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Sheridan Downey III
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THE PROPOSED BANKRUPTCY REORGANIZATION PROVISIONS: A COMPARISON OF THE CURRENT LAW WITH CHAPTER 11 OF H.R. 8200 AND S. 2266

Sheridan Downey III*  
Jeffrey T. Ferriell**  
Roland D. Pfeiffer***

INTRODUCTION

During the last ten years, there has been a great deal of debate, in Congress as well as among jurists and other legal scholars, over the prospect of a general revision of the bankruptcy laws of the United States.1 This decade of discussion has produced a number of proposed revisions,2 but, until recently, 

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* Assistant Professor of Law, University of Santa Clara School of Law; B.A., 1963, Stanford University; J.D., 1966, Boalt Hall School of Law, University of California, Berkeley.

** Graduate Teaching Assistant, University of Illinois at Champaign-Urbana, School of Law; B.S., 1975, Ohio State University; J.D., 1978, University of Santa Clara School of Law.

*** Third year law student, University of Santa Clara School of Law; B.S., 1973, University of Nebraska; M.B.A., 1976, University of Santa Clara.


no bill had received the approval of either wing of Congress. In
February, 1978, however, the House of Representatives passed
H.R. 8200 and thus forwarded the burden of reforming the
bankruptcy act to the Senate. The Senate now must determine
whether to accept H.R. 8200 as it was reported by the House,
to amend the House bill or to adopt S. 2266, a modified version
of the original House bill.

Among the changes from the current law that would occur
upon implementation of either version of the bankruptcy revi-
sion, one of the most apparent would be the consolidation of
the three existing business reorganization chapters into a single
proceeding. Although both H.R. 8200 and S. 2266 would con-

Bankruptcy Act: Some Substantive Differences in Procedure, 52 J. Urb. L. 929 (1975);
Coogan, Broude & Glatt, Comments on Some Reorganization Provisions of the Pend-
ing Bankruptcy Bills, 30 Bus. Law. 1149 (1975); Lee, A Critical Comparison of the
Commission Bill and the Judges Bill for the Amendment of the Bankruptcy Act, 49

A good history of the two proposals can be found in Cyr, Setting the Record

3. H.R. 8200, 95th Cong., 1st Sess. (1977) [hereinafter cited as House Bill], was
Feb. 1, 1978). The House Bill was originally introduced as H.R. 6, 95th Cong., 1st Sess.

cited as Senate Bill]. The differences between the House and Senate bills with respect
to bankruptcy reorganizations will be the subject of this article. There are, however, a
number of other differences between the bills that will have to be resolved prior to the
enactment of a general revision of the Bankruptcy Act. Perhaps the most significant
of these differences deals with the structure of the bankruptcy courts and the status
of the bankruptcy judges. See generally Bankruptcy Reform Act of 1978, Hearings on
S. 2266 and H.R. 8200 Before the Subcomm. on Improvements in Judicial Machinery
of the Senate Comm. on the Judiciary, 95th Cong., 1st Sess. (1977) [hereinafter cited
as 1977 Senate Hearings].

5. This consolidation is in accordance with the recommendations of the Bank-
ruptcy Commission. Commission Report, supra note 1, at 23. The Commission's rec-
ommendation was based upon the need for a single, flexible reorganization procedure
that could be used to shape whatever relief was appropriate given the facts and circum-
stances of each case. Id. at 248. For a discussion of the ways in which the existing
bankruptcy reorganization chapters did not, in the Commission's view, suit this need,
see id. at 245-48. Some, however, have disagreed over the wisdom of abolishing the
differences between Chapters X and XI of the current law. See Lee, supra note 2 at
39-41; Levit, A Statement on the Bankruptcy Reform Act, 81 Com. L. J. 93, 94 (1976);
Weintraub & Crames, Critique of Chapter VII and Related Sections of the Proposed
Chapter VII (Reorganizations) as Proposed by the Bankruptcy Commission: The Wid-
ening Gap between Theory and Reality, 47 Am. Bankr. L. J. 323 (1973). See also King,
The Business Reorganization Chapter of the Proposed Bankruptcy Code—Or What-
ever Happened to Chapters X, XI and XII, 78 Com. L.J. 429 (1973), which raises a
number of questions with respect to the consolidation of Chapters X-XII, but does not
indicate approval or disapproval of their combination into a single proceeding.
solidate existing Chapters X, XI, and XII into a broader, more flexible Chapter 11, there are, nevertheless, a number of important differences between the two versions of the proposed business reorganization chapter. Among those differences, the Senate's special provisions governing the treatment of publicly held companies\(^6\) looms ominously as a potential barrier to agreement between the House and Senate in the area of business reorganizations.\(^7\) Whether an agreement on some of the more political differences evident in the two proposals will yield agreement on the substantive issues remains to be seen.

At this time, politics, jealousies and the territorial imperative threaten to delay Congressional action for a longer period of time than is customarily devoted to haggling over technicalities of two bills. The great stumbling block to the Senate's passage of H.R. 8200 is, without doubt, the House's proposal to separate the bankruptcy courts from the federal district courts and to staff the bankruptcy courts with Article III,\(^8\) life-tenured judges.\(^8\)

Such influential and prestigious organizations as the Commission on The Bankruptcy Laws, the National Bankruptcy Conference, the Commercial Law League of America, the American Banker's Association and the American Bar Association have given unified support to a separate and independent bankruptcy court.\(^9\) The Chief Justice of the United States and the Judicial Conference, however, have adamantly opposed this proposal.\(^10\)

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6. As will be seen, the Senate Bill provides for special treatment of publicly-held companies. See notes 99-103 and accompanying text infra. In this regard, the Senate Bill follows the Commission's bill which proposed standards, reminiscent of Chapter X, providing special protective measures for the reorganization of publicly-held companies. See Trost & King, Congress and Bankruptcy Reform, Circa 1977, 33 Bus. Law. 489, 530 (1978).

7. Compare 1977 Senate Hearings, supra note 4, at 619-20 (supplemental statement of the Commercial Law League of America) and id. at 621-24 (statement of Philip A. Loomis, Jr.) with id. at 576 (statements of Robert J. Grimmig & John W. Ingraham).

8. U.S. Const. art. III, § 1 provides:
The Judicial Power of the United States shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish. The Judges, both of the supreme and inferior Courts, shall hold their Offices during good Behavior, and shall at stated Times, receive for their Services, a Compensation, which shall not be diminished during their Continuance in Office.


11. Trost & King, supra note 6, at 494.
The minority opposition is thought by many to have sufficient influence in the Senate to ensure defeat of the life tenure provisions of H.R. 8200. Under S. 2266 the bankruptcy courts will remain adjuncts of the federal district courts and bankruptcy judges will be appointed for twelve-year terms by the judicial council of each circuit.\footnote{12}

District court judges have long been noted for their lack of interest in bankruptcy proceedings.\footnote{13} One would expect reorganization proceedings, which demand both expertise and constant attention, to be as welcome as the plague when placed before a district judge. At the outset, then, Judicial Conference opposition to H.R. 8200 is surprising. Little light is shed on the matter by the objections put forth by the Conference:

the creation of a separate court to provide services in the limited field of bankruptcy, as a specialized court, is, in the opinion of this Committee, contrary to all trends of modern judicial administration. The creation of a separate court structure for bankruptcy cases would decrease the flexibility of the administration and the overall efficiency of the Federal courts.\footnote{14}

The historical justification for the Conference's opposition is of doubtful validity or relevance.\footnote{15} One can only speculate over why the Conference felt that formal separation of the bankruptcy courts from the district courts would make either inflexible or inefficient.\footnote{16}

The unfortunate truth may be that the Judicial Conference opposes life tenure for bankruptcy judges only because there exists an instinctive reluctance to part with or share any presently vested interests or powers. Whether the bloodlines of the Senate have inherited this defense mechanism will likely determine the date and the pervasiveness of any bankruptcy

\footnote{12. Senate Bill, supra note 4, § 201 (adding § 771(a), (c) to 28 U.S.C.). If the bankruptcy courts are not given article III status but are granted the jurisdiction and powers now under consideration in H.R. 8200 and S. 2266, important Constitutional issues may have to be dealt with. An excellent discussion of these issues appears in 1977 House Report, supra note 10, at 7-87.}

\footnote{13. See, e.g., 1977 House Report, supra note 10, at 14.}

\footnote{14. Special Committee of the Judicial Conference Review H.R. 6, Preliminary Report 1 (1977).}


\footnote{16. See 1977 House Report, supra note 10, at 28-29.}
Assuming, however, that these political differences will be resolved in the near future, this article’s focus will be on the substantive provisions of the two bills as they relate to business reorganizations. The article will first examine a number of general provisions of the proposed legislation which will be applicable to the more specialized reorganization chapter of the new law. The authors will then go on to compare the proposed reorganization provisions of the House and Senate bills and examine the changes in the current law that would result from an enactment of either bill. In the aftermath of this comparison and examination, the authors conclude that the House version’s flexible approach to bankruptcy reorganizations is preferable to the Senate’s more restrictive provisions which purport to provide greater protection for public investors than the House bill.

**Provisions Generally Applicable to All Bankruptcy Proceedings**

Except for the dischargeability legislation of 1970, the substantive provisions of the Bankruptcy Act are now forty years old. The bills before Congress contain much new law applicable to both ordinary bankruptcy and to reorganizations. Although the authors’ principal concern is with the specific provisions of Chapters 11 of H.R. 8200 and S. 2266, the wholesale revisions of the remaining Chapters ought not to be ignored. The authors shall examine a few provisions of Chapters 1, 3, and 5 of the House and Senate Bills which change current law and which are expected to influence the course of or the practitioner’s decision to initiate a Chapter 11 case.

**Jurisdiction**

Under the Bankruptcy Act, so-called summary jurisdiction resides in the bankruptcy court to hear and determine

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18. Both versions of the proposed Bankruptcy Act specify: "Except as provided in section 1161 of this title, chapters 1, 3, and 5 of this title apply in a case under chapter 7, 11 or 13 of this title." House Bill, supra note 3, § 101 (adding § 103(a) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 103(a) to 11 U.S.C.). Section 1161 of the new bankruptcy law makes certain provisions inapplicable to railroad reorganization cases. House Bill, supra note 3, § 101 (adding § 1161 to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 1161 to 11 U.S.C.).

For an analysis of the impact of the proposed legislation upon consumers, see Donnelly, supra note 2.
administrative matters and, in many instances, controversies respecting property in the actual or constructive possession of the estate. Absent such possessory interest the exercise of summary jurisdiction is dependent upon consent, express or implied, of the parties. In an effort to streamline the administration of liquidation and reorganization cases the Senate and House bills propose to vest original jurisdiction "of all civil proceedings arising under or related to cases under Title 11" in the bankruptcy courts.

The venue provisions of H.R. 8200 dig a not-so-shallow grave for the geographically distant creditor, claimant or obligor of the debtor, trustee or debtor-in-possession. With minor exceptions, "a proceeding arising under or related to a case under Title 11 may be commenced in the bankruptcy court in which such case is pending." The principal exceptions to this rule are those involving claims of less than $1000 or consumer debts of less than $5000. Money judgments on such claims must be sought "in the bankruptcy court for the district in which a defendant resides."

The saving grace, if any, for the trade creditor in, let us say, Carson City, Nevada who is alleged to have received a $1,200 preference from a New York City debtor-in-possession lies in the liberal change of venue provisions of H.R. 8200. A venue change is permitted, "in the interest of justice and for the convenience of the parties."

H.R. 8200 not only opens the bankruptcy court to trustee or debtor initiated cases now relegated to state courts, but goes one step further: certain cases which are frequent sources of

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22. House Bill, supra note 3, § 243 (adding § 1473(a) to 28 U.S.C.). The Senate Bill, supra note 4, § 203 (adding § 1391(h) to 28 U.S.C.) retains the current venue provisions of 28 U.S.C. § 1391(b)-(f) (1970). Thus, the defendant's residence or the district in which the claim arose will be the normal situs of the action.

It would be no surprise if section 1475 becomes a wellspring of pyrrhic victories. Counsel for debtors and creditors will agree that the ability to bring contested claims from around the country before a single forum is of enormous practical importance. Many debtor decisions to initiate reorganization cases may turn on this jurisdictional windfall.
collateral litigation to bankruptcy proceedings, but which did not involve the trustee or debtor-in-possession as a direct claimant, are expressly treated by the House bill. The proposed revision would overturn Caplin v. Marine Midland Grace Trust Co. of New York by allowing the trustee or debtor-in-possession to succeed to certain choses in action held not by the debtor but by "a creditor, a class of creditors," or "equity security holders" of the debtor. The circumstances under which such choses in action will pass to the representative of the estate are intricate, but not far-fetched. Reorganization cases, in particular, may provide a convenient if unexpected forum for resolving securities fraud claims of equity security holders against third parties unrelated to the debtor.

Initiating the Proceeding

Under both proposed bills, eligible debtors may commence a liquidation or reorganization proceeding voluntarily. Involuntary cases are commenced by three or more qualified creditors holding claims aggregating at least $5000 over and above any liens securing their claims. If the debtor has fewer than twelve creditors a single qualified creditor may initiate the case. These provisions represent only modest change from

28. The chose in action must not pass to the trustee (or debtor in possession) under any other provision of title 11; any recovery must go to the original claimholders (less expenses) and thereby benefit the estate by reducing the demands on the estate of such claimholders; the defendant in the action must not have a likely subrogation claim against the estate; and the suit must otherwise be in the best interest of the estate. House Bill, supra note 3, § 101 (adding § 544(c)(1)(A)-(D), (c)(3) to 11 U.S.C.).
29. The trustee or debtor-in-possession must file an action arising under § 544(c) in the bankruptcy court of the district in which the case might have been brought without regard to the bankruptcy venue provisions. House Bill, supra note 3, § 243 (adding § 1473(c) to 28 U.S.C.).
30. See text accompanying notes 88-103, supra.
32. House Bill, supra note 3, § 101 (adding § 303(b)(1) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 303(b)(1) to 11 U.S.C.). A creditor is qualified to act as a petitioning creditor if the creditor is an entity holding a claim against the debtor that is not contingent as to liability. House Bill, supra note 3, § 101 (adding § 303(b)(1) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 303(b)(1) to 11 U.S.C.). Indenture trustees representing such holders are similarly qualified. House Bill, supra note 3, § 101 (adding § 303(b)(1) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 303(b)(1) to 11 U.S.C.).
33. House Bill, supra note 3, § 101 (adding § 303(b)(2) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 303(b)(2) to 11 U.S.C.). The Bankruptcy Commission's
current law. 34

The grounds upon which a court will enter an "order for relief"35 in an involuntary case, however, are brand new. Gone are the familiar "acts of bankruptcy." 34 In their place the petitioning creditor(s) must demonstrate either that "the debtor is generally unable to pay" his debts as they come due37 or that the equivalent of a general assignment for benefit of creditors has taken place within 90 days of the date the petition was filed. 38

The major impact of the proposed revisions upon reorganization cases lies in the fact that creditors of both small and large business, corporate or otherwise, will have a choice of involuntary relief. At present, no involuntary cases may be brought under Chapters XI39 and XII40 of the Bankruptcy Act. Only Chapter X provides creditors with an alternative to an involuntary liquidation. 41 Creditors electing to file involuntary cases 42 will also be pleased with their lightened burden of

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proof—in most cases a showing of equitable insolvency.

The creditors' sword, twice sharpened, must be wielded carefully, for the proposed bills authorize the court to grant judgment against petitioning creditors for costs and attorney's fees if the petition is dismissed by the court.43 If a trustee was appointed prior to the hearing on the petition,44 damages proximately caused by the debtor's ouster from possession may also be awarded.45 If creditors file their petition in bad faith,46 all damages proximately caused by the filing and punitive damages may be awarded.47

The creditor's burden in initiating an involuntary case, thus, is easily fulfilled. Too easily, Congress must have thought, for even where petitioning creditors have otherwise carried their burden, the court may dismiss the petition or suspend the proceedings if, "the interests of creditors and the debtor would be better served by such dismissal or suspension."48

Property of the Estate

State law now controls many questions as to what property will comprise the debtor's estate.49 Dependence upon state law, for the most part, is eradicated by both bills.50 Except for spendthrift trusts51 and powers which the debtor might exercise

43. House Bill, supra note 3, § 101 (adding § 303(i)(1)(A), (B) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 303(i)(1)(A), (B) to 11 U.S.C.). Compare these identical provisions with Bankruptcy Act of 1898, § 69a, 11 U.S.C. § 109(a) (1970) which allows recovery of counsel fees and damages only when a receiver has been appointed. See also Fed. R. Bankr. P. 115(e).
44. Such appointment will be possible in some reorganization cases under the conditions which are slightly different under each bill. See text accompanying notes 144-57, infra.
47. House Bill, supra note 3, § 101 (adding § 303(i)(2) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 303(i)(2) to 11 U.S.C.).
48. House Bill, supra note 3, § 101 (adding § 305(a)(1) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 305(a)(1) to 11 U.S.C.). This abstention provision is designed to permit out of court work-outs or the continuation of previously instituted litigation, such as equity receiverships. See 1977 House Report, supra note 10, at 324. An order of dismissal under this Section will not be "reviewable on appeal or otherwise." House Bill, supra note 3, § 101 (adding § 305(c) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 305(c) to 11 U.S.C.).
50. House Bill, supra note 3, § 101 (adding § 541(a) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 541(a) to 11 U.S.C.).
51. House Bill, supra note 3, § 101 (adding § 541(c)(2) to 11 U.S.C.). S. 2266 however, brings spendthrift trusts into the estate, excluding only "the income reason-
solely for the benefit of third parties,52 "all legal or equitable interests of the debtor in property as of the commencement of the case" will pass to the estate.53

Commercial leases often contain a so-called "bankruptcy clause" which gives a lessor the option of terminating the lease upon the filing, by or against the lessee, of any proceeding in bankruptcy. Section 70b of the Bankruptcy Act54 makes such clauses enforceable against the estate.55

Retention of leasehold interests are usually vital to the continued operation of a debtor's business and thus to the success of the reorganization proceeding. This fact has prompted some courts to sidestep the plain wording of section 70b56 on "policy" grounds.57 Consistent with the treatment of secured creditors and the use of their collateral,58 the proposed legislation invalidates lease provisions triggered by the debtor's insolvency or "the commencement of a case under this title."59

If, at the time a case is commenced, the lessor already has a right of termination such right remains prima facie enforceable. Leases, however, are executory contracts and are subject to the provisions of section 365(b)(1) of the proposed bankruptcy law.60 Under that provision a lease may be reinstated by a trustee or debtor-in-possession by: 1) curing the default (or providing adequate assurance of prompt cure); 2) compensat-

52. House Bill, supra note 3, § 101 (adding § 541(b) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 541(b) to 11 U.S.C.).
53. House Bill, supra note 3, § 101 (adding § 541(a)(1) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 541(a)(1) to 11 U.S.C.). However, § 522(b) of the new bankruptcy law expressly overrides § 541(a) in allowing the debtor to exclude exempt property from the estate. House Bill, supra note 3, § 101 (adding § 522(a) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 522(a) to 11 U.S.C.).
56. "[A]n express covenant that an assignment by operation of law or the bankruptcy of a specified party thereto . . . shall terminate the lease or give the other party an election to terminate the same is enforceable." Bankruptcy Act of 1898, § 70b, 11 U.S.C. § 110b (1970).
57. See Queens Boulevard Wine & Liquor Corp. v. Blum, 503 F.2d 202, 202-06 (2d Cir. 1974) (termination avoided because of substantial injustice to the debtor); In re Fleetwood Motel Corp., 335 F.2d 857 (3d Cir. 1964) (termination avoided because counter to public interest and inequitable windfall to lessor).
58. See text accompanying notes 126-136, infra.
ing the lessor for actual pecuniary loss (or providing adequate assurance of prompt compensation); and 3) providing adequate assurance of future performance under the executory contract.\textsuperscript{61}

Preferences and Floating Liens

Of special interest to business debtors and their creditors is the treatment of preferential transfers in the Senate and House bills. The familiar elements of a preference are little changed.\textsuperscript{62} In place of the longstanding four-month rule, however, a ninety day period has been selected.\textsuperscript{63}

Trade creditors and lenders will be displeased with two major changes from current law. The recovery of preferential transfers will no longer be dependent upon the transferee's actual or constructive knowledge of the debtor's insolvency.\textsuperscript{64} Insolvency at the time of the transfer is still necessary, but is presumed to exist for the ninety days prior to the time the petition was filed.\textsuperscript{65}

The foregoing proposals regarding recovery of preferential transfers, coupled with the expansion of bankruptcy court j-

\textsuperscript{61} S. 2266 would not apply \textsection 365(b)(1) of the new bankruptcy law to liquidation cases, to leases entered into before the effective date of the legislation, to leases of property not essential to the debtor's business, or in cases where lease payments are substantially less than the fair rental value of the property. Senate Bill, supra note 4, \textsection 101 (adding \textsection 365(b)(3)(A)-(D) to 11 U.S.C.).

\textsuperscript{62} As under current Bankruptcy Act \textsection 60a(1), 11 U.S.C. \textsection 96a(1) (1970), there must be: (1) a transfer of the debtor's property (2) to or for the benefit of a creditor (3) on account of an antecedent debt (4) made while the debtor is insolvent (5) that enables the creditor to receive more than he would have (without the transfer) in a bankruptcy liquidation and (6) the transfer must have occurred within the statutory period. House Bill, supra note 3, \textsection 101 (adding \textsection 547(b)(4)(A) to 11 U.S.C.); Senate Bill, supra note 4, \textsection 101 (adding \textsection 547(b)(4)(A) to 11 U.S.C.).

\textsuperscript{63} House Bill, supra note 3, \textsection 101 (adding \textsection 547(b)(4)(A) to 11 U.S.C.); Senate Bill, supra note 4, \textsection 101 (adding \textsection 547(b)(4)(A) to 11 U.S.C.). Special provisions deal with preferential transfers to "insiders" as defined in House Bill, supra note 3, \textsection 101 (adding \textsection 101(24) to 11 U.S.C.); Senate Bill, supra note 4, \textsection 101 (adding \textsection 101(25) to 11 U.S.C.). The 90 day period is extended to 1 year. House Bill, supra note 3, \textsection 101 (adding \textsection 547(b)(4)(B)(i) to 11 U.S.C.); Senate Bill, supra note 4, \textsection 101 (adding \textsection 547(b)(4)(B)(i) to 11 U.S.C.).

\textsuperscript{64} House Bill, supra note 3, \textsection 101 (adding \textsection 547(b) to 11 U.S.C.); Senate Bill, supra note 4, \textsection 101 (adding \textsection 547(b) to 11 U.S.C.). Compare the proposed revision with Bankruptcy Act of 1898, \textsection 60b, 11 U.S.C. \textsection 96b (1970).

In the case of insiders only, recovery of preferential transfers occurring between the 90th day and one year before filing of the petition is dependent upon proof of the insider's knowledge of the debtor's insolvency. House Bill, supra note 3, \textsection 101 (adding \textsection 547(b)(4)(B)(ii) to 11 U.S.C.); Senate Bill, supra note 4, \textsection 101 (adding \textsection 547(b)(4)(B)(ii) to 11 U.S.C.).

\textsuperscript{65} House Bill, supra note 3, \textsection 101 (adding \textsection 547(f) to 11 U.S.C.); Senate Bill, supra note 4, \textsection 101 (adding \textsection 547(f) to 11 U.S.C.).
risdiction, should substantially increase the trustee's ability and motivation to recover funds for the estate.

A slight inroad in the trustee's recovery power will result from a new twist in the treatment of certain "antecedent debts." Both versions of the prepared law bar recovery of payments on debts "incurred in the ordinary course of business or financial affairs" of both the debtor and transferee, made within "45 days after such debt was incurred," if the payment was made in the ordinary course of business of both parties.

A new test is provided for the avoidance of floating liens upon inventory and receivables. The ratio decendi, although not the holdings of Dubay v. Williams and Grain Merchants of Indiana, Inc. v. Union Bank & Savings Co. are swept away by the proposed legislation. Both bills permit the avoidance of perfected security interests in after-acquired collateral only where the secured party has improved its position during the ninety-day period.

Avoidance of Security Interests

The so-called "strong arm" clause, section 70c of the Bankruptcy Act, is incorporated in the Senate and House bills with some welcome clarifying language. Both bills allow the trustee or debtor-in-possession to avoid most security interests

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66. See text accompanying notes 19-29, supra.
69. House Bill, supra note 3, § 101 (adding § 547(c)(2)(C) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 547(c)(2)(C) to 11 U.S.C.).
70. "Inventory" is defined at House Bill, supra note 3, § 101 (adding § 547(a)(1) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 547(a)(1) to 11 U.S.C.).
71. "Receivable" is defined at House Bill, supra note 3, § 101 (adding § 547(a)(3) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 547(a)(3) to 11 U.S.C.).
72. 417 F.2d 1277 (9th Cir. 1969).
73. 408 F.2d 209 (7th Cir. 1969). Dubay and Grain Merchants concluded that no preference had in fact occurred. The Senate and House bills reach the same result by making the "preference" nonrecoverable.
74. Since the key dates are the date the petition is filed and the 90th day before, a creditor whose collateral initially falls in value (during the 90 day period) and then rises shortly before the filing date will not have received a recoverable preference, unless, of course, the increase in value carries the collateral above the value 90 days before filing.
75. See 4A COLLIER ON BANKRUPTCY ¶70.45, at 559 (14th ed. 1940).
77. House Bill, supra note 3, § 101 (adding § 544(a) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 544(a) to 11 U.S.C.).
which are not perfected at the time a case is commenced. The trustee is given the rights of: 1) a creditor on a simple contract with a judicial lien on property of the debtor on the date the case is commenced; 2) a creditor with a writ of execution against the property of the debtor unsatisfied on the date of filing, and 3) a bona fide purchaser of the debtor's real property as of the date of the petition.

In no case does it matter whether any such creditor actually exists on the date the petition is filed. Any actual or constructive knowledge of the security interest on the part of the trustee or actual creditors is similarly unimportant.

Rejecting the Bankruptcy Commission's recommendation that Moore v. Bay be overturned, the proposed revisions allow the trustee to set aside transfers of the debtor's property which are voidable by any actual unsecured creditor of the estate and to do so for the benefit of the entire estate.

THE GENERAL EFFECT OF A CONSOLIDATED, SINGLE REORGANIZATION CHAPTER

Though the changes in Chapters 1, 3, and 5 are important, perhaps the most significant changes in the law of bankruptcy reorganization that would be implemented by either H.R. 8200 or S. 2266, is the consolidation of Chapters X, XI and XII of the current Bankruptcy Act into a single reorganization proceeding. Among the effects of such a consolidation would be

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81. The proposed revision would thereby overturn Pacific Fin. Corp. v. Edwards, 304 F.2d 224 (9th Cir. 1962), which held that section 70c required the existence of an actual creditor (on the date of bankruptcy) who could avoid an unperfected lien.

82. House Bill, supra note 3, § 101 (adding § 544(a) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 544(a) to 11 U.S.C.).

83. 284 U.S. 4 (1931).

84. COMMISSION REPORT, supra note 1, Part II § 4-604(b)(1) at 160-61.

85. House Bill, supra note 3, § 101 (adding § 544(b) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 544(b) to 11 U.S.C.).

86. Chapter 11 of the new bankruptcy act would also apply to railroad reorganizations which are currently governed by § 77 of the current act, 11 U.S.C. § 205 (1970). However, the proposed revision continues to recognize that railroad reorganizations involve issues that are peculiar to railroad corporations and thus contains a separate subchapter devoted entirely to procedures and standards that would apply solely in those cases. House Bill, supra note 3, § 101 (adding §§ 1161-1172 to 11 U.S.C.); Senate
the elimination of two barriers, extant in the current law, which in many cases operate to prevent a financially troubled business from acquiring the kind of relief that is needed for its rehabilitation. The first of these barriers is the eligibility restrictions which prohibit certain business entities from obtaining relief under current Chapters X and XII. The second barrier is the restriction on the ability of a plan of reorganization to affect secured debtors under Chapter XI.

This section of the article will proceed to review these two types of restrictions before going on to analyze the impact of their elimination under proposed Chapter 11. In addition, although the differences between H.R. 8200 and S. 2266 with respect to these restrictions are few, it will be seen that one important difference between them is the special provisions in the Senate bill alone, for the treatment of "public companies."^87

Eligibility for Relief

The current Bankruptcy Act permits only certain forms of business entities to obtain relief under each of its reorganization chapters. Thus, the rehabilitative provisions of Chapter X are available only to corporations,^88 and although the Bankruptcy Act contains a rather broad definition of what qualifies as a corporation,^89 most partnerships and individually owned businesses are ineligible for relief under Chapter X.^90


87. See notes 99-103 and accompanying text infra.

88. Section 106(5) of the current Bankruptcy Act defines "debtor" for the purposes of Chapter X as "a corporation by or against which a petition has been filed under [Chapter X]." 11 U.S.C. § 506(5) (1970) (emphasis added). Section 126 further provides that "[a] corporation . . . may . . . file a petition under this chapter." 11 U.S.C. § 526 (1970); see 6 Collier on Bankruptcy ¶ 4.05[1], at 786-87 (14th ed. 1940).

89. Bankruptcy Act of 1898, § 1(8), 11 U.S.C. § 1(8) (1970) provides that:

"[c]orporation" shall include all bodies having any of the powers and privileges of private corporations not possessed by individuals or partnerships and shall include partnership associations organized under laws making the capital subscribed alone responsible for the debts of the association, joint-stock companies, unincorporated companies and associations, and any business conducted by a trustee or trustees wherein beneficial interest or ownership is evidenced by certificate or other written instrument.

Because of this broad definition, Chapter X is applicable to many forms of business entities that are not commonly referred to as corporations. See 6 Collier on Bankruptcy ¶ 2.07[1], at 314-16 (14th ed. 1940).

90. The requirement that a Chapter X petition be filed "in good faith" operates to prevent otherwise ineligible entities from altering their form of organization merely
Alternatively, under Chapter XI any "person who could become a bankrupt under [section 4] of [the Bankruptcy Act]" may file a petition for relief. The language of this chapter encompasses natural persons, partnerships, and corporations other than those specifically excluded or treated elsewhere in the Bankruptcy Act.

The eligibility requirements in Chapter XII relate not only to the form of organization of the debtor, but also to the type of property which secures the debtor's obligations. Section 406(6) of the Bankruptcy Act operates to permit any person "other than a corporation as defined in [the Bankruptcy] Act . . . who is the legal or equitable owner of real property or a chattel real which is security for any debt" to petition the court for rehabilitation under Chapter XII. As a result, Chapter XII is available only to individuals and partnerships who own real property which is security for any debt, whether owned by the Chapter XII petitioner or by another.

Chapters X and XII, then, place significant restrictions upon the kinds of debtors who may apply for relief. In contrast, Chapter XI, on its face, would appear to be the most flexible among the reorganization proceedings. As will be seen, however, the imposition of other restrictions in Chapter XI upon

in order to become eligible for relief under Chapter X. Bankruptcy Act of 1898, § 141, 11 U.S.C. § 541 (1970); e.g., In re Metropolitan Realty Corp., 433 F.2d 676 (5th Cir. 1970), cert. denied, 401 U.S. 1008 (1971); see 6 COLLIER ON BANKRUPTCY ¶ 1.07[2], at 1050-54 (14th ed. 1940). But see In re Northand Construction Co., 560 F.2d 756 (7th Cir. 1977), where the court indicated that it might have found the debtor's petition to be in good faith, notwithstanding an incorporation of the debtor's business solely to qualify for Chapter X, had there been a showing of the "need which a reorganization under Chapter X is ordinarily designed to serve." Id. at 760. See notes 184-85 and accompanying text, infra.

92. 8 COLLIER ON BANKRUPTCY ¶ 2.09 at 82-84 (14th ed. 1940).
Section 4a indicates who may become voluntarily bankrupt and § 4b indicates who may become involuntarily bankrupt. Bankruptcy Act of 1898 § 4a, b, 11 U.S.C. § 22a, b (1970). See 8 COLLIER ON BANKRUPTCY ¶ 2.09 at 82-83 (14th ed. 1940).
95. The language of § 406(6) which limits Chapter XII to non-corporate entities "who are the legal or equitable owners of real property . . . which is security for any debt," 11 U.S.C. § 806(6) (1970), means that "[i]t is not necessary . . . that the debt be owing by the person seeking relief under Chapter XII." 9 COLLIER ON BANKRUPTCY ¶ 2.07, at 763 (14th ed. 1940).
the type of debts that may be affected severely limits its otherwise apparent flexibility.

As opposed to the current law, both proposed revisions render any individual, partnership or corporation which resides, has a place of domicile or business, or owns property in the United States eligible for relief. The proposed business rehabilitation chapter of the new law would retain existing restrictions preventing insurance companies, banks, and the like from obtaining relief under the act and would also provide for the specialized treatment, within Chapter 11, of railroad corporations.

Although both versions of the proposed act would contain only these very few eligibility restrictions, the Senate Bill does provide for the special treatment of what its drafters refer to as "public companies." It provides more stringent protective measures for debtors who "within twelve months prior to the filing of a petition for relief under [chapter 11], had outstanding liabilities of $5,000,000 or more, exclusive of liabilities for goods, services, or taxes and not less than 1,000 security holders." Although the special treatment afforded public compa-
nies under the Senate version is not truly an eligibility restriction, such treatment would restrict the flexible application of the new chapter. The details of this protective treatment will become apparent in the sections that follow dealing with the control of the debtor's business during reorganization, solicitation of acceptances of the plan by creditors, the role of the Securities and Exchange Commission in a reorganization proceeding, and the standard of fairness required for confirmation of a reorganization plan.

Affecting the Rights of Secured Creditors

In addition to the differences among Chapters X, XI, and XII with respect to eligibility for relief, there are important differences among those chapters in the extent to which the rights of secured creditors and stockholders may be affected. For example, Chapter X is the most flexible of the reorganization proceedings in this area, permitting the alteration of the rights of both secured and unsecured creditors as well as those of stockholders. Any alteration of those rights however, is of course, subject to a standard of fairness which requires that senior claims be satisfied completely before junior creditors, or stockholders may participate in the reorganized company.

In sharp contrast to the provisions of Chapter X, "[it is uniformly recognized that the rights of secured creditors cannot be affected or modified" by a Chapter XI plan of arrangement. Despite this proscription, however, it is equally clear that although a plan of arrangement may not affect the rights of secured creditors, the Chapter XI proceeding frequently does

100. See notes 144-57 and accompanying text, infra.
101. See notes 195-210 and accompanying text, infra.
102. See notes 176-94 and accompanying text, infra.
103. See notes 229-36 and accompanying text, infra.
104. Section 216(1) of the current Bankruptcy Act provides that a Chapter X plan of reorganization "shall include in respect to creditors generally or some class of them, secured or unsecured, and may include in respect to stockholders generally or some class of them, provisions altering or modifying their rights . . . ." 11 U.S.C. § 616(1) (1970); 6A COLLIER ON BANKRUPTCY ¶ 10.03, at 15-20 (14th ed. 1940).
105. See notes 229-30 and accompanying text, infra.
106. Murphy, Restraint and Reimbursement: The Secured Creditor in Reorganization and Arrangement Proceedings, 30 Bus. Law. 15, 43 & n.179 (1974); see 8 COLLIER ON BANKRUPTCY ¶ 2.07[3], at 77-79 (14th ed. 1940). This rule is based on §§ 306(1), 307, 356 and 357 of the Bankruptcy Act, which do not in any way provide for the treatment of secured debt. 11 U.S.C. §§ 706(1), 707, 756, 757 (1970); 9 COLLIER ON BANKRUPTCY ¶ 7.05[4], at 30-32 (14th ed. 1940); Murphy, supra at 43; see, e.g., SEC v. United States Realty & Improvement Co., 310 U.S. 434, 452 (1940).
have an impact upon their rights. The arrangement proceeding can affect those rights via the automatic stay provisions of section 314 of the Bankruptcy Act and Bankruptcy Rule 11-44, which, taken together, prevent creditors, including those holding security, from enforcing their rights during the pendency of the Chapter XI case. The stay may be lifted however, and the debtor will thereby be denied use of the secured property if the creditor cannot be provided with protection against the loss of the value of the collateral during the arrangement proceeding. The rights of stockholders, also not literally permitted to be affected by the Chapter XI plan, are similarly affected by the automatic stay.

Chapter XII, it will be remembered, is available only to non-corporate entities which own real property that is security


108. Section 314 of the Bankruptcy Act provides that

[the court may . . .] . . . enjoin or stay until final decree the commencement or continuation of suits other than suits to enforce liens upon the property of a debtor, and may, upon notice and for cause shown, enjoin or stay until final decree any act or the commencement or continuation of any proceeding to enforce any lien upon the property of the debtor.


109. There are a number of factors which determine whether the stay will be lifted to permit the secured creditor to foreclose upon his collateral. Those factors include whether the debtor has equity in the collateral, whether the delay caused by the stay will impair the value of the collateral, whether the collateral is necessary for the operation of the debtor's business, and whether there is a realistic possibility of formulating a successful arrangement between the debtor and his unsecured creditors. See Anderson, supra note 107, at 15-20; Countryman, supra note 108, at 350; Peitzman & Smith, supra note 108, at 1224-33; Seidman, supra note 108, at 347; Werth & Reed, supra note 108, at 37-46.

110. See Blum & Kaplan, Affecting Rights to Equity Interests Under Chapter XI of the Bankruptcy Act, 1972 WIS. L. REV. 978, 981-82.

111. Id.
for any debt.\textsuperscript{112} Quite the opposite of a Chapter XI plan of arrangement, a Chapter XII plan must have as its \textit{primary purpose}, the modification or alteration of those obligations which are secured by the petitioner's real property.\textsuperscript{113} As long as the plan is consistent with this primary purpose, the plan may, in addition, affect the rights of unsecured creditors.\textsuperscript{114} Since corporations are ineligible for relief under Chapter XII, however, the rights of stockholders are not in issue.

Just as in the area of eligibility requirements, proposed Chapter 11 significantly alters the present treatment accorded creditors. It eliminates all restrictions upon the types of interests which may be affected by a plan of reorganization. Both revisions provide that a Chapter 11 plan may "impair or leave unimpaired any claim or interest."\textsuperscript{115} Thus, a plan under proposed Chapter 11 may affect any debt, whether secured or unsecured, as well as any equity interest.\textsuperscript{116} The manner in which those debts and interests are affected, of course, will remain subject to the "fairness standard" of the proposed revision, and all parties will continue to be entitled to at least what they would have received in a liquidation of the debtor.\textsuperscript{117} However, the ability to affect secured debt in the single reorganization chapter of the proposed act provides a flexibility that currently is available only in the otherwise restrictive Chapter X.

The proposed revision retains a modified version of the automatic stay provision of the current Bankruptcy Rules and provides both a procedure and a standard for the court to use in determining whether to modify or terminate the stay.\textsuperscript{118}

\textsuperscript{112} See text accompanying notes 94-95, supra.
\textsuperscript{113} 9 COLLI\textit{ER ON BANKRUPTCY} \S 2.02, at 756 (14th ed. 1940).
\textsuperscript{114} Bankruptcy Act of 1898, \S 461(3), 11 U.S.C. \S 861(3) (1970); 9 COLLI\textit{ER ON BANKRUPTCY} \S 8.04, at 1069-70 (14th ed. 1940).
\textsuperscript{115} House Bill, supra note 3, \S 101 (adding \S 1123(b)(1) to 11 U.S.C.); Senate Bill, supra note 4, \S 101 (adding \S 1123(b)(1) to 11 U.S.C.). A claim or interest is impaired by the plan if it alters the "legal, equitable [or] contractual rights" of the holder of a claim or interest, unless the alteration of those rights is otherwise cured or compensated for. See House Bill, supra note 3, \S 101 (adding \S 1124 to 11 U.S.C.); Senate Bill, supra note 4, \S 101 (adding \S 1124 to 11 U.S.C.).
\textsuperscript{116} Trost \& King, supra note 6, at 531.
\textsuperscript{117} See notes 229-36 and accompanying text, infra.
\textsuperscript{118} House Bill, supra note 3, \S 101 (adding \S 362 to 11 U.S.C.); Senate Bill, supra note 4, \S 101 (adding \S 362 to 11 U.S.C.). The types of actions that would be forestalled by the automatic stay are the same under both bills. The scope of the stay is clarified in the proposed revision, expanding its coverage in some areas and contracting it in others. 1977 HOUSE REPORT, supra note 10, at 174. In particular, the bills make it clear that actions by government agencies, in the enforcement of the agency's police or regulatory power, would not be stayed. House Bill, supra note 3, \S 101 (adding \S 362(b)(4) to 11 U.S.C.); Senate Bill, supra note 4, \S 101 (adding \S 362(b)(4) to 11
Upon the formal request of a creditor, the stay can be removed or altered after a noticed hearing, however, if the court does not affirmatively order the continuance of the stay within 30 days after the creditor's request for relief, the stay will be terminated automatically. Both versions also provide, upon a showing of irreparable damage, for an ex parte grant of relief from the stay.

The standard for relief in a noticed hearing, however, is only that "cause" be shown. In addition to this nebulous standard, however, both versions provide that the burden is on the debtor or trustee to justify continuance of the stay and that "the lack of adequate protection of an interest in property" held by the party seeking relief constitutes cause for the relief sought. Although both versions indicate how adequate protection can be provided, the Senate bill goes on to require relief from the stay whenever "the court finds that the debtor has no equity in the property subject to the stay," whether or not adequate protection can otherwise be provided.

In addition to the automatic stay, the proposed bills pro-

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119. House Bill, supra note 3, § 101 (adding § 362(d) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 362(d) to 11 U.S.C.). For a proposed redrafting of this provision see Peitzman & Smith, supra note 108, at 1256-62.

120. House Bill, supra note 3, § 101 (adding § 362(e) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 362(e) to 11 U.S.C.). To continue the stay beyond the 30 day period the debtor must attend a preliminary hearing and at least show that there is a "reasonable likelihood that the [debtor] will prevail at [a] final hearing." House Bill, supra note 3, § 101 (adding § 362(e) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 362(e) to 11 U.S.C.). This provision restricts the current practice of some bankruptcy courts of simply refusing to hold a hearing on the termination of the stay and thereby endangering the value of the secured party's collateral. See Trost & King, supra note 6, at 538.

121. House Bill, supra note 3, § 101 (adding § 362(f) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 362(f) to 11 U.S.C.).

122. House Bill, supra note 3, § 101 (adding § 362(d) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 362(d) to 11 U.S.C.).

123. House Bill, supra note 3, § 101 (adding § 362(d) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 362(d) to 11 U.S.C.).

124. See notes 132-36 and accompanying text, infra.

125. Senate Bill, supra note 4, § 101 (adding § 362(d) to 11 U.S.C.). Such a rule could, however, render rehabilitation impossible where the property sought by a creditor is essential to the business of the debtor. See 1977 Senate Hearings, supra note 4, at 856-58 (statement of John J. Credeon).
vide, in nearly identical sections, for the debtor's use, sale or lease of the property of the estate.\textsuperscript{126} Although notice and a hearing are required before any such treatment of the debtor's property outside the ordinary course of business,\textsuperscript{127} there are fewer restrictions upon its use or sale when such action is in the ordinary course of the debtor's business.\textsuperscript{128} Important to creditors is a requirement that the debtor in possession or trustee notify any secured party before selling or using any inventory, accounts, or other property which may be easily dissipated and that such property may only be used or sold for five days after such notice unless the court thereafter authorizes the treatment of the property sought by the representative of the estate.\textsuperscript{129}

The only difference between the two proposed bills in this area deals with the requirements for a sale of property free and clear of any interest claimed by a third party. Both bills require one of a number of alternate qualifying criteria which are designed to protect the interest of the third party claimant.\textsuperscript{130} The Senate bill, in addition, requires that the property be sold at a "fair upset price and on not less than 30 days notice" to the adverse party.\textsuperscript{131} The effect of this additional provision is to help ensure the protection of secured creditors whose interests may be lost or impaired if they are unable to prevent the sale or use of their collateral.

\textsuperscript{126} House Bill, \textit{supra} note 3, § 101 (adding § 363 to 11 U.S.C.); Senate Bill, \textit{supra} note 4, § 101 (adding § 363 to 11 U.S.C.); see generally 1977 \textit{House Report}, \textit{supra} note 9, at 181-83, 344-46; Trost & King, \textit{supra} note 6, at 538-43.

\textsuperscript{127} House Bill, \textit{supra} note 3, § 101 (adding § 363(b) to 11 U.S.C.); Senate Bill, \textit{supra} note 4, § 101 (adding § 363(b) to 11 U.S.C.).

\textsuperscript{128} House Bill, \textit{supra} note 3, § 101 (adding § 363(c) to 11 U.S.C.); Senate Bill, \textit{supra} note 4, § 101 (adding § 363(c) to 11 U.S.C.).

\textsuperscript{129} House Bill, \textit{supra} note 3, § 101 (adding § 363(c) to 11 U.S.C.); Senate Bill, \textit{supra} note 4, § 101 (adding § 363(c) to 11 U.S.C.). The notification requirement is designed to enable a secured party to move quickly to protect his interest. 1977 \textit{House Report}, \textit{supra} note 10, at 182.

\textsuperscript{130} Those criteria permit the sale of property free and clear of any third-party interest in the property if:

\begin{enumerate}
  \item applicable nonbankruptcy law permits sale of such property free and clear of such interest;
  \item such entity consents;
  \item such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of such interest;
  \item such interest is in bona fide dispute; or
  \item such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.
\end{enumerate}


\textsuperscript{131} Senate Bill, \textit{supra} note 4, § 101 (adding § 363(f) to 11 U.S.C.).
As with creditors seeking relief from the automatic stay, secured creditors can prevent the sale or use of their collateral whenever it is necessary to provide adequate protection of their interests. Under the House bill, adequate protection can be provided by making periodic cash payments, providing additional or alternative security, granting the creditor an administrative priority claim or any other relief which would protect the secured party’s interest. The Senate bill however does not include the latter two methods, reflecting a fear that any method other than the first two would result in an increased risk to secured creditors.

PROCEDURE DURING THE FORMULATION OF A PLAN

Eligibility to Propose a Plan of Reorganization

Aside from eligibility for a particular reorganization proceeding, the current law places certain restrictions, within each chapter, upon which of the parties may formally propose a plan of reorganization or arrangement. Under Chapter X, when a trustee is appointed, only the trustee, the creditors, and stockholders have a right to make the initial proposal of a plan.

132. House Bill, supra note 3, § 101 (adding § 363(e) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 363(e) to 11 U.S.C.).

133. Cash “rental payments” have been recognized in the past as a method of reimbursing secured creditors for any economic depreciation of collateral left in the hands of a debtor during reorganization. In In re Bermec Corp., the debtor was permitted to retain equipment needed to operate its business in return for periodic payments that were to compensate the secured party for any actual depreciation of the secured property. In re Bermec Corp. [1970-1973 Transfer Binder] Bankr. L.Rep. (CCH) ¶ 64, 065 (S.D.N.Y. July 15, 1971), aff’d, 445 F.2d 367 (2d Cir. 1971). In an earlier case, however, the same circuit court of appeal affirmed a federal district court judge’s refusal to require such payments. In re Yale Express Sys., Inc., 384 F.2d 990, 992 (2d Cir. 1967), aff’d from remand after 370 F.2d 433 (2d Cir. 1966). Countryman, supra note 108, at 351, 353; Festersen, Equitable Powers in Bankruptcy Rehabilitation: Protection of the Debtor and the Doomsday Principle, 5 Creighton L. Rev. 221, 239 (1972); Murphy, supra note 106, at 32-36; Murphy, Use of Collateral in Business Rehabilitations: A Suggested Redrafting of Section 7-203 of the Bankruptcy Reform Act, 63 Calif. L. Rev. 1483, 1494-95 (1975); Rosenberg, Beyond Yale Express: Corporate Reorganization and the Secured Creditor’s Right of Reclamation, 123 U. Pa. L. Rev. 509 (1975).


136. 1977 Senate Hearings, supra note 4, at 705 (statement of Edward J. Kulik).

137. In Chapter X of the current law, a trustee must take over the debtor’s business where there is over $250,000 in debt. Bankruptcy Act § 156, 11 U.S.C. § 556 (1970). Otherwise, it remains within the discretion of the court whether to appoint a trustee or to continue the debtor in possession. Id.; Fed. R. Bankr. P. 10-202(a). See 6 Collier on Bankruptcy ¶ 7.06 at 1198-1202 (14th ed. 1940).
of reorganization. Under Chapter XI, the debtor has the sole right throughout the arrangement proceeding to propose a plan of arrangement, and in Chapter XII, both the debtor and creditors may propose plans for consideration by the court and the creditors. Thus, eligibility to file a plan varies with each chapter of the current law.

Under both versions of the proposed revision, however, the initial eligibility of the parties to propose a plan turns on whether a trustee is appointed. When a trustee is appointed, then "[a]ny party in interest, including the debtor, the trustee, a creditor's committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee, may file a plan ... ." If the debtor is allowed to remain in possession during the reorganization proceeding, these parties in interest can propose a plan only if the debtor fails to file a plan within 120 days of the order for relief or is unable to acquire the acceptances of the requisite number of creditors within 180 days from such date. Thus, both versions of the proposed revision grant the debtor the exclusive right to file a plan unless a trustee is appointed or unless the debtor is unable, after a specified time, to formulate or acquire the creditors' approval of a plan.

Control of the Debtor's Business During Reorganization

Under the current bankruptcy act, the choice of the type of reorganization proceeding often dictates whether and under what circumstances a trustee will be appointed to control the debtor's business during the reorganization proceeding. The alternative to the appointment of a trustee is to continue the debtor in possession of the estate and allow him to manage the

138. 6 COLLEER ON BANKRUPTCY ¶ 7.33, at 1292-93 (14th ed. 1940). COLLEER, however, continues to suggest a theory, arising under the debtor's 'right to be heard on all matters arising in a [Chapter X] proceeding . . . .' under which the debtor is entitled to propose a plan even before the trustee has that right. Id. at 1293. (quoting Bankruptcy Act of 1898, § 206, 11 U.S.C. § 606 (1970)).


140. FED. R. BANKR. P. 12-36(a), (b); see 9 COLLEER ON BANKRUPTCY ¶ 8.01, at 1062 (14th ed. 1940).

141. See notes 144-57 and accompanying text, infra.

142. House Bill, supra note 3, § 101 (adding § 1121(c)(1) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 1121(c)(1) to 11 U.S.C.).

143. House Bill, supra note 3, § 101 (adding § 1121(c)(2) and (3) to 11 U.S.C.). Both the 120 and the 180 day periods, however, can be extended or reduced upon a showing of cause at a noticed hearing. House Bill, supra note 3, § 101 (adding § 1121(d) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 1121(d) to 11 U.S.C.).
business as well as to control the reorganization effort.

Under Chapter X, a trustee must be appointed where there is over $250,000 in debt, and may be appointed when the debt is below that benchmark. Under Chapter XI, on the other hand, the debtor continues in possession, unless either, "a trustee in bankruptcy had been previously appointed" or "unless there is some reason for the appointment of a receiver." Similar to Chapter XI, Chapter XII contemplates the continuation of the debtor in possession of the estate in most cases. Thus, the retention or removal of the debtor’s management in favor of a trustee or receiver, under existing law, is largely controlled by the choice of reorganization proceeding.

The House and Senate versions of the proposed revision, however, differ with respect to the circumstances under which such protection is deemed appropriate. The House version provides, upon request of a party in interest and after a noticed hearing, for a balancing test to determine the need and value of an independent trustee. The law, thus revised, would require the court to weigh the need for “the protection afforded by a trustee” against “the costs and expenses of . . . the protection [so] afforded.” Although the section is “not intended to [establish] a strict cost/benefit analysis,” it does clearly require the court to consider the cost of appointing a trustee to manage the debtor's business.

The Senate version, on the other hand, adopts an amended version of the foregoing balancing standard for nonpublic companies and requires the appointment of a trustee in cases dealing with public companies. With respect to nonpublic companies, the Senate version requires, in addition to the balancing standard in the House bill, that a trustee may be elected "for cause shown." It remains unclear whether this showing requires something more than the showing, already required,

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146. 8 COLLIER ON BANKRUPTCY ¶ 5.09[9], at 570-71 (14th ed. 1940).
147. Id. ¶ 5.09[1], at 566.
148. See Advisory Committee Note to FED. R. BANKR. P. 12-17.
149. Trost & King, supra note 6, at 534.
150. House Bill, supra note 4, § 101 (adding § 1104(a) to 11 U.S.C.); see 1977 HOUSE REPORT, supra note 10, at 232-34, 402-03; Trost & King, supra note 6, at 534-35.
151. 1977 HOUSE REPORT, supra note 10, at 403.
152. Id.
153. Senate Bill, supra note 4, § 101 (adding § 1104(b) to 11 U.S.C.).
154. Id.
that "the protection afforded by a trustee is needed,"155 however, it appears that this additional language is a mere restatement of the balancing standard already required by both bills.

In conformity with the pattern evident in the Senate version of the proposed revision, S. 2266 makes the appointment of a trustee156 mandatory in cases involving public companies.157 Thus, any business with more than $5,000,000 in debt and more than 1,000 security holders, finding itself in Chapter 11 of the Senate version of the proposed revision would also find itself saddled with an independent trustee whether or not the protection afforded by such trustee can be shown to be needed or worth its expense. In effect then, the Senate version contains a legislative conclusion that a trustee is both needed and cost-effective in cases involving public companies, whereas the House version would leave that determination up to the bankruptcy courts on a case-by-case basis.

_Creditor’s and Equity Holder’s Committees_

Although creditor’s committees, formulated as representatives of larger numbers of creditors, are recognized in all three reorganization proceedings,158 Chapter XI alone provides for their selection and designates their powers and rights during the reorganization proceeding.159 Both versions of the proposed revision would retain the creditors committee’s “functions of investigation, consultation and negotiation.”160 In addition, the committee would continue to be a party in interest with the right to appeal.161 The creditor’s committee will also be given the right, in a departure from existing practice, to formally


156. In cases involving non-public companies the Senate bill provides for the election of the trustee by the creditors, whereas the House version would require the court to appoint a trustee. Compare Senate Bill, supra note 4, § 101 (adding § 1104(b) to 11 U.S.C.) with House Bill, supra note 3, § 101 (adding § 1104(a) to 11 U.S.C.).

157. Senate Bill, supra note 4, § 101 (adding § 1104(a) to 11 U.S.C.). This provision has been generally criticized by those favoring a flexible reorganization proceeding. See, e.g., 1977 Senate Hearings, supra note 4, at 585 (statement of Patrick A. Murphy).

158. 8 COLLIER ON BANKRUPTCY ¶ 5.48[4], at 724 (14th ed. 1940); see 1977 HOUSE REPORT, supra note 10, at 235.


160. Trost & King, supra note 6, at 536.

161. See 8 COLLIER ON BANKRUPTCY ¶ 5.48[1], at 721 (14th ed. 1940); cf. SEC v. United States Realty & Improvement Co., 310 U.S. 434 (1940) (SEC permitted to intervene and appeal the propriety of a Chapter XI petition).
propose a plan of reorganization to the court. Although "[i]t is not expected that the committee would often exercise this right," the fact that it retains the power to do so is expected to render the "debtor more sensitive to the desire of creditors" during the formulation of a plan.

Despite the equivalent powers granted to the creditor's committees by both versions of the proposed act, the Senate and House bills differ greatly over the manner for selecting members of the committees. The House version dictates the appointment, by the court, of a central creditor's committee which:

shall ordinarily consist of the persons that hold the seven largest claims against the debtor of the kinds represented on such committee, or of the members of a committee organized by creditors before the order for relief under [Chapter 11], if such committee was fairly chosen and is representative of the different kinds of claims to be represented.

The House version then provides an avenue for any party in interest to challenge the membership of a committee on the basis that "such committee is not representative of the different kinds of claims or interests to be represented."

Alternatively, the Senate version, maintains the policy existing under the current bankruptcy act, in favor of allowing the creditors to elect their representatives from among their number. This committee, however, must consist of at least three members "each of whom holds an allowable unsecured claim against the debtor."

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162. Unless a trustee is appointed, however, the debtor is given the first opportunity to propose a plan of reorganization. See notes 137-43 and accompanying text, supra.

163. Trost & King, supra note 6, at 536.

164. Id.

165. House Bill, supra note 3, § 101 (adding § 1102(b)(1) to 11 U.S.C.). If a committee of stockholders is appointed, such committee will also "ordinarily consist of the persons that hold the seven largest amounts of equity securities of the debtor of the kinds represented" by the committee. Id. (adding § 1102(b)(2) to 11 U.S.C.). The committees, however, are not required to consist of those persons holding the seven largest claims or interests of the type represented by their respective committees. See 1977 House Report, supra note 10, at 401. Thus, if an eligible creditor or stockholder declines membership on the committee, the court should feel free to appoint any holder of a claim or interest which is similar to those represented by the other members of the committee.

166. House Bill, supra note 3, § 101 (adding § 1102(c) to 11 U.S.C.).

167. Senate Bill, supra note 4, § 101 (adding § 1102(a) to 11 U.S.C.).

168. Id. This rule is consistent with the minimum of three members required
An enactment of this provision would perpetuate the current practice of allowing creditor's committees to be elected and would thus frustrate the Bankruptcy Commission's recommendation that the creditor's committee be appointed in order to enhance the control which creditors will have over the reorganization proceeding. However justified, the Commission felt that election of creditor's committees had failed as a device to encourage creditor participation and control over the reorganization effort.

Another important difference between the two bills concerns whether secured creditors may be included in the membership of the creditor's committee which has just been described. The House version excludes secured creditors from this mandatory committee and permits the appointment of "additional committees of creditors . . . if necessary to assure adequate representation of creditors . . . ." This provision presumably permits the appointment of committees to consist solely of secured creditors.

The Senate version is less clear. It provides for the discretionary election of a committee of creditors which must contain, if elected at all, "not fewer than three creditors, each of whom holds an allowable unsecured claim against the debtor." Although the Senate bill goes on to permit the appointment of additional committees, which may include secured creditors, it is uncertain whether the elected committee may contain secured creditors provided the committee consists of at least three unsecured creditors.

under Chapter XI of the current law. See 8 Collier on Bankruptcy ¶ 5.48[1], at 719-22 (14th ed. 1940).

170. See Trost & King, supra note 6, at 535.
173. See id. (adding § 1102(c) to 11 U.S.C.).
174. Senate Bill, supra note 4, § 101 (adding § 1102(a) to 11 U.S.C.) (emphasis added).
175. This is an ambiguity that should be resolved prior to the enactment of the Senate version. It is clear that because of their dissimilar interests, secured and unsecured creditors should not be on the same committee. See 1977 House Report, supra note 10, at 236. It is equally clear, however, that the Senate bill could be interpreted to permit such a result. See 1977 Senate Hearings, supra note 4, at 576-77 (statement of Robert J. Grimmig).
SECURING APPROVAL OF THE PLAN FROM THE PARTIES

Once a plan of reorganization has been formulated, it must then be submitted to the parties to the reorganization in order to secure their approval. In addition, in Chapter X of the current law the Securities and Exchange Commission (SEC) plays an important role in the approval of a plan to be submitted to the court for confirmation. The following sections of this article will examine first, the role of the SEC in reorganization cases under both the current law and under the proposed House and Senate revisions. Second, existing and proposed rules relating to the solicitation of approvals from creditors and stockholders will be compared. Last, this section will review the percentages of creditors and stockholders who must accept a plan of reorganization and examine the “cramdown” rules for forcing a plan upon a group of creditors who refuse to assent to its terms.

Role of the Securities and Exchange Commission

The SEC has traditionally played a key role in Chapter X corporate reorganization proceedings. Although the agency’s role is more limited in Chapter XI cases, its power to challenge a Chapter XI petition and transfer a case to Chapter X renders the SEC important in any reorganization case. Both versions of the proposed revision would give the SEC a role in the reorganization of a business debtor under new Chapter 11, however, before that role is examined, the powers and functions of that agency under current law should be reviewed.

The hallmark of the SEC’s split role under the current Bankruptcy Act is the extent of its involvement under Chapter X. In a proceeding under that chapter, the SEC is initially entitled to receive a statement of the trustee’s investigation. Furthermore, if the debtor’s schedules reveal more than $3,000,000 in debt, “the judge must submit to the Securities and Exchange Commission for examination and report the plans which the judge regards as worthy.” The judge must

then wait until the SEC has: 1) filed a report, 2) indicated its intention not to file a report, or 3) failed to do either before the expiration of a reasonable time, before he may approve a reorganization plan. Finally, the SEC is entitled to appear at the Chapter X confirmation hearing, when a plan of reorganization is selected by the court.

In comparison, the role of the SEC in Chapter XI of the current act is minimal. The agency is entitled initially only to notice that a chapter proceeding has been filed. More significant, however, is the SEC's right to object to the confirmation of a plan of arrangement and to request a transfer of the proceedings to Chapter X. The bankruptcy judge may then "enter an order dismissing the proceedings . . . unless . . . the petition [is] amended to comply with the requirements of Chapter X . . . ." Whether such an order is warranted depends upon "the needs to be served" in the rehabilitation proceedings. Such needs include the size of the company sought to be reorganized as well as whether the existing management of the debtor has been guilty of any fraud or mismanagement in regard to the corporation. If placed in Chapter X, the comprehensive role of the SEC, summarized above, then comes into play, and the plan of reorganization submitted to the court and the creditors then comes within the auspices of the regulatory agency as well.

At first glance, the proposed bankruptcy revisions, with their consolidated reorganization procedures, seems to eliminate the distinctions in the current law with respect to the

180. Katskee, supra note 132, at 191.
184. General Stores Corp. v. Shlensky, 350 U.S. 462, 466 (1956). There, the Court rejected the contention of the SEC that appropriate relief could be obtained only under Chapter X where the debtor was a corporation with publicly-held securities. Id. In a later case, SEC v. American Trailer Rentals Co., 379 U.S. 594 (1965), the Court again struck down the SEC's persistent contention that Chapter XI could never provide appropriate relief for a corporate debtor with publicly-held securities. Id. at 607, 611-13. The Court conceded, however, that there is a general, although not absolute, rule, that "Chapter X is the appropriate proceeding for adjustment of publicly held debt." Id. at 613. See generally, 8 COLLIER ON BANKRUPTCY ¶ 4.22, at 461-77 (14th ed. 1940).
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SEC's role in reorganization proceedings. As will be seen, however, the Senate bill, if enacted, would virtually reestablish the current dual role of the SEC.

The House bill, which again contains no special provisions for public companies, entitles the SEC to "appear and be heard on any issue" in a reorganization proceeding. Although the SEC is not made a "party in interest" by the House bill, it nevertheless has a formal right to object to the plan's confirmation, however, the SEC has no right, under H.R. 8200 to appeal from any order of confirmation.

S. 2266, on the other hand, establishes a dual role for the SEC much like the one that exists under the current act. The Senate bill grants the SEC the same benefits, save the right to appeal, that are available to a party in interest, when the business involved in the proceedings is a non-public company. In addition, as in Chapter X of the current law, in a case involving a public company the SEC is given the opportunity to examine any plan the court considers to be "worthy of consideration." The court may not confirm a plan unless the SEC has either filed a report on the plan or failed to file a report within the time specified for its preparation. The SEC may also appear, although not as a party in interest, if so requested or authorized by the court in a case dealing with a non-public company.

The effect of this distinction between public and non-public companies, and the role of the SEC that rests upon it, amounts to a retention of the dual role of the SEC and of the distinctions between Chapters X and XI which the proposed revision has otherwise been designed to eliminate. This becomes particularly apparent when it is recognized that the SEC has long argued that the proper bankruptcy proceeding for any corporation with public debt is a Chapter X reorganization.

Rather than consolidate the currently existing reorganization

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189. Senate Bill, supra note 4, § 101 (adding § 1109(b) to 11 U.S.C.).
190. Id.
191. Id. (adding § 1128(b) to 11 U.S.C.).
192. Id. (adding § 1128(c) to 11 U.S.C.).
193. Id. (adding § 1109(b) to 11 U.S.C.).
194. The SEC has consistently argued that there should be an absolute rule in favor of reorganizing publicly held corporations through Chapter X. See SEC v. American Trailer Rentals Co., 379 U.S. 594, 613 (1965); 1977 Senate Hearings, supra note 4, at 621-24 (statement of Phillip A. Loomis Jr.).
Chapters and provide a more flexible single procedure for the rehabilitation of businesses, S. 2266, at least in this one respect, maintains and strengthens the inflexible procedures of the past.

Solicitation of Acceptances from Creditors and Stockholders

Another important function of the SEC, under the proposed revisions, is the approval or disapproval of disclosure statements that must be made prior to the solicitation of acceptances of the plan from those whose assents are necessary for confirmation. In a major deviation from current law, both versions of the proposed revision contain an elaborate, securities-type, scheme for ensuring that acceptances of a plan of reorganization are made on the basis of a full and accurate understanding of the terms of the plan.

Under current law, the distinctions between Chapters X and XI are encountered again in the rules regarding the solicitation of approvals of a plan from creditors. In Chapter X, the court must approve a plan of reorganization before approvals may be solicited.\textsuperscript{195} However, after that approval is acquired, "solicitation is unrestricted and committees or persons seeking either support or rejection of the plan are free to act accordingly."\textsuperscript{196} In Chapters XI and XII, however, acceptances may be obtained not only prior to the court’s approval of the plan but prior to the filing of the petition as well.\textsuperscript{197} Thus, the only explicit restriction upon the solicitation of acceptances under the current act is in Chapter X, and even there, once solicitation is permitted, there are no express restrictions in the bankruptcy act upon the tactics which may be employed to obtain the requisite number of acceptances.\textsuperscript{198}

The proposed revision, departing from the policy of the current law, contains an elaborate disclosure requirement, which if fulfilled, provides the debtor with a safe harbor against allegations of securities fraud in connection with its solicitation.

\textsuperscript{195} Bankruptcy Act of 1898, § 176, 11 U.S.C. § 576 (1970); Fed. R. Bankr. P. 10-303(f), 10-304; see 6 Collier on Bankruptcy ¶ 7.39, at 1321-28 (14th ed. 1940). The court can authorize solicitation of approvals prior to approving the plan, but the power is rarely exercised. Id. at 1326 n.18.

\textsuperscript{196} 6 Collier on Bankruptcy ¶ 7.39 at 1324-25 (14th ed. 1940).


\textsuperscript{198} See 9 Collier on Bankruptcy ¶ 9.20, at 318-21 (14th ed. 1940).
As in other areas of the proposed act, however, the Senate version provides special provisions, similar to those in Chapter X of the current law, applicable to cases involving public companies.

The House version permits solicitation before or after the petition is filed, but applies a different set of rules to prepetition and post-petition solicitation of acceptances. Acceptances solicited prior to the filing of the petition are valid if the solicitation was either "in compliance with any applicable nonbankruptcy law, rule, or regulation governing the adequacy of [such a disclosure]" or, in the absence of such a regulation, if the solicitation was preceded by a disclosure of "adequate information."

Although "adequate information" is also the standard to be applied to post-petition solicitations of acceptances, the House version of the revision requires the court to rule on whether the information disclosed is adequate prior to its dissemination. The information disclosed must contain both "a summary of the plan and a written disclosure statement," the adequacy of which is to be determined solely according to the standard in Chapter 11. Thus, acceptances may not be

199. House Bill, supra note 3, § 101 (adding § 1125(e) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 1125(e) to 11 U.S.C.); see 1977 House Report, supra note 10, at 229. Both versions thus provide that:

a person that solicits, in good faith and in compliance with the applicable provisions of this title, or that participates, in good faith and in compliance with the provisions of this title, in the offer, issuance, sale, or purchase of a security, offered or sold under the plan . . . is not liable, on account of such solicitation or participation, for violation of any applicable law, rule, or regulation governing the offer, issuance, sale, or purchase of securities.


200. See generally Trost & King, supra note 6, at 547-50.


203. House Bill, supra note 3, § 101 (adding § 1125(b) to 11 U.S.C.). The court's ruling is to be on the adequacy of the information released with the solicitation, rather than on the merits of the plan itself. See 1977 House Report, supra note 10, at 226.

204. House Bill, supra note 3, § 101 (adding § 1125(b) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 1125(b) to 11 U.S.C.).

205. See House Bill, supra note 3, § 101 (adding § 1125(d) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 1125(d) to 11 U.S.C.). However, other regulatory agencies, such as the SEC, "may be heard on the issue of whether a disclosure state-
solicited after the petition has been filed unless a summary of
the plan and a written disclosure statement, both approved by
the court, have been transmitted to creditors and stockholders
whose acceptances have been solicited.

The "adequate information" standard, applicable to both
post or pre-petition solicitations requires the transmission of
information of a kind, and in sufficient detail, as far as is
reasonably practicable in light of the nature and history of
the debtor and the condition of the debtor's books and
records, that would enable a hypothetical reasonable
investor typical of holders of claims or interests of the rele-
vant class to make an informed judgment about the
plan.208

In order to provide flexibility, "[t]he disclosure section per-
mits the disclosure required to different classes to differ, . . .
but requires the disclosure to each member of a particular class
to be the same."207

The Senate version, as indicated earlier, adopts a different
procedure in cases involving public companies. Although the
Senate has adopted the House's adequate information stan-
dards, S. 2266 goes a step further requiring the SEC report, or
a summary thereof, to accompany the other materials that
must be transmitted to any class whose acceptance is solici-
ted.208 In addition, the Senate bill also prohibits any solicita-
tion, in cases involving public companies, prior to obtaining
the court's approval of the plan of reorganization.209 Thus, the
Senate bill has rejected the motion apparent in its House coun-
terpart that creditors and stockholders of publicly held compa-
nies can arrive at "an informed judgment of their own, rather

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208. House Bill, supra note 3, § 101 (adding § 1125(d) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 1125(d) to 11 U.S.C.).
209. Senate Bill, supra note 4, § 101 (adding § 1125(f) to 11 U.S.C.).
than having the court or the [SEC] inform them in advance of whether the proposed plan is a good plan.\(^{210}\)

**Approval of Creditors**

As in other areas of the current Bankruptcy Act, the particular reorganization chapter under which the debtor is proceeding dictates the rules concerning the percentage of creditors who must approve the plan prior to its confirmation by the court. In Chapters X and XII, a two-thirds majority in *amount* among each class of creditors must approve a plan which is to be submitted to the court for confirmation.\(^{211}\) In Chapter XI, however, only one-half of each class of creditors, in *number and amount* must approve the plan.\(^{212}\)

Under the proposed revisions, the approval of each class of creditors and stockholders is required, unless under the plan the claims or interests of the unaccepting classes are unimpaired.\(^{213}\) The requisite percentages of approval by each member of a class of creditors or stockholders, in the proposed revisions, although the same under both bills, represents a change from the current law. Each class of holders of claims,\(^{214}\) when required to accept the plan, must do so by at least a two-thirds majority in *amount* and more than one-half in *number*.\(^{215}\) A class of interests,\(^{216}\) on the other hand, is deemed to have accepted a plan when it is accepted by two-thirds in *amount* among the members of a class of the holders of such interests.\(^{217}\) Together, these are large acceptance requirements\(^{218}\) and closely resemble the more demanding standards of Chapter X of the current law.


\(^{212}\) *Id.* § 362(1); 11 U.S.C. § 762 (1970).


\(^{214}\) A creditor or an indenture trustee can be the holder of a claim. See House Bill, *supra* note 3, § 101 (adding § 501(a) to 11 U.S.C.); Senate Bill, *supra* note 4, § 101 (adding § 501 to 11 U.S.C.).

\(^{215}\) House Bill, *supra* note 3, § 101 (adding § 1126(c) to 11 U.S.C.); Senate Bill, *supra* note 4, § 101 (adding § 1126(c) to 11 U.S.C.).

\(^{216}\) An equity security holder is the holder of an interest which may be filed. House Bill, *supra* note 3, § 101 (adding § 501(a) to 11 U.S.C.); Senate Bill, *supra* note 4, § 101 (adding § 501(a) to 11 U.S.C.).

\(^{217}\) House Bill, *supra* note 3, § 101 (adding § 1126(d) to 11 U.S.C.); Senate Bill, *supra* note 4, § 101 (adding § 1126(d) to 11 U.S.C.).

Cramdown Rules

As indicated above, the approval of each class whose claims or interests are impaired, is normally required before the court may confirm a plan. However, the proposed revision, like Chapters X and XII of the current law provide for the confirmation of a plan over the objection of a dissenting class of creditors. The so-called “cramdown” provisions of the House and Senate bills are very different from each other as well as from the current law, with the differences in the Senate bill concentrating on the treatment of public companies.

Under current law, a plan of reorganization, under Chapters X or XII, may be approved over the objections of a class of affected creditors if the plan provides for the “adequate protection” of the members of the dissenting class. That protection can be provided via one of four methods outlined in both Chapter X and Chapter XII of the current law. They include:

a) [T]he transfer or sale, or by the retention by the debtor, of such property subject to such claims; b) A 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) Appraisal and payment in cash of the value of such claims; or d) by such method as will, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection . . .

These methods of providing adequate protection for dissenting creditors are the same in Chapter X as they are in XII, however, there is no similar procedure in Chapter XI of the current act.

An important effect of the consolidation of Chapters X, XI, and XII into new Chapter 11 would be the availability of the cramdown provision of the new act to all reorganization proceedings. Although the cramdown sections of the two versions of the revision are different, both would nevertheless permit a plan to be confirmed over the objection of a dissenting class of creditors.

The House version provides that the members of a non-assenting class of creditors or stockholders may have the plan

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221. See generally, 6A COLLIER ON BANKRUPTCY ¶ 10.12-.17, at 51-86 (14th ed. 1940).
confirmed over their objections provided that the dissenting class is treated fairly.\textsuperscript{222} Classes of secured creditors whose claims are impaired but who have not accepted the plan of reorganization must, in order to be treated fairly, "receive or retain . . . property of a value . . . equal to the allowed amount" of their claim.\textsuperscript{222} This same rule applies to dissenting classes of unsecured creditors, who however, may receive less than the allowed amount of their claims if junior creditors receive nothing.\textsuperscript{224} In effect then, the cramdown provision requires an application of the absolute priority rule to any dissenting class of creditors.\textsuperscript{225} This same rule is applied to dissenting classes of equity holders.\textsuperscript{226}

The Senate version adopts this same scheme for the treatment of dissenting classes of creditors and shareholders of non-public companies but provides a different standard applicable in cases involving public concerns. That standard requires "adequate protection for the realization of [the] claims or interests,"\textsuperscript{227} of the dissenting class, and thus appears to adopt the requirements currently applicable in Chapter X cases.\textsuperscript{228} The most significant effect of this rule, applicable only to public companies, is that it further distinguishes the two tracks within proposed Chapter 11 and makes it appear, more and more, to be a re-enactment of Chapter X of the current law.

\textbf{Substantive Requirements for Confirmation of a Plan}

\textit{The Fairness Standard}

In addition to the necessary approvals from the creditors

\begin{footnotes}
\item 224. House Bill, supra note 3, § 101 (adding § 1129(b)(2) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 1130(c)(2) to 11 U.S.C.).
\item 225. See 1977 House Report, supra note 10, at 413.
\item 226. House Bill, supra note 3, § 101 (adding § 1129(b)(3) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 1130(c)(3) to U.S.C.); see 1977 House Report, supra note 10, at 413-14, 417-18.
\item 227. Senate Bill, supra note 4, § 101 (adding § 1130(b) to 11 U.S.C.).
\item 228. The "adequate protection" required by the Senate's cramdown provision is not the same adequate protection that is required in order to continue the automatic stay or for the debtor to continue to use a secured party's collateral. See House Bill, supra note 3, § 101 (adding § 361 to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 361 to 11 U.S.C.). It is unclear whether the Senate's failure to make § 361 of the new title 11 applicable to its cramdown standard was merely an oversight or whether it represents an intentional retention of the existing protection standard required in Chapter X. See notes 219-21 and accompanying text supra.
\end{footnotes}
and equity holders, the bankruptcy act contains substantive
legal criteria to be applied before a plan is confirmed by the
court for implementation. In Chapter X of the current law the
proposed plan of reorganization must be “fair and equitable,” which has been interpreted to impose a rule of
“absolute priority” in the satisfaction of claims and interests
held by creditors and stockholders. The rule of absolute prior-
ity requires that each claim be satisfied in full, in accordance
with its contractual priority, before any subordinate claims are
satisfied at all. Chapters XI and XII, on the other hand, require only that the plan be “in the best interests of creditors” which has been applied to require that, under the plan, the creditors receive at least what they would have received in
a straight bankruptcy liquidation.

The proposed revision, in response to the Bankruptcy
Commission’s suggestion that the absolute priority rule be
abandoned, adopted a modified version of the best interests
test to be applied in all cases under new Chapter 11. As has
often been the case, however, the Senate version of the pro-
posed revision has adopted the standard that now exists in
Chapter X for application to public companies.

The House version’s fairness standard is closely tied to its
cramdown provision, already discussed. If all classes of credi-
tors and equity holders accept a plan of reorganization then the
best interests standard applies and operates to require that any
dissenting creditor, within a class that has approved the plan,
be given at least what would have been received “if the debtor
were liquidated under Chapter 7.” If any class of creditors
has failed to approve the plan by the required percentages then
the cramdown provision can be asserted against the members
of that class only if under the plan, they will receive an amount
equal to the allowed amount of their claims. If they receive less
than that full amount, the plan must not permit a creditor,

229. Bankruptcy Act of 1898, § 221(2), 11 U.S.C. § 621(2) (1970); see 6A COLLI-
ER ON BANKRUPTCY ¶ 11.06 at 204-34 (14th ed. 1940).
230. Case v. Los Angeles Lumber Prods. Co., 308 U.S. 106 (1939); see COMMISSION
REPORT, supra note 1, at 254-55.
Corp.) 314 F.2d 303, 305 (2d Cir. 1963); see generally 9 COLLI-
ER ON BANKRUPTCY ¶¶ 9.17, at 281-86, 9.07[3], at 1137-40 (14th ed. 1940).
233. House Bill, supra note 3, § 101 (adding § 1129(a)(7)(B) to 11 U.S.C.);
Senate Bill, supra note 4, § 101 (adding § 1130(a)(8)(B) to 11 U.S.C.); see Trost &
King, supra note 6, at 553-56.
junior to those in the dissenting class, to participate in the reorganized company. Thus, if all classes of creditors and stockholders accept the plan, the best interest rule applies; however, the absolute priority rule applies to any class which does not accept the plan.

The Senate version adopts the foregoing set of rules in cases involving nonpublic companies. However, in cases involving public companies, the plan would have to be "fair and equitable," and thus the absolute priority rule would apply.

As in other areas of the Senate's bill then, the proposed revision would effectively reenact the fairness standard of Chapter X of the current law and apply it across the board to publicly held companies.

Feasibility of the Plan

All three Chapters of the current Bankruptcy Act require that the court be satisfied that a plan is "feasible" before such plan can be confirmed. However, this requirement has taken on a different meaning in Chapter X than it has in the other two reorganization Chapters. Under Chapter X, the feasibility requirement "is concerned with the economic soundness of the proposed financial structure of the plan . . .," and requires that the debtor will "emerge in a solvent condition with reasonable prospects of [sic] financial stability and success." In Chapters XI and XII, on the other hand, feasibility refers to the "probability that the creditors will receive the amount . . . provided for them pursuant to the plan, and not that there is probable prospect of the debtor's future financial rehabilitation and continued business success."

Here, both versions of the proposed revision adopt the same feasibility standard, which is patterned after the test provided in Chapter X of the current act. Under proposed Chapter 11 it must be determined that "[c]onfirmation of the plan is not likely to be followed by the liquidation, or the need

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234. See text accompanying notes 222-28 supra.
235. Trost & King, supra note 6, at 556.
238. 6A COLLIER ON BANKRUPTCY ¶ 11.07, at 235 (14th ed. 1940).
240. 9 COLLIER ON BANKRUPTCY ¶ 9.07[3], at 1139-40 (14th ed. 1940); See id. ¶ 9.18[1], at 287-91.
for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan. Thus, the proposed revision would require the court to conduct the close examination of the value of the debtor's business that such a determination demands.

Liquidation Rather than Rehabilitation

Under the existing Bankruptcy Act, the court has the authority, on a number of grounds, to transfer a reorganization case to a liquidation proceeding. Although the grounds differ among the three Chapters, they generally include failure to obtain confirmation of a plan, lack of prosecution, failure to consummate a plan which has been confirmed, the revocation of confirmation for fraud, or termination of the plan due to the occurrence of a condition specified in the plan.

Both versions of the proposed revision would retain most of those grounds for transfer of a reorganization case to Chapter 7 for liquidation. The Senate version would add "continuing loss to or diminution of the estate of an insolvent debtor" and the "absence of a reasonable likelihood of rehabilitation" to the list. These last two contingencies, however, appear to be already covered by the feasibility requirement and the denial of confirmation that would result upon a finding of infeasibility.

CONCLUSION

The enactment by Congress of either H.R. 8200 or S. 2266 would result in a number of important changes in the law of bankruptcy reorganizations. In many areas, the enactment of either version would yield the same result. Both versions give

244. Id. 11-42(b)(1), 12-41(b)(1). There is, however, no similar provision in the Chapter X rules.
245. Id. 10-308(a)(5), 11-42(b)(5)(A), 12-41(b)(5)(A).
246. Id. 11-42(b)(4), 12-41(b)(4).
247. Id. 11-42(b)(5)(B), 12-41(b)(5)(B).
248. See House Bill, supra note 3, § 101 (adding § 1112(b) to 11 U.S.C.); Senate Bill, supra note 4, § 101 (adding § 1112(b)(3)-(10) to 11 U.S.C.).
249. Senate Bill, supra note 4, § 101 (adding § 1112(b)(1) to 11 U.S.C.).
250. Id. (adding § 1112(b)(2) to 11 U.S.C.).
the bankruptcy courts expanded jurisdiction to resolve matters currently relegated to litigation in state courts. In addition, both the House and Senate bills would change the current law related to the property of the estate and the trustee's or debtor-in-possession's powers to recover previously transferred property for the use of the reorganized business. More closely related to reorganization proceedings in particular are the changes from the current law in the areas of eligibility for relief, both voluntarily and involuntarily, and the treatment of the rights of secured creditors.

Apart from these particular areas, the most striking changes in the law of bankruptcy reorganization that would result from the enactment of H.R. 8200 or S. 2266 arise from the merger of the existing three reorganization chapters into a single proceeding applicable to all business entities and designed to provide business debtors with whatever type of relief is necessary to give them a fresh start. Between the two proposed revisions, however, the House version departs further from the current law and is generally more flexible than the proposal suggested by the Senate. In particular, the Senate version's specialized treatment of public companies would inhibit the flexibility of the new reorganization chapter and is in many ways closely akin to the restrictive features of Chapter X of the current law.

The Senate version's insistence, for example, upon the appointment of a trustee, and the resulting loss of control by the debtor, in cases involving public companies, is very similar to the current rules for the appointment of a trustee under Chapter X. The House version, on the other hand, provides for a more flexible standard, allowing the court to retain the debtor-in-possession of the business and thus avoiding the added expense of a trustee where the protection so provided is either unwarranted or prohibitively expensive, whether or not the debtor is a publicly held company. The public or private nature of the securities of the debtor would presumably be a factor, under H.R. 8200, in determining whether a trustee's appointment is warranted, but it would not necessarily be the conclusive factor that it would be under both S. 2266 and current Chapter X.

The Senate version also adopts what is tantamount to a reenactment of Chapter X in its rules relating to the role of the SEC and the solicitation of acceptances from creditors in cases involving public companies. More importantly, the Senate version's imposition of the absolute priority rule—through the fair
and equitable standard, upon all public companies indicates that the Senate's version is a consolidation of Chapters X and XI in name alone.

The House version contains many of the protective procedures of the Senate bill, but unlike the latter proposal, permits the court to determine when they should be imposed, according to the needs and circumstances of each case presented. This discretion would result in a more flexible law designed to rehabilitate financially troubled businesses in the most economical and expeditious manner possible. Whatever the outcome of the dispute over the status of the bankruptcy courts, the authors strongly encourage the Senate to adopt the flexible reorganization procedures of H.R. 8200.