. D. C. N. Y. 1935) 12 Fed. Supp. 739, holding that old shareholders have no preemptive right to new stock; In re New York Railway Corporation (C. C. A. 2, 1936) 82 F. (2d) 739.

37. In re New Rochelle Coal & Lumber Co. (C. C. A. 2, 1935) 77 F. (2d) 881.

no primary offering need be made to such holders if it appears that the sale of such securities to other investors is a practical way of obtaining new working capital.[38] That result may be criticized on the theory that valuable rights in the debtor's property are being subverted to inferior security holders, since it is apparent that the property value behind these new securities must be substantially in excess of the sale price to insure such sale. The equity receivership cases however, viewing the problem pragmatically, have not regarded this as an unfair invasion of priorities. The tenor of the 77B decisions indicates that this rule will in all probability be followed.[39]

II. FAIRNESS AS BETWEEN MEMBERS OF THE SAME CLASS

Once the classes of creditors are determined, the rule of strict equality, with only such minor deviations as are necessary because of controlling practical reasons, prevails.[40] Because of the bookkeeping expense of carrying small claims in reorganization, cash payments to minor claimants have been held fair, though holders of larger claims of the same class have received new securities or suffered various impairments of their securities.[41] Likewise, different treatment in reorganization may be permissible if a particular member of a given class of creditors has a separate and unliquidated claim against the debtor, the plan providing a better treatment for that member. That has been done as to compromised claims where the court had sufficient facts before it to indicate that the compromise was fair.[42]

The relative treatment in reorganization of holders of liens on different portions of a debtor's property is an important one which often arises, particularly with large corporations. The courts have worked out the problem by requiring, as nearly as possible, an apportionment of new securities to the respective

38. In re Jameson v. Guaranty Trust Co. of New York (C. C. A. 7, 1937) 20 F. (2d) 808; In re Celotex Co. (D. C. D. Del. 1935) 12 Fed. Supp. 1, indicating the subscription rights to new stock may be awarded the various classes as part of the rights received by them in lieu of their old securities.

39. In re United Railways and Electric Co. of Baltimore's Reorganization, (D. C. D. Md. 1935) 11 Fed. Supp. 717; In re 333 North Michigan Ave. Bldg. Corp. (C. C. A. 7, 1936) 84 F. (2d) 936.

40. Finletter, *Principles of Corporate Reorganization* (1937) 430.

41. In re Anchor Post Fence Co. (D. C. D. Md. 1936) 14 Fed. Supp. 801; cf. J. S. Farlee & Co., Inc., v. Springfield-South Main Realty Co. (C. C. A. 1, 1936) 86 F. (2d) 931, where a plan failing to provide for given creditors within a class was held unfair.

42. In re Burns Bros. (D. C. S. D. N. Y. 1936) 14 Fed. Supp. 910, where an unsecured claimant also held an unliquidated claim against the debtor for breach of contract.

lien holders based on the actual values that adhere to the respective properties each lien covers.[43] This value is not the present liquidation value but is estimated on the basis of its value as property of a going concern.[44]

III. CONCLUSION

It is difficult to formulate any statement of the precise factors indicative of that fairness and equality required by section 77B. The cases indicate that a plan of reorganization for a solvent debtor will be approved which invades an old priority, provided old inferior security holders' and stockholders' rights suffer a corresponding impairment,[45] and provided the general impairment is necessary for successful rehabilitation of the debtor.[46] No *quid pro quo* for invaded priorities need be given.[47] It further appears that, although the debtor be insolvent and stockholders or junior security holders have no equity in the debtor's property, they may be given at least common stock in the reorganized debtor despite an invasion of senior priority.[48] A plan of reorganization for a solvent corporation may invade old priorities and even require their relinquishment to old inferior security holders, provided the old priority holders are given some compensating advantage, sufficient to adequately protect them.[49]

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43. In re United Railways and Electric Co. of Baltimore's Reorganization (D. C. D. Md. 1935) 11 Fed. Supp. 717. The debtor had outstanding 4% and 6% consolidated bonds, the value of the property securing this lien being less than that of a different part of the debtor's property represented by certain underlying divisional bonds. The courts approved a plan whereby the latter bondholders received new 5% first debentures, whose par value was 50% that of the old bonds held, and 50% in 5% preferred stock, while the former 6% and 4% consolidated bondholders received 50% of the par value of their bonds in 4% first debentures, and 50% in 5% preferred stock. The difference in interest between the old 4% and 6% consolidated bonds was made up by giving holders of the latter one share of common stock for each $100 bond.

44. In re United Railways & Electric Co. of Baltimore's Reorganization (D. C. D. Md. 1935) 11 Fed. Supp. 717.

45. In re Pressed Steel Car Co. of New Jersey (D. C. W. D. Pa. 1936) 16 Fed. Supp. 329; In re New York Railways Corporation (C. C. A. 2, 1936) 82 F. (2d) 739; In re Anchor Post Fence Co. (D. C. D. Md. 1936) 14 Fed. Supp. 801.

46. In re Pressed Steel Car Co. of N. J. (D. C. W. D. Pa. 1936) 16 Fed. Supp. 329; In re New York Railways Corporation (C. C. A. 2, 1936) 82 F. (2d) 739.

47. In re New Rochelle Coal & Lumber Co. (C. C. A. 2, 1935) 77 F. (2d) 881; In re Consolidation Coal Co. (D. C. D. Md. 1935) 11 Fed. Supp. 594; In re Anchor Post Fence Co. (D. C. D. Md. 1936) 14 Fed. Supp. 801.

48. Downtown Inv. Ass'n v. Boston Metropolitan Bldgs., Inc., (C. C. A. 1, 1936) 81 F. (2d) 314; J. S. Farlee & Co., Inc., v. Springfield-South Main Realty Co., Inc., (C. C. A. 1, 1936) 86 F. (2d) 931.

49. In re Consolidation Coal Co. (D. C. D. Md. 1935) 11 Fed. Supp. 594.

The courts have almost uniformly asserted that acceptance of a proposed plan by the requisite percentage of parties interested is strong evidence that it is fair and equitable,[50] and further that if the number of those actively objecting to the plan is small, this is still more strongly indicative of its fairness.[51] In spite of the express requirement of section 77B that the judge shall approve the plan only if he himself is satisfied that it is fair and equitable,[52] it has been held that the proponents of a plan meet all requirements as to the proof of its fairness by showing that the requisite number of creditors, stockholders, and bondholders have assented to it.[53] Plainly there is, in practice at least, a strong presumption of fairness as to any plan offered and a correspondingly heavy burden on opponents to show such ill-treatment as will truly shock the court's conscience.[54]

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50. In re Burns Bros. (D. C. S. D. N. Y. 1936) 14 Fed. Supp. 910; In re Pressed Steel Car Co. of New Jersey (D. C. W. D. Pa. 1936) 16 Fed. Supp. 329; Downtown Inv. Ass'n v. Boston Metropolitan Bldgs., Inc., (C. C. A. 1, 1936) 81 F. (2d) 314, indicating that the court will not disapprove a plan opposed by a comparatively small minority class of security holders, absent any persuasive showing of unfairness and discrimination. It is indicated, however, that the weight of this evidence is much impaired if it appears that some assents to the plan may have been due to ulterior reasons, not common to that class of creditors or stockholders.

51. J. S. Farlee & Co., Inc., v. Springfield-South Main Realty Co. (C. C. A. 1, 1936) 86 F. (2d) 913. Here 78% in interest of bondholders expressly approved the plan and but 3⅝% actively objected. The court declared that the small number of objectors was indicative of fairness. But see Frank, Some Realistic Reflections on Some Aspects of Corporate Reorganization (1933) 19 Va. L. Rev. 698, criticizing the policy of the courts in giving such great weight to the number of assents as being indicative of the fairness of the plan. It is suggested that the widely scattered, poorly informed security and stockholders, whose assents are solicited by self-constituted committees, do not really assert an independent judgment in the matter. (1934) 48 Stat. 915, (1937) 11 U. S. C. A. 207 (b) (10) provides that the judge may disregard the terms of any objectionable depositary agreements. See In re Broadway Corporation (C. C. A. 2, 1935) 79 F. (2d) 108.

52. (1934) 48 Stat. 919, (1937) 11 U. S. C. A. 207 (f) (1).

53. In re New Rochelle Coal and Lumber Co. (C. C. A. 2, 1935) 77 F. (2d) 881; but see First National Bank of Cincinnati v. Flershem (1934) 290 U. S. 504, 54 S. Ct. 298, 78 L. ed. 465 (a pre-77B case indicating that the proponents of a plan bear the burden of proving it fair).

54. See In re Studebaker Corp. (D. C. N. D. Ind. 1935) 9 Fed. Supp. 426; In re McCrory Stores Corp. (S. D. D. C. N. Y. 1935) 14 Fed. Supp. 739; cf. Horn v. Ross Island Land and Gravel Co. (C. C. A. 9, 1937) 88 F. (2d) 64, where a solvent corporation proposed to pay certain of its bondholders one-fourth the face value of their bonds in cash as a complete settlement. Although the plan was held unfair, the court, in view of the large number of assenting bondholders, gave the objecting bondholders a lien on the debtor's property for the face value of his claim and allowed the plan to stand. "There is no reason why the bondholders who have expressly agreed to the plan should not be bound thereby, and in default of objection by other bondholders there seems to be no reason why they should not also be bound to the order to which they, in legal effect, have concurred."