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CHAPTER X OR CHAPTER XI: COEXISTENCE FOR THE MIDDLE-SIZED CORPORATION*

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THE years 1954 and 1955 have brought forth exacting and stimulating problems in the field of corporate conflicts of jurisdiction between Chapters X¹ and XI² of the Bankruptcy Act. Two recent decisions, *In re Transvision, Inc.*,³ and *In re General Stores Corp.*,⁴ made unobtrusive starts in the referee's courtroom and wound up with noteworthy opinions in the district courts and the United States Court of Appeals, and with a petition for certiorari in each instance in the Supreme Court. An interesting feature of both cases is that each debtor relied heavily upon an interpretation of the *SEC v. United States Realty and Improvement Co.*⁵ decision, but the former was held to be properly filed in Chapter XI and the latter's petition under Chapter XI was dismissed, notwithstanding the fact that the unsecured creditors' committee representing those to be affected by the plan in both instances favored the Chapter XI proceeding.⁶

Although there were several cases⁷ which labored with the problem of clashing jurisdiction between the chapters prior to the determination of the Supreme Court in the *United States Realty* case, nevertheless, all

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* Substance of address delivered by Benjamin Weintraub before National Association of Referees in Bankruptcy at Washington, D.C., on October 10, 1955 with recent annotations.
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4. 129 F. Supp. 801 (S.D.N.Y. 1955), aff'd, 222 F. 2d 234 (2d Cir. 1955), cert. granted, 350 U.S. 809 (1955). Argument was held on January 17, 1956. The Supreme Court has as yet rendered no decision.
5. 310 U.S. 434, reversing 108 F. 2d 794 (2d Cir. 1940).
6. In *In re General Stores Corp.*, a caveat was rendered by Chief Judge Clark: "Even the unsecured creditors who are urging the reinstatement of the Chapter XI petition may come to regret their decision during the interval of postponed payment, without interest, of their claims." 222 F. 2d at 236.
7. In *In re Reo Motor Car Co.*, 30 F. Supp. 785 (E.D. Mich. 1939), where the court refused to transfer a Chapter X proceeding to one under Chapter XI, holding Chapter X to be the "only proper chapter which may be utilized for the reorganization of corporations with publicly held securities . . ." Id. at 789. See also *In re Credit Service, Inc.*, 30 F. Supp. 878 (D. Md. 1940), holding debtor with securities outstanding to be properly in Chapter XI.
current interpretations stem from this case which was once considered the open sesame to the solution of the court’s jurisdiction to entertain a debtor’s petition under Chapters X and XI, but has now been analyzed in recent decisions in the light of new facts and situations.

I. The Law Reviews

The existence of this problem was not unnoticed by contemporary writers for law reviews shortly before and after the decision in the United States Realty case. One review in discussing an argument presented by the Securities and Exchange Commission there, namely, that from the development of the law it can be seen that it was the intention of Congress to exclude from Chapter XI all corporations with securities in the hands of the public, observed that the question was never even considered in congressional debates. The author then continued to analyze the intention of the framers and concluded:

"... but nowhere in any of the debates, hearings or reports can a single expression be found indicating an intention to exclude a corporation from the use of Chapter XI simply because its securities are publicly held."

The writer rejected the theory of publicly held securities as the test for excluding a corporation from Chapter XI, as contended by the Commission and even if this test existed, he argued that there still would be the problem of determining "how large a corporation would have to be to fit this category." Finally, the writer somewhat perplexed, ended on a note with a prayer for congressional relief to clarify the problem.

Another law review observed that the literal language of Chapter XI opens the proceeding to "all corporations, regardless of size or of amount of outstanding securities. ..." Again an effort was made to fathom the intention of Congress and the drafters of the act and the inevitable conclusion was arrived at, that the

"... Congressional hearings and reports disclose no attempt to delimit the cases to which these chapters are respectively applicable in order to carry out the original design. Certainly there is no expression to the effect that the availability of relief

9. See notes 3, 4 supra. See also In re Wilcox-Gay Corp., 133 F. Supp. 548 (W.D. Mich. 1955), appeal pend. 6th Cir. Decision has been reserved.
11. Id. at 1057. But see In re Reo Motor Co., 30 F. Supp. 785 (E.D. Mich. 1939) reaching a contrary conclusion.
12. Id. at 1059.
14. Id. at 105.
under either chapter is to be determined by the existence of securities outstanding and in the hands of the public.”

Once more the public issue test, as ipso facto determinative, was rejected as the solution for the appropriate chapter. The unsatisfactory basis of such a determination can be seen in the other considerations presented by the author which play a significant part, such as dollar value and number of shares of securities outstanding and the other particular facts of each case. Having made so stirring an argument, we can only assume that limited space made his peroration another plea for “legislative” rather than judicial settlement.

A third article commented that in

“its large way, Congress intended Chapter X for the reorganization of big corporations, and Chapter XI for the relief of small debtors, incorporated and unincorporated. But the forty-odd experts who worked eight years revising the act omitted from it any formula for determining which corporate debtors should be rehabilitated under Chapter X and which under Chapter XI.”

A sad commentary upon the experts, particularly when the authors glowed with pride in expounding the virtues of Chapter X, and then with unstinted horror looked askance at Chapter XI.

Consider the ebullience with which they described Chapter X:

(a) “It represents the response of its draftsmen to the great reorganization cases and to the atmosphere of melodrama and importance which colors all discussion of them.”
(b) “Its ritual is more complex and impressive, its substance more satisfying, its promise of protection to investors more emphatic.”

Then, contrast it with the Dickensian poverty of status ascribed by the authors to Chapter XI:

“Chapter XI, on the other hand, has about it the grubbiness of bankruptcy. It provides a cheap and practical method of settlement, based on the history of composition in bankruptcy, for poor debtors whose estates cannot afford the expense of an elaborate public ceremonial.”

They then went on to say:

“. . . Chapter XI anthologizes the evils of procedure and shortcomings of scope and purpose. . . .”

Pursuing their point further the authors argued that the section of the act dealing with the type of corporations which may properly seek

15. Id. at 107.
16. Id. at 109.
18. Ibid.
19. Ibid.
20. Ibid.
21. Id. at 1337.
relief in Chapter X because adequate relief cannot be had in Chapter XI, is vague and obscure. The failure to specifically state what set of facts, circumstances or rules constitute the sum total of adequate relief seemed to them to be the area where the draftsmen went astray.

Reiteration of the suggestion was made that only in Chapter X may adequate relief be given to corporations having securities in the hands of the public, or even requiring any large corporation (in terms of assets and liabilities) regardless of whether its securities are widely distributed, to seek relief in Chapter X. A thought was even hazarded that perhaps Chapter XI should be denied to corporations and maintained only for individuals, or if not, the court should be enabled by congressional legislation to determine what corporations belong in Chapter XI and such legislation should define "more concretely" what constitute the ingredients of inadequacy of either chapter.

II. THE NUMBERS DOCTRINE

Through these three articles runs the thinking that the ultimate solution as to which corporations belong in either of the respective chapters is bound to be fraught with difficulty and result in faulty administration, unless a formula or rule is evolved which can at once funnel the X's and XI's into their proper grooves. Such thinking received even greater impetus with the decision of the United States Realty case.

Shortly thereafter the efficacy of the doctrine of numbers made strong strides. Another authority suggested a rule of thumb, pleading for a clear distinction between the chapters, and substantially approved a bill then pending in Congress which adopted a simple expedient: corporations which had 100 security holders of any one class would be deemed to have a public interest. But then, as an afterthought, he added another possible criterion, namely a minimum indebtedness of $250,000 which would also be the maximum for Chapter XI.

How simple a solution to a vexing problem. But what about the closed corporation with $251,000 in liabilities. This corporation might be well  

22. Id. at 1362-63. Bankruptcy Act § 146, 11 U.S.C.A. 546 (1938), "Without limiting the generality of the meaning of the term 'good faith,' a petition shall be deemed not to be filed in good faith if

"(2) adequate relief would be obtainable by a debtor's petition under the provisions of chapter 11 of this title . . . ." See also Bankruptcy Act, 150 (7), 11 U.S.C.A. 550(7) (1938), requiring an allegation " . . . showing the need for relief under this chapter and why adequate relief cannot be obtained under chapter 11 of this title . . . ."

23. Rostow & Cutler, supra note 17, at 1372.


advised to pay off the extra $1,000 of indebtedness so that it could arrange its financial structure under Chapter XI and avoid the elaborate and expensive procedure of Chapter X. And similarly the corporation with 100 security holders might well arrange for the purchase of the holdings of one holder to come within the confines of Chapter XI.

The so-called numbers bill was never passed by Congress, but the uncertainty of the state of future cases and the inevitable comparison with the numbers involved in the United States Realty case, has again brought forth suggestions for certainty by the use of numbers. Thus, in a concurring opinion in the General Stores\textsuperscript{27} case, Judge Frank indicates that it might be well to limit judicially Chapter XI proceedings by corporations to situations where the facts are in most respects similar to the Transvision case. Several of the indicia of similarity would be that the assets and liabilities did not exceed approximately $1,000,000,\textsuperscript{28} the public investors were not more than 425, there was no listing on a national exchange of the debtor's securities, and only the faintest suspicion of irregularities existed.

Writing concerning this problem in 1941, we suggested that because of the many germane factors which are relative and not absolute concepts, such as sheer size of assets and liabilities, financial structure, funded or unfunded debts, widely or closely held securities and similar factors, "no determination by mechanical rule which will foreclose discretion . . . "\textsuperscript{29} should be adopted. For, in the final analysis it would appear that it was the intention of Congress to allow a sound judicial discretion to weigh all the necessary factors in order that a fair determination be made in connection with the borderline corporation.

III. SIZE AS A FACTOR

Perhaps a more graphic description of the place of the borderline or middle-sized corporation can be seen in the financial structures of two corporations which availed themselves of Chapter X and Chapter XI respectively. In 1940 in the proceedings of Associated Gas and Electric Corp.\textsuperscript{30} and High Peak Dairies, Inc.,\textsuperscript{31} petitions were filed on the same day in the Southern District of New York. A study of the financial structure of each reveals a picture of extremes. Associated Gas with its principal subsidiary had 7 direct subsidiaries, 70 public utility companies, 15 transportation companies, 2 ice companies and 26 miscellaneous-

\textsuperscript{27} In re General Stores Corp., 222 F. 2d at 237.
\textsuperscript{28} In the Transvision case the assets fell slightly short of this ceiling, namely $998,041.
\textsuperscript{29} Levin, Weintraub & Singer, The Third Year of Arrangements under the Bankruptcy Act: Crossroads and Signposts, 18 N.Y.U.L.Q. Rev. 375, 379 (1941).
\textsuperscript{30} Bankruptcy Docket No. 75634 (S.D.N.Y. 1940).
\textsuperscript{31} Bankruptcy Docket No. 75635 (S.D.N.Y. 1940).
ous companies. In addition to this asset picture, these companies were serving about 1,762,000 customers in 20 states and the Philippine Islands, and was descriptively in the "atmosphere of melodrama and importance." On the other page of the docket was High Peak Dairies with $250 in assets and owing $3,379.38 to 12 creditors, including taxing authorities, and was tainted in short with the so-called "grubbiness" of the corner grocery store.

Fortunately each corporation chose the proper chapter and there was no need for the Commission's intervention. These cases may very well represent the high and low of it, and our problem may be over-simplified with the query: To what extent should the Chapter X ceiling be depressed until it reaches the ever climbing High Peaks?

Confronted with no congressional indication of intention, and lacking similarly the guides of the draftsmen, we are not, however, as we were almost seventeen years ago, lacking in the experience of the intervening years; they have given us cases with which to formulate, if not a fixed rule, at least a directional theory of the place of the middle-sized corporation.

IV. THE UNITED STATES REALTY CASE

The term "middle-sized" corporation appears in a footnote in the United States Realty case. And we may very well characterize this case as the prototype of the middle-sized corporation endeavoring to avail itself of Chapter XI.

Here was a real estate investment company, with a financial structure of 900,000 shares of common stock listed on the New York Stock Exchange, held by 7,000 stockholders. Assets exceeded $7,000,000. Liabilities were approximately $5,000,000, consisting of $2,339,000 of publicly held debentures, secured by a first mortgage owned by the debtor. In addition, the debtor was liable as a guarantor on mortgage certificates of $3,710,500 issued by its wholly-owned subsidiary, Trinity Building Corporation, which were held by 900 investors and which in turn were secured by a mortgage on the subsidiary's real estate. These mortgage certificates were in default for failure to pay principal, interest, and to set aside the moneys due for a sinking fund.

32. Levin, Weintraub & Singer, supra note 29, at 376.
33. Rostow & Cutler, supra note 17, at 1334.
34. Ibid.
35. SEC v. United States Realty and Improvement Co., 310 U.S. at 437. But cf. In re Transvision, Inc., 217 F. 2d at 246, where Judge Medina states that §§ 130(7) and 146(2) indicate "a conscious purpose of Congress to encourage resort to Chapter XI whenever the remedy afforded thereby adequately protects the interests involved."
36. 310 U.S. at 450, n. 8. But see id. at 444 where the Commission characterizes this company as a "large" corporation.
Accordingly, the United States Realty and Improvement Co. filed a petition under Chapter XI, and when attacked by the Commission the District Court held that it was properly brought under Chapter XI. The United States Court of Appeals affirmed. The Supreme Court reversed, and dismissed the proceeding. The Commission's principal argument was that Chapter X was the exclusive procedure for reorganization of a large corporation having its securities outstanding in the hands of the public.

In analyzing the chapters the Supreme Court observed that no definition existed in either chapter which could serve to classify a corporation either as large or small, "its security holders few or many, or that its securities are 'held by the public,' so as to place the corporation exclusively within the jurisdiction of the court under one chapter rather than the other."37

The Court stated that the answer as to whether it should entertain jurisdiction in Chapter XI was to be found in a determination as to whether there were "public or private interests involved requiring protection by the procedure and remedies afforded by Chapter X."38 And these public and private interests are the host of variable factors we have just discussed, such as size, securities outstanding, need for investigation, and the like.

No one will cavil with the fact that the United States Realty and Improvement Co. was a middle-sized corporation which should be in Chapter X in view of 900,000 shares of stock listed on a national exchange held by 7,000 stockholders and owning a subsidiary having a funded debt consisting of mortgage certificates of close to $4,000,000, held by 900 investors, with the intricate problem of a guarantee existing to the certificate holders of its subsidiary.

Moreover, in the United States Realty case the Court held that Chapter XI could not give the debtor adequate relief because under section 366(3) of Chapter XI, the debtor's plan would have to be "fair and equitable."39 This the Court indicated meant that within the principles of the Boyd40 and the Los Angeles41 cases of absolute priority being accorded to senior interests as against junior interests, a plan such as proposed could hardly be held to be fair and equitable to the unsecured creditors without some "rearrangement" of the rights of stockholders such as could only be effectuated under Chapter X. But the Court added that this did not mean that there was no scope for the application of

37. Id. at 447.
38. Id. at 454.
39. Id. at 453.
Chapter XI in many cases where the debtor's financial, business and corporate structure differed from respondents.

It is, therefore, apparent that the elimination of the "fair and equitable" doctrine from Chapter XI makes it now possible for debtors to obtain adequate relief under Chapter XI and effectuate an arrangement under this chapter without the necessity for a "re-arrangement" of their capital structure.

V. THE MECCA TEMPLE CASE

The first proceeding to follow the United States Realty case involving the problem of jurisdiction of a middle-sized corporation was the Mecca Temple case, a membership corporation, having a roster of 2800 members with bonds held by 1834 persons. Referee Stephenson dismissed the petition under Chapter XI sua sponte. His determination was reversed by the District Court whose determination in turn was reversed by the United States Court of Appeals. Judge Clark held, following the United States Realty case, that the public and private interests, namely the number of bonds held by public investors and the application of the fair and equitable doctrine, particularly the fact that creditors were receiving substantially less than the income of the organization warranted, required the dismissal of the petition.

VI. THE TRANVISION CASE

It was not until the Transvision case that the lines of distinction were drawn between middle-sized corporations. In this case the debtor had 385,000 shares of common stock outstanding, of which 250,000 were owned by management and 135,000 by 425 public investors. The preferred stock was all owned by management. The stock had been sold at $2.75 per share to the public. Assets were valued at $998,041 and liabilities were $722,589. District Judge Sugarman in arriving at his well reasoned opinion, analyzed the United States Realty case, and emphasized that neither the public interests, nor the private interests warranted a finding that relief under Chapter XI was inadequate.

It is noteworthy that in the Transvision case, neither the public nor private interests were significant. The corporate structure was simple,

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43. Mecca Temple of Ancient Arabic Order of Nobles of Mystic Shrine v. Darroch, 142 F. 2d 869 (2d Cir.), cert. denied, 323 U.S. 784 (1944).
44. For an excellent discussion on the Transvision case by Professor Seligson, see Bankruptcy, 30 N.Y.U.L. Rev. 558, 572 (1955), reprinted in 29 Ref. J. 111, 116 (1955) as well as 30 N.Y.U.L. Rev 1115, 1117 (1955), reprinted in 29 Ref. J. 139 (1955) where the writer states: "There cannot be an effective and realistic inflexible rule by which to determine the propriety of use of Chapter XI."
irregularities had not been shown to exist and the stock outstanding amounted to less than $400,000. In affirming, the United States Court of Appeals, far from decreeing the inadequacy of Chapter XI as a procedure designed to sacrifice efficiency and safeguards in exchange for speed and economy of operation stated:

"... the summary procedure provided by Chapter XI ... was designed to implement the successful invocation of relatively simple plans for affording debtors means by which, with a minimal disturbance of operations, to extricate themselves from current financial difficulty, without employing the elaborate investigatory and protective procedures attendant upon the usual corporate reorganization proceeding under Chapter X."45

The United States Court of Appeals also reiterated that the determination of the propriety of the chapters was in the sound discretion of the district court, and that the court had not abused its discretion in the instant case.

VII. THE GENERAL STORES CASE

Close on the heels of the Transvision case came the General Stores case, but with a contrasting corporate structure, intricate problems, and public investors of a far more complicated nature. The debtor filed a petition under Chapter XI and only sought an extension of its unsecured indebtedness. Assets totalled about $5,000,000, and liabilities $4,000,000. The capital consisted of 2,322,422 outstanding shares of $1 par common stock held by 7,000 stockholders and the stock was listed on the American Exchange. The debtor also owned all of the outstanding stock of Stineway Drug Company which it had purchased at $1,220,320, and of Ford Hopkins Company whose stock it had contracted to purchase at $2,800,000. And the latter company in turn held a subsidiary's stock, Sargent's Drug Store. Considering this intricate financing in the purchase of the Hopkins and the Stineway stock, Judge Dimock concluded that the private and public interests involved required this debtor to be in Chapter X.

The United States Court of Appeals indicated that the case differed markedly from the Transvision proceeding; there was a widespread stockholder interest, and this was not a small corporation where the calculated risk of the informal Chapter XI proceeding was warranted:

"It does not fall into the category of tightly knit structures where the subordinate creditors and stockholders are the management of the business and where the preservation of going concern value through their continued management of the business may compensate for reduction of creditor claims without alteration of management interests."46

45. 217 F. 2d at 246.
46. 222 F. 2d at 236.
As a matter of fact each judge wrote a separate opinion, Judge Clark writing the opinion for the majority, Judge Frank a concurring opinion,47 and Judge Galston dissenting.49 The Commission far from seeking a denial of the petition for certiorari joined in the request, evidently anticipating that the Supreme Court would set down definite lines of demarcation for the middle-sized corporation.

VIII. THE WILCOX-GAY CASE

An interesting variation of the regular procedure of filing a petition under Chapter XI occurred in the Wilcox-Gay40 case. The debtor and its wholly owned subsidiary filed petitions under Chapter X and the petitions were approved by the court and a trustee appointed. The debtors' consolidated balance sheet showed assets of $5,990,606, and liabilities of $4,479,940 which latter figure also included $222,300 of debenture bonds, outstanding in the hands of the public, which were held by several public investors. Its capital structure consisted of 1,600,000 shares of no par value common stock held by management and 1,614,865 shares of $1 par value common stock, 500,000 of which were held by the debtor's president and 1,114,865 held by other officers, and approximately 3,000 public investors.

In its petition under Chapter X the debtors alleged that relief under Chapter XI was inadequate because the "rights of secured creditors required consideration and adjustment..." The opinion does not specify the respects in which Chapter XI would not be adequate. However, after several months under Chapter X it appeared that such "adjustment" was no longer necessary and the debtors petitioned the court to transfer the proceedings to Chapter XI. This application was granted and the proceedings were transferred to Chapter XI. Several months thereafter the Commission moved to dismiss the petition under Chapter XI unless the debtors' prior petitions under Chapter X were reinstated.51

In denying the application Judge Kent followed the reasoning of Judge Sugarman in the Transvision52 case, namely, that the holding of shares

47. Id. at 237.
48. Ibid.
50. Id. at 549.
51. Id. at 550.
52. In analyzing the meaning of public interest in the United States Realty case, Judge Sugarman observed: "The quoted language does not mean that Chapter XI is available only to individual and privately owned corporate debtors. It does mean that Chapter XI is not adequate if there are public or private interests which require the investigatory process and protection afforded by Chapter X. The norm is public interest not public ownership of stock,
of stock by public investors did not mean that the proceeding was one in which there was a public interest which necessitated the use of the machinery of Chapter X. Some of the factors which the court emphasized as militating against the necessity of having the proceeding in Chapter X because of the private interests involved were that there had already been an investigation by a trustee, a creditors' committee had been formed, had retained an accountant and counsel, had actively worked out a plan with the debtors, and that the basic relief sought was an adjustment of the unsecured claims.

The court reiterated with approval Judge Medina's opinion in the Transvision case emphasizing among other things that all the foregoing factors had to be weighed in order for the court to arrive at a sound decision. It is noteworthy that in this case there were approximately 3,000 public investors and yet the court held in its sound discretion that there was no public interest involved because of the particular facts of the case.

IX. THE LIBERTY CASE

The most recent of all cases involving the propriety of jurisdiction between the chapters was In the Matter of Liberty Baking Corporation. A petition under Chapter XI was filed by Liberty which was a holding corporation having as its sole asset the common stock of its wholly owned subsidiary, Bell Bakeries, Inc., which was engaged in the manufacture and distribution of bread to the retail trade. Its sole liabilities were monies due to debenture holders of an issue of approximately $1,600,000 held by 225 investors, of which management held approximately 30%. Eliminating duplicates and management claims, there were a total of 333 public holders of approximately 27,000 securities, including common, preferred stock and debentures having a face value of a little over $1,000,000.

The plan which the debtor proposed was to convert the unsecured debentures into preferred stock. Since the debentures originally had been converted on a voluntary basis from preferred stock, the plan substantially was to convert them to their old status so that the company would not be weighed down with the difficulty of having to meet fixed

although both were joined in the certificate holding creditors in the Realty case. In re Transvision, Inc., 119 F. Supp. at 135.


54. Total Securities

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payments. Other provisions of the plan gave stringent controls to the new preferred stockholders. The plan met with the unanimous approval of the debenture holders' committee.

Prior to the filing by Liberty of its petition under Chapter XI, its wholly owned subsidiary, Bell, had filed a petition under Chapter XI and had had its plan confirmed. Notwithstanding this fact the Commission moved to dismiss the Liberty petition on the grounds that the proceedings should have been brought under Chapter X. As attorneys for the debtor we argued that the proceeding was properly in Chapter XI because there were "no public or private interests involved requiring the protection of the procedure and remedies afforded by Chapter X." Furthermore we contended that the case was on a par with the Transvision and Wilcox-Gay cases, and that it could hardly be argued that a public interest existed where there were only 333 public stockholders holding approximately 27,000 securities, particularly when there was no listing of the securities on a national exchange.

In addition, the debtor asserted that in the Chapter XI proceeding of Bell, a committee of creditors had been officially elected and had retained counsel and an accountant and had made an exhaustive examination of the debtor's books, records and transactions. Furthermore that the order of confirmation of the referee in effect adjudicated all these issues and that in so far as the private interests were concerned such as the need for investigation, adjustment, allowance of claims, and similar matters, these had been determined in the Chapter XI proceeding of Bell and accordingly could not be collaterally attacked in the Liberty proceeding as was decided in United States Realty decision.

Finally, the Commission countered that Chapter X was the proper procedure because the debentures were held by the public and could not be affected in Chapter XI. It was the debtor's position that it was not affecting either the common stock, approximately 79% of which was held by management, or the preferred stock of which 791 shares were held by 27 investors, but the debentures which were merely unsecured obligations, and that the machinery of Chapter XI was adequate for the purpose of compromising unsecured claims. Judge Noonan recently rendered a yet unreported memorandum opinion. In a careful analysis of the facts, it was observed that the problem of the middle-sized corporation has constituted a growing problem for the bar and the bench. The court noted that the Transvision case was authority for the proposition:

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55. By a recent amendment to the Bankruptcy Act 11 U.S.C.A. 728 (1952), the Commission was granted the power to intervene and move to dismiss a Chapter XI petition.
"That public ownership of a substantial portion of the stock is not, per se, proof of sufficient public interest to call for all of the safeguards of a Chapter X proceeding.

The court then analyzed the facts as stated in the Liberty Baking case and concluded that the proposed arrangement did not affect a substantial public interest. Citing from Judge Medina's opinion in the Transvision case, it was noted that the remedy afforded by the arrangement which had been worked out between the debtor and its creditors adequately protected the interests of the parties involved. The court further stated that "to require the parties to go through a Chapter X proceeding would be needless and time consuming, as well as the cause of further expense to all the parties." The petition for the Commission to intervene and to dismiss the Chapter XI proceeding, was therefore denied. The Commission has filed a notice of appeal to the United States Court of Appeals for the Second Circuit.

It will be interesting to note whether the Supreme Court's decision in the General Stores case will in any way affect the opinion of the court in either the Wilcox or the Liberty Baking cases.

In all the jurisdictional disputes it has been basically the Commission desiring the transfer from XI to X and the debtor and its creditors opposing such transfer. Rarely, as in the General Stores case, does even a solitary stockholder support the Commission's position.

It is interesting to note that the composition of the panel in the United States Court of Appeals may sometimes determine the ultimate choice of chapters. Thus Chief Judge Clark's dissenting opinion in the United States Realty case was substantially adopted by the majority in the Supreme Court. Therefore, when the Mecca Temple case came before the United States Court of Appeals, Judge Clark decided the case on the basic points of law enunciated in the United States Realty case. Similarly when the General Stores case was argued he adhered very strongly to the principles of the United States Realty and the Mecca Temple cases, even commenting on the fact that the criteria set out in the Mecca Temple case "were rather slighted in the more recent decision of In re Transvision, Inc." although it is to be noted, as the Chief Judge so well commented in the Mecca Temple case, that "... there still is no well defined answer in the borderline cases to the question as to whether a particular type corporation should be permitted to proceed under

58. Mecca Temple of Ancient Arabic Order of Nobles of Mystic Shrine v. Darrock, 142 F. 2d at 871, where Judge Clark stated: "And since the Supreme Court in the United States Realty case . . . has made an exhaustive comparison and analysis of the respective purposes of, and merits of proceedings under, the two chapters, there is little which can be added to the criteria set forth there."

59. In re General Stores Corp., 222 F. 2d at 236.
Chapter XI. . . Judge Frank in a concurring opinion clearly indicated that the court had no intention of overruling the decision in the Transvision case although he did state that had he been sitting on that panel, he would have dissented. It can, therefore, be seen that the Transvision case, the leading case pleading the cause of the middle-sized corporation for Chapter XI, might very well have been dismissed had the panel which decided the General Stores case been then sitting.

X. Some Middle-Sized Chapter XI Cases

Since the United States Realty case some corporations with greater or comparable assets and liabilities than that of the United States Realty and Improvement Co. have availed themselves of Chapter XI. A few of the many cases filed in the past fifteen years in the Southern and Eastern Districts of New York present a picture of the types of middle-sized corporations with no public interest involved which have effectively availed themselves of the machinery of Chapter XI. Thus, in In Matter of Sword Line, Inc., Referee Kurtz confirmed an arrangement where the debtor's assets were $12,722,143 and its liabilities $7,870,024, and in the recent Tele King Corporation case, Referee Loewenthal confirmed an arrangement of a debtor with assets of $5,201,251.32 and liabilities of $4,752,970.69. Referee Doran confirmed an arrangement of Terry Brick Corp., a debtor and its 6 wholly owned subsidiaries. Referee Warner confirmed an arrangement of a debtor manufacturing electronic equipment with assets of over a million dollars. Referee Stephenson continued a debtor in possession operating shoe concessions in numerous department stores in many eastern states. Referee Joyce continued a ship chandler as a debtor in possession, operating in New York and Virginia. Referee Castellano confirmed an arrangement of a yacht club having a substantial amount of unsecured debentures outstanding to its membership. Referee Duberstein confirmed an arrangement of a million dollar electronics manufacturer.

60. 142 F. 2d at 871.
61. 222 F. 2d at 237.
64. Bankruptcy Docket No. 86531 (S.D.N.Y. 1949).
Relief, therefore, under Chapter XI has been effective and adequate for the closed middle-sized corporation, regardless of the large amount of assets and liabilities and has not been meant merely for the "hot dog stand" as the Commission contended in one case.\textsuperscript{70} For, to all intents and purposes these middle-sized corporations have had complex legal problems which the referee in administering the Chapter XI proceeding has considered in arriving at his finding that the plan was fair and equitable and feasible,\textsuperscript{71} or as he finds today that the plan is for the best interests of creditors and feasible.\textsuperscript{72}

\textbf{XI. FUNCTIONAL PURPOSE OF THE CHAPTERS}

Now, this choice of chapters is not merely an academic exercise in legal gymnastics, but has definite values in the administration of the chapters and the ultimate rehabilitation of the debtor. This importance is emphasized in the relative rights a debtor has in a Chapter XI proceeding as against those possessed by a debtor in a Chapter X proceeding. Under Chapter XI, subject to the authorization of the referee, the debtor may remain in possession of his business, operating as he has before,\textsuperscript{73} and with the approval of his creditors formulates a plan of arrangement.\textsuperscript{4} This plan basically need only be for the best interests of creditors and feasible.\textsuperscript{75}

Under Chapter X, if the liabilities are over $250,000, there will be an independent trustee\textsuperscript{76} who operates the business,\textsuperscript{77} examining the debtor and witnesses as to their prior acts and conduct,\textsuperscript{78} and the trustee formulates a plan subject to court approval.\textsuperscript{79} The Commission is often an active participant.\textsuperscript{80}

If the problem were just one of more efficient and comprehensive control, the middle-sized corporation might well be relegated to Chapter X, but, in most cases, the character of the corporation is such that management plays an important role in the rehabilitation scheme. The financial

\textsuperscript{70} Bankruptcy Docket No. 91173 (S.D.N.Y. 1955). The brief of the Commission at 5 states: "Apprehension was directed rather to the possibility that 'hot-dog stand' cases, where only trade creditors were involved, might seek the protection of Chapter X. (House Hearings on H.R. 6439, 75th Cong., 1st Sess. (1937), p. 175.) Consequently Sec. 146(2) was formulated to restrict those small companies to the relief afforded by Chapter XI."

\textsuperscript{71} Bankruptcy Act § 366(3), 11 U.S.C.A. 766(3) (1938); deleted by 1952 amendment.


\textsuperscript{74} Bankruptcy Act § 323, 11 U.S.C.A. 728 (1952).


\textsuperscript{78} Bankruptcy Act § 156, 11 U.S.C.A. 556 (1938).


\textsuperscript{81} Bankruptcy Act § 175, 11 U.S.C.A. 575 (1938).

difficulties may have been caused as a result of a seasonal slack in business, unusual competition by giant concerns, a need for capital, or a host of other factors. These with the skill of management and an extension of time or reduction of unsecured debts, may very well remedy the existing ailment, preserve going concern value, and rehabilitate the debtor. This contribution has been recognized by the Supreme Court as constituting valid consideration for management's retention of its stock interest because its contribution is the equivalent of money's worth. Subjecting the debtor on the other hand to a trustee, the Commission, and an elaborate procedure, may result in the dwindling of management's contribution and interest with ultimate bankruptcy liquidation as the alternative.

Unfortunately in law, unlike the sciences, there are no comparatives. We just cannot put the same case through Chapter X and then through Chapter XI and examine the results, choosing the better outcome. However, the exercise of a sound judicial discretion should basically set the pattern for a minimum of error.

Although there appears to be little discussion in the Congressional record of what Congress meant by adequate relief, it would seem to be that the generality of the term was purposeful to allow the court to exercise its discretion and common-sense experience in arriving at a conclusion. Indeed Judge Medina concluded after analyzing sections of Chapter X that it was the "... conscious purpose of Congress to encourage resort to Chapter XI whenever the remedy afforded thereby adequately protects the interests involved."

The straight-jacket of numbers might very well have resulted in the annihilation of many of the large concerns which in the past seventeen years have availed themselves of Chapter XI, with economic hardship, not only to management but added losses to creditors and loss of employment to wage earners. Just a few months ago, Mr. William M. Freeman reviewing our handbook, "What the Business Executive Should Know About Chapter XI" wrote in the New York Times:

81. See SEC v. United States Realty & Improvement Co., 310 U.S. 434 (1940), where, at 454, the Court states: "In cases where subordinate creditors or the stockholders are the managers of its business, the preservation of going-concern value through their continued management of the business may compensate for reduction of the claims of the prior creditors without alteration of the management's interests, which would otherwise be required by the Boyd case. See Case v. Los Angeles Lumber Products Co., 303 U.S. 105 (1939), 121, 122.

82. See Mankiewicz, Trial (Harpers & Brothers 1954). The author plays with the problem of possible outcome of a conviction in a murder trial if other counsel had tried the case.

83. In re Transvision, Inc., 217 F. 2d 243, 246 (2d Cir. 1954). See also Montgomery, 13 Ref. J. 17 (1938) where Mr. Montgomery in an address before the National Association of Referees in Bankruptcy gave an added reason for the allowance of the borderline case in Chapter XI, namely, "burdening the court with 77B proceedings..."
"The underlying purpose of Chapter XI is to prevent the economic waste involved in the liquidation of a business. It seeks to assist the enterprise that seems likely to be able to weather financial troubles if given a little time and encouragement."

Contrast this with the position of the Commission in the Liberty case where it urged upon the court the principle enunciated in a section 77B proceeding:

"We think it also may be safely said that it was not the intention of Congress in enacting § 77B to place crutches under corporate cripples, fit subjects for liquidation, and send them out into the business world to be a menace to all who might purchase their securities or deal with them on credit."

It is, therefore, clear that a choice of chapters may also mean the life or death of a debtor by the application of the strict priority doctrine of the Boyd and Los Angeles cases, or the doctrine of feasibility expounded in the DuBois case, namely, ascertaining capitalization by an application of an algebraic formula of future earnings based upon numerous factors including past experience.

The middle-sized corporation's subjective point of view is reflected in the past seventeen years' experience of the referees in bankruptcy. With the aid of the referee's court, which may very well be designated as a court of bankruptcy, considering its skill and resourcefulness, the middle-sized corporation has been rehabilitated and returned to our economic society to continue a useful existence. No sound purpose is served either to the economy of the community or in the administration of justice in attempting to bedeck a middle-sized corporation with all the glamour and fastidiousness of judicial enterprise, while all it needs, to quote an eminent jurist of the New York Appellate Division is "prompt, low-cost, expert justice."

84. N.Y. Times, Sept. 19, 1955, p. 34, col. 4.
87. "The criterion of earning capacity is the essential one if the enterprise is to be freed from the heavy hand of past errors, miscalculations or disaster, and if the allocation of securities among the various claimants is to be fair and equitable. . . . Since its application requires a prediction as to what will occur in the future, an estimate, as distinguished from mathematical certitude, is all that can be made. But that estimate must be based on an informed judgment which embraces all facts relevant to future earning capacity and hence to present worth, including, of course, the nature and condition of the properties, the past earnings record, and all circumstances which indicate whether or not that record is a reliable criterion of future performance. A sum of values based on physical factors and assigned to separate units of the property without regard to the earning capacity of the whole enterprise is plainly inadequate." Consolidated Rock Products Co. v. DuBois, 312 U.S. 510 (1941) at 526.
88. See admirable article of Charles D. Breitel and Sol Neil Corbin, Courts and Bar May Stand or Fall, 13 N.Y. County Bar. Bull. 1, 8 (N.Y. County Lawyers Ass'n May, 1955).
XII. Conclusion

Looking back on the seventeen years of Chapter XI is easier than looking ahead. But the experience of seventeen years of rehabilitating the middle-sized corporation has taught us much.

First, the clamor for a complete revision of Chapter XI to include in its orbit only individuals or partnerships and not corporations has been hushed by the results obtained in administering these middle-sized corporations. 89

Second, the numbers formula of determining which corporation should be in Chapter XI based upon arbitrary ceilings of assets, liabilities and securities outstanding to the public, is not designed to be in the best interests of either the creditors or the debtor. 90

Third, judicial interpretation of the terminology “adequate relief” is making it possible to determine the proper chapter for the middle-sized corporation. Co-existence of Chapter X and Chapter XI is not only possible on a dignified basis, but is a reality for the middle-sized corporation. Public and private considerations will determine the availability of the respective chapters. Such availability will depend upon numerous variable factors and perhaps permutations and combinations of such factors, e.g. assets, liabilities, stock outstanding to the public, intricacy of corporate structure, need for investigation, and management’s contribution, all properly evaluated by the exercise of judicial discretion.

Fourth, summary relief for corporations such as exemplified by Chapter XI as against plenary relief provided by Chapter X, is consistent with modern growth and progress in the law. 91 It is not synonymous as some writers believe with neglect, wastefulness, or indifference to the rights of vested interests, or acquiescence in unbridled reign by management. There is nothing grubby or coarse in this relief or inept or inefficient. Summary relief in Chapter XI is no more a new concept than summary judgment in most state jurisdictions: neither deprives litigants of rights they possessed without a hearing. 92

Fifth, if Chapter XI has risen to a position of dignity, existing side by side with Chapter X, and serving the “public with prompt, low cost, expert justice,” 93 we have in part to thank the forty-odd framers. But it would have been a meaningless pattern of words if the referees by

89. See notes 62-69 supra.
90. Gerdes, Recent Developments in Corporate Reorganizations Under the Bankruptcy Act, 26 Va. L. Rev. 999, (1940) at 1027: “Chapter XI requires revision in a number of respects. It should be amended: (a) to specify the corporations subject to its provisions. . . .”
91. SEC v. United States Realty & Improvement Co., supra note 81, at 446.
92. Breitel & Corbin, supra note 88, at 12 (see the excellent discussion of ejectment and summary proceedings).
93. Id. at 8.
constant application, diligence and learning had not infused in it the spark of humanity\textsuperscript{94} necessary to rehabilitate a sick business so that when it left the confines of the court, it could continue as a useful part of our economic society, albeit a little scarred and handicapped by the experience.

The late Robert S. Oglebay, writing in the Referee's Journal in 1948 said:

"But the statute itself would have been a lifeless system of legal jargon had not the courts, through the years, breathed into it the living substance of construction and interpretation, adapting the statutory language to situations of reality, and even by misconstruction emphasizing the necessity for the changes which are a part of the growth of our law.\textsuperscript{95}\"

May we not with equal force describe the gradual growth of Chapter XI in the seventeen years of its existence? When it was hardly three years of age, almost an "inconspicuous legal fledgling,"\textsuperscript{96} we heralded its achievements in the \textit{New York University Law Quarterly Review}.\textsuperscript{97} When it was approaching its 'teens in 1950, we extolled its possibilities and its growth in the \textit{Cornell Law Quarterly Review}.\textsuperscript{98} Now that it has reached seventeen years of successful operation in the courts, we are looking forward to the time when in its twenty-fifth year of maturity it will flourish on the same dignified basis as Chapter X, and render to the community a valuable service in the economic rehabilitation of the middle-sized corporation.

\textsuperscript{94}See Atlantic Coast Line R.R. v. St. Joe Paper Co., 216 F. 2d 832, 836 (5th Cir. 1954): "... at present the bankruptcy law, especially the federal statutes, are founded on principles of humanity as well as justice. ..."

\textsuperscript{95}Oglebay, Some Landmark Cases in the Development of the Bankruptcy Act of 1898, 22 Ref. J. 105 (1948).

\textsuperscript{96}Address of Chief Judge Charles E. Clark, of the Second Circuit, before New York State Bar Association, reported in 78 Rep. N.Y.S.B.A. 51, 53 (1955).

\textsuperscript{97}Weintraub, Levin & Singer, Third Year of Arrangements Under the Bankruptcy Act: Cross-Roads and Signposts, 18 N.Y.U.L.Q. Rev. 375 (1941).

\textsuperscript{98}Weintraub & Levin, Chapter XI Approaches its "Teens," 35 Cornell L.Q. 725 (1950).