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BANKRUPTCY - CORPORATE REORGANIZATION - FAIRNESS OF THE PLAN

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BANKRUPTCY — CORPORATE REORGANIZATION — FAIRNESS OF THE PLAN — In a reorganization under 77B [1] the unsecured creditors were to be paid by receiving non-voting preferred stock of the insolvent debtor up to the amount of their claims. The old preferred stockholders were to keep the balance of this same class of stock. One thousand shares of voting common stock were to be given to the old shareholders on the basis of one new share for each old share. The plan was approved by ninety-four per cent of the creditors, but the master proposed an amendment whereby the creditors were to have the right to vote in the selection of the management. Upon objection to this amendment it was *held* that the plan was unfair, and the court stated that a decree confirming the plan would be entered conditioned upon the plan being amended so that (1) the creditors receive a voting stock preferred over that of the old shareholders, and (2) the common stock be reduced to one hundred shares. *In re Tharp Ice Cream Co., Inc.*, (D. C. Pa. 1938) 25 F. Supp. 417.

Whether a particular plan is fair and equitable depends on the particular facts of each case, and is largely a matter of the "wide discretion" of the district court.[2] However, some general principles can be laid down.[3] It has been said that an agreement by a large percentage of the creditors is evidence of the fair-

[1] 48 Stat. L. 912 (1934), 11 U. S. C. (1934), § 207.

[2] In re Burns Bros., (D. C. N. Y. 1936) 14 F. Supp. 910; In re Georgian Hotel Corp., (C. C. A. 7th, 1936) 82 F. (2d) 917; Kansas City Terminal Ry. v. Central Union Trust Co., 271 U. S. 445, 46 S. Ct. 549 (1926); Cralle v. Louisville Title Co., 244 Ky. 753, 52 S. W. (2d) 891 (1932).

[3] See Levi and Moore, "Bankruptcy and Reorganization: A Survey of Changes, II," 5 UNIV. CHI. L. REV. 219 (1937).

ness of the plan.[4] The principal case, as well as others, shows the weakness of this test.[5] The fundamental principle of recognizing the equities in their proper order, as enunciated in the *Boyd* case,[6] is still applicable under 77B and probably under the Chandler Act.[7] The trouble with the original plan in the principal case was in giving the shareholders too much. Shareholders can participate in the reorganization plan under some circumstances.[8] One test of shareholder participation is whether "adequate" provisions are made for the unsecured creditors,[9] others say the creditors must be made "whole," [10] and still others that they must be "fairly compensated." [11] Examples of situations permitting shareholders to retain an interest are where shareholders make additional payments to the corporation,[12] shareholders have an equity in the corporation,[13] they waive some right to help the creditor,[14] their managerial assistance is valuable,[15] there is no extreme insolvency,[16] there is no indirect divesting of assets that should go to the creditors,[17] etc. Assuming the shareholders can participate in the particular case, the problem of how to recognize the equities in the proper order still remains. As suggested by the principal case, giving the creditors a senior security interest is one method, and giving them voting power and control is another.[18] Amongst the remaining possibilities can be mentioned giving the prior claimant more of the same class of security or giving him the same security but at a lower assessment.[19] In general, however, the preservation of the creditor rights is a practical matter, and the method used will depend on the particular troubles

[4] In re Los Angeles Lumber Products Co., (D. C. Cal. 1938) 24 F. Supp. 501.

[5] Horn v. Ross Island Sand & Gravel Co., (C. C. A. 9th 1937) 88 F. (2d) 64; In re Day & Meyer, Murray & Young, Inc., (C. C. A. 2d, 1938) 93 F. (2d) 657.

[6] Northern Pac. Ry. v. Boyd, 228 U. S. 482, 33 S. Ct. 554 (1913).

[7] 2 GERDES, CORPORATE REORGANIZATIONS, §§ 1082, 1084, 1085 (1936); Downtown Inv. Assn. v. Boston Met. Bldgs., (C. C. A. 1st, 1936) 81 F. (2d) 314; Louisville Trust Co. v. Louisville N. A. & C. Ry., 174 U. S. 674, 19 S. Ct. 827 (1899). Section 221(2) of the Chandler Act, 52 Stat. L. 897 (1938), 11 U. S. C. A. (Supp. 1938) § 621(2), requires the plan to be fair and equitable, but does not have the clause as in 77B that the plan shall not discriminate unfairly in favor of any class of creditors or stockholders.

[8] See annotation in 88 A. L. R. 1238 (1934).

[9] 2 GERDES, CORPORATE REORGANIZATIONS, § 1084 (1936).

[10] In re New York Rys. Corp., (C. C. A. 2d, 1936) 82 F. (2d) 739 at 744.

[11] Northern-Pacific Ry. v. Boyd, 228 U. S. 482, 33 S. Ct. 554 (1913).

[12] In re Barclay Park Corp., (C. C. A. 2d, 1937) 90 F. (2d) 595; Price v. Spokane Silver & Lead Co., (C. C. A. 8th, 1938) 97 F. (2d) 237.

[13] Cases cited supra, note 12.

[14] In re Los Angeles Lumber Products Co., (D. C. Cal. 1938) 24 F. Supp. 501.

[15] Ibid.

[16] Levi and Moore, "Bankruptcy and Reorganization: A Survey of Changes, III," 5 UNIV. CHI. L. REV. 398 at 414 (1938).

[17] In re Day & Meyer, Murray & Young, Inc., (C. C. A. 2d, 1938) 93 F. (2d) 657; Price v. Spokane Silver & Lead Co., (C. C. A. 8th, 1938) 97 F. (2d) 237.

[18] 2 GERDES, CORPORATE REORGANIZATIONS, § 1088 (1936).

[19] 2 GERDES, CORPORATE REORGANIZATIONS, § 1088 (1936); 88 A. L. R. 1238 at 1243 (1934).

and the history of the insolvent corporation.[20] Under the original plan in the principal case the stockholders not only were to have the same class of stock as the creditors, but the control of the corporation was kept in the hands of the common stockholders, so the decision was clearly proper.

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[20] Kansas City Terminal Ry. v. Central Union Trust Co., 271 U. S. 445, 46 S. Ct. 549 (1926); Cralle v. Louisville Title Co., 244 Ky. 753, 52 S. W. (2d) 891 (1932).