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FROM UNITED STATES REALTY TO AMERICAN TRAILER RENTALS: THE AVAILABILITY OF DEBTOR RELIEF FOR THE MIDDLE-SIZED CORPORATION

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THE year 1940 witnessed SEC v. United States Realty & Improvement Co.,¹ the first decision of the Supreme Court resolving a problem of jurisdictional conflict between the reorganization of a corporation under Chapter XI² and rehabilitation under Chapter XI.³ No one could have realized then that this case would become the keystone upon which all future decisions in this area would be built. Nevertheless, it has loomed mightily in the analysis and discussion of principles directed at affirming the viability of Chapter X, vis-à-vis Chapter XI, as a required means of reorganization of corporations with public securities outstanding.

During the succeeding twenty-five years, a slow but steady stream of cases has wended its way through the United States Courts of Appeals and the Supreme Court, and, invariably, these cases all returned to the cornerstone case for comfort through stare decisis. Indeed, the latest decision of the Supreme Court, SEC v. American Trailer Rentals Co.,⁴ strongly reaffirmed the principles of United States Realty.⁵ Such approval again brings to the forefront for introspection the host of cases decided over the past twenty-five years. From this group we have culled for discussion the ten leading cases.⁶

When we realize that, in this era of the greatest upsurge in business, a newly organized enterprise has less than a 50-50 chance of survival,⁷ we begin to understand the heavy and insistent pressure at the doors of corporate reorganization. Indeed, the failures are not confined solely to the area of newly organized businesses; the percentages are also sig-

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1. 310 U.S. 434 (1940).
5. Id. at 613.
6. For an examination of the financial structures of the various debtors in these cases, see appendix infra.
significant for well established companies. Although the relief chapters of the Bankruptcy Act cannot provide preventive assistance, they are designed to aid the financially sick corporate debtor to get on its feet and to become a useful economic unit. Yet, the hospitality of this reception hinges upon whether the debtor has the proper credentials to allow it to remain in one chapter as against another. Since this rejection in one chapter often results in a failure of reorganization and a bankruptcy, such determination is of the utmost concern to the three principal parties involved, namely, the debtor, its creditors, and its public investors.

Indeed, on occasion, the corporate debtor may be repulsed on both fronts. In In the Matter of Liberty Mortgage Corp., the debtor had filed a petition under Chapter XI for an arrangement. The Securities and Exchange Commission moved pursuant to Section 328 of the Bankruptcy Act to dismiss the proceeding unless the debtor amended its petition to comply with the requirements of Chapter X, and an order was entered by the court requiring the debtor to file an amended petition or face dismissal. The debtor then filed its petition under Chapter X. Once within Chapter X, the debtor hardly had time to relax before it was met with a motion to dismiss the Chapter X petition on the ground that it had not been filed in good faith, i.e., it was unreasonable to expect that a plan of reorganization could be effected. This motion was opposed by the debtor and by the Commission. The fact that this case had been transferred from Chapter XI on the ground that Chapter XI was not the proper proceeding made no difference. The court dismissed the Chapter X proceeding.

The Liberty Mortgage case represents a variance from the norm. The
usual procedure is to move under section 32S to transfer from Chapter XI to Chapter X on the ground that the proper proceeding is Chapter X. It is a rarity that the transferred proceeding is also rebuffed in the Chapter X proceeding. In some instances the reorganization is consummated, and in others the debtor is adjudicated a bankrupt upon consent and upon its failure to file an amended petition. Our problem, however, is to evaluate the criteria attendant upon a direction for a transfer and to interpret present judicial trends. For these purposes, we turn to the earliest of the high Court cases.

I. The United States Realty Case

The principles enunciated by the Supreme Court in United States Realty have been reaffirmed, as indicated above, in SEC v. American Trailer Rentals Co., as well as in the earlier case of General Stores Corp. v. Shlensky.

In United States Realty, the debtor was a corporation engaged in the business of management and ownership of real estate investments. Its financial structure consisted of 900,000 shares of capital stock, listed on the New York Stock Exchange, which were held by 7,000 stockholders. Its liabilities were in excess of 5,000,000 dollars, which included two series of publicly held debentures aggregating 2,339,000 dollars, which were secured by a pledge of corporate stock of little value and a 3,000,000 dollar note secured by a first mortgage owned by the debtor. In addition, the debtor was also liable as a guarantor of mortgage certificates of 3,710,500 dollars issued by its wholly owned subsidiary, Trinity Building Corporation of New York, and these certificates were in the hands of 900 holders. These certificates were in default and were secured by a mortgage on Trinity's real estate.

Before the maturity of the mortgage certificates, the debtor and Trinity proposed a plan to certificate holders to extend the maturity date of the certificates, to reduce the interest rate, and to modify the sinking fund. Debtor's guaranty was to be modified accordingly, and sinking fund payments were to be eliminated. The plan was to be consummated by utilizing two proceedings: the filing of a Chapter XI proceeding by the debtor modifying its guaranty but leaving unaffected its stock and other indebtedness; and an attempt, instituted on behalf of Trinity in the New York State courts, to secure an appropriate modification of

Trinity's primary obligation on the certificate. Thus, the debtor sought an arrangement for itself under Chapter XI of the Bankruptcy Act, and a modification of its subsidiaries' secured indebtedness under New York law.

In dismissing the petition as not having been properly filed under Chapter XI, the Supreme Court held: (1) The debtor, "although a large corporation with its securities widely distributed in the hands of the public, is nevertheless within the literal terms of Chapter XI . . ." and, therefore, can file an arrangement under Chapter XI.\(^{17}\) (2) Chapter XI provides a summary procedure for a debtor seeking an arrangement of its unsecured debts and is available to any person who could become a bankrupt under Section 4 of the Bankruptcy Act.\(^{18}\) (3) There is no definition or classification in either chapter which would enable the court to place a corporate debtor exclusively in one chapter rather than in the other.\(^ {19}\) (4) The court has jurisdiction to entertain the proceeding of a corporate debtor in Chapter XI, but in all cases the question involved is the propriety of such jurisdiction, and the answer to this turns on considerations growing out of the public policy of the Act found both in its legislative history and in an analysis of its terms, and of the authority of the court clothed with equity powers and sitting in bankruptcy to give effect to that policy through its power to withhold relief under Chapter XI when relief is available under Chapter X, which is adequate and more consonant with that policy.\(^ {20}\)

(5) It did not appear that any fair and equitable arrangement in the best interests of creditors could be effected without some rearrangement of the capital structure of the debtor.\(^ {21}\)

The effect of these holdings on succeeding cases was to thoroughly entrench the principle that a corporation with public security holders could file a petition under Chapter XI provided its plan (unlike the instant one) did not require some readjustment, directly or indirectly, of the rights of the public investors. Such readjustment could not be accomplished without the aids for the protection of creditors and the public interest which Chapter X provides, \(i.e.,\) the independent trustee, the intervention of the Commission, the examination under Section 167 of the Bankruptcy Act,\(^ {22}\) and other provisions of close judicial surveillance.

\(^17\) 310 U.S. at 445.
\(^18\) Ibid.
\(^19\) Id. at 446; see Bankruptcy Act § 4, 52 Stat. 845 (1938), 11 U.S.C. § 22 (1964).
\(^20\) 310 U.S. at 447.
\(^21\) Id. at 448.
\(^22\) Id. at 453-54.
In 1952, twelve years after United States Realty, section 328 was added to Chapter XI. This section provides that, upon the application of the Commission or any party in interest, the judge, upon finding that the proceedings should have been brought under Chapter X of the act, may enter an order dismissing the proceedings under Chapter XI unless the petition is amended to comply with the requirements of Chapter X. The House report indicated that the transfer provisions codified the United States Realty decision and adopted the procedure of section 147 for transferring a proceeding to Chapter XI.

At the same time, section 366 was amended to eliminate the provision that a plan under Chapter XI had to be fair and equitable. The Senate report indicated that the amendment was intended to eliminate a provision which was impractical in Chapter XI. No corporate debtor with stock ownership substantially identical with management could effectuate an arrangement by scaling down its debts since no such plan would be “fair and equitable” inasmuch as there could be no retention of a stock interest by management where senior interests such as creditors were not being paid in full.

As Mr. Justice Frankfurter indicated in his dissent in General Stores, the lower court had given no consideration to the elimination of the fair and equitable rule from Chapter XI. With this elimination from United States Realty, it is fair to assume, as he indicated, that the generalizations of United States Realty should be restricted to its own facts, namely, that “a critical reading of the extended opinion in the Realty case requires the conclusion that all its general observations must be limited to the particular situation which elicited them.”

24. Bankruptcy Act § 328, 66 Stat. 432 (1952), 11 U.S.C. § 728 (1964). The section authorizes dismissal where the proceeding was not properly in Chapter XI. Prior thereto, the authority to dismiss was based on the inherent power of a court of bankruptcy. For exercise of a similar power to adjudicate a Chapter XI debtor a bankrupt, see Ira Haupt & Co. v. Klebanow, 348 F.2d 907 (2d Cir. 1965).
28. General Stores Corp. v. Shlensky, 350 U.S. 462, 471 (1956) (dissenting opinion). Mr. Justice Frankfurter described the fair and equitable doctrine as “the absolute rule for equity reorganizations” which had been established earlier by the Court. Id. at 471 (dissenting opinion), citing Case v. Los Angeles Lumber Prods. Co., 303 U.S. 106 (1939); Northern Pac. Ry. v. Boyd, 228 U.S. 452 (1913).
30. 350 U.S. at 471, 472 (dissenting opinion).
31. Id. at 471 (dissenting opinion).
The Court in *General Stores* summarized the *United States Realty* holding:

There one class of creditors was being asked to make sacrifices, while the position of the stockholders remained unimpaired . . . Moreover, the history of the company raised a serious question "whether any fair and equitable arrangement in the best interest of creditors" could be effected "without some re-arrangement of its capital structure."32

To sum up *United States Realty*, we conclude that the case was transferred basically because a fair and equitable plan required a readjustment of stockholdings which could not be effected under Chapter XI.33 It is noteworthy that the Court did not discuss any existing irregularities in connection with management's operation.

II. FROM *United States Realty* TO *General Stores*

A. The Mecca Temple Case

A small number of significant appellate cases appeared between the landmark case and the next Supreme Court decision, *General Stores Corp. v. Shlensky*,34 in 1956. During these sixteen years, the first was *Mecca Temple v. Darrock*.35 The debtor was an insolvent membership corporation of approximately 2,800 members. Its unsecured liabilities amounted to 1,200,000 dollars, which was raised for a building project that was foreclosed and for which bonds were issued. These bonds were originally sold exclusively to members of the debtor but, through inheritance and sale, found themselves in the hands of others than the fraternal members. The corporation's assets included an interest in two pieces of real property and income from dues. The debtor had filed a petition under Chapter XI and had submitted an arrangement proposing to pay each bondholder ten per cent over a period of years. The referee dismissed the petition sua sponte, holding that the proceedings should be transferred to Chapter X. The court of appeals, in affirming the referee, held: (1) there had not been an adequate explanation of the deficiency between receipts and disbursements;36 (2) a better plan should be given to unsecured creditors and it was not in their best interests;37 (3) there was a public interest even though the bonds originally had been privately issued;38 and, (4) finally, the fair and equitable doc-

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32. Id. at 466, quoting from SEC v. United States Realty & Improvement Co., 310 U.S. 434, 456 (1940). (Citations omitted.)
34. 350 U.S. 462 (1956).
35. 142 F.2d 869 (2d Cir.), cert. denied, 323 U.S. 784 (1944).
36. 142 F.2d at 871.
38. 142 F.2d at 871.
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trine might presumably dictate that the members' rights might be sub-
ordinated to the rights of other creditors.\(^9\)

Again we find a public interest and the fair and equitable doctrine as
the reason for transfer. It would appear that the proceeding was not a
true test of the principles enunciated in *United States Realty* since the
court was not dealing with a commercial entity.

B. *The Transvision Case*

*In the Matter of Transvision, Inc.*\(^{40}\) drew sharp lines of distinction
as to the type of middle-sized corporation which was amenable to Chap-
ter XI even though a public interest was involved. There were 385,000
shares of common stock outstanding, of which management owned 250,-
000, and the balance was owned by 425 public investors. Assets were
nearly 1,000,000 dollars and liabilities were approximately 700,000
dollars. The court of appeals, in affirming the district court, called at-
tention to the fact that this was not a complex debt structure nor a
sizeable diffusion of stock which might intensify "the impulsion to rele-
gate the petitioner to the relief afforded him under Chapter X."\(^{41}\) More-
over, there was no evidence of wrongdoing. However, this did not fore-
close the Commission or any other interested party from bringing to the
court's attention substantial evidence of wrongdoing or other factors
affecting the debtor's ability to confirm a plan.\(^{42}\)

Again the court emphasized the summary nature of Chapter XI
whereby a debtor, to extricate itself from financial straits, may secure
confirmation of an arrangement of its unsecured obligations "with a
minimal disturbance of operations [and] . . . without employing the
elaborate investigatory and protective procedures attendant upon the
usual corporate reorganization proceeding under Chapter X."\(^{43}\)

III. THE *General Stores* CASE

The second decision rendered by the Supreme Court dealing with the
problem of transfer was *General Stores Corp. v. Shcnsky.*\(^{44}\) The extent
to which the Supreme Court relied upon *United States Realty* to base
its decision in *General Stores* is evident from the Court's indication that
much of the argument on both sides was devoted to the "meaning" of the
*United States Realty* case.\(^{45}\) Here again, the Court held that the position

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39. Id. at 872.
41. 217 F.2d at 246.
42. Id. at 247.
43. Id. at 246.
44. 350 U.S. 462 (1956).
45. Id. at 465.
taken by the Commission, that Chapter X affords relief for corporations with publicly held securities while Chapter XI is available to those whose stock is closely held, was rejected. The Court emphasized that the distinction as to the availability of Chapter XI was dependent upon "whether the formulation of a plan under the control of the debtor, as provided by c. XI, or the formulation of a plan under the auspices of disinterested trustees, as assured by c. X and the other protective provisions of that chapter, would better serve 'the public and private interests concerned including those of the debtor.'

Neither the character of the debtor, its capital structure, nor its size was considered to be controlling. The "needs" test was held to be paramount: Was there a need to apply the fair and equitable doctrine, or a need for readjustment of the debt structure, or for an accounting by management for misdeeds, or for new management?

Passing upon these standards as they applied to the facts of the case, the Court found that there had been one reorganization; heavy short term loans were impending; shares of stock of valuable subsidiaries had been pledged; provision should be made for merger of the parent with the subsidiaries; a balanced capital structure did not exist; and heavy borrowings on a short term basis indicated disaster for post-confirmation operation.

Indeed, the Court stated that the paramount consideration was that the debtor's plan was not feasible. Moreover, it subordinated the fair and equitable doctrine to the question of feasibility: "A question as to what is 'fair and equitable' between creditors and stockholders may eventually be reached in the reorganization. But the paramount issue at present concerns what is 'feasible.'

Since the application of the fair and equitable doctrine was subordinated to the feasibility problem, it might accordingly be argued that such a test of feasibility would be made in the arrangement proceeding which sets up the same standard. We cannot overlook the countervailing effect of the soundness of the arguments contained in the dissenting opinion of Mr. Justice Frankfurter. The effect of the elimination of the fair and equitable doctrine has already been discussed. The other standards of the utilization of Chapter XI for readjustments with credit-

46. Ibid.
47. Id. at 465, quoting from SEC v. United States Realty & Improvement Co., 310 U.S. 434, 455 (1940).
48. 350 U.S. at 466.
49. Id. at 467.
51. See text accompanying note 29 supra.
ors where no change in the capital structure is involved, where no irregularities are charged, and where the creditors urge that the arrangement is for their best interest should be given serious consideration in the evaluation involving a transfer.

IV. FROM General Stores TO American Trailer Rentals

The General Stores case emphasized the need for a practical resolution of a difficult problem, but it also indicated that no hard and fast rule could be drawn: The guideposts were not riveted to firm foundations, but would depend upon the application of judicial discretion on a case-to-case basis. The appellate cases of the succeeding ten years leading up to the next Supreme Court case indicated the feasibility of the suggested standards.

A. The Wilcox-Gay Case

In In the Matter of Wilcox-Gay Corp., the district court denied the application of the Commission to transfer the Chapter XI proceeding to Chapter X, and the court of appeals unanimously affirmed this decision. The appellate court stated that it had withheld its decision until the Supreme Court had rendered its opinion in the General Stores case.

Its conclusions from the Court’s analysis were that the discretion of the district court which had relied upon the Transvision decision was a sound exercise of discretion.

The basis of such discretion was rooted in the following factors: a feasible plan; a reasonable likelihood of rehabilitation of the debtor; a benefit to stockholders only in the event that operations were profitable; adoption of the creditors’ assertion that existing management was necessary for the continuation of the business; an opportunity open at all times for interested parties to call any irregularities to the attention of the court; the probability that a transfer to Chapter X might be prejudicial to the ultimate success of the plan; the fact that there was no public interest as distinguished from public ownership which required the intervention of the Commission; and, finally, the fact that further investigation was unnecessary in view of the active participation of the various interests involved, including a creditors’ committee.

Moreover, the court of appeals held that the findings of the district

53. 350 U.S. at 465, 463.
56. Id. at 860.
57. Id. at 860-61.
58. Id. at 860.
59. Id. at 860-61.
court were compatible with the principles of the *General Stores* case.\(^60\) It is interesting to note that emphasis was placed upon the following factors: the necessity for the continuance of existing management even though management was in control when insolvency took place; the capacity of a Chapter XI proceeding to deal with irregularities; the omission of a reference to the fair and equitable rule; the weight accorded the recommendation of a creditors' committee; and, finally, the conclusions of law that the findings were in harmony with *General Stores*.\(^61\)

**B. The Liberty Case**

A year later, the Court of Appeals for the Second Circuit also applied the principles of *General Stores* by holding, in *SEC v. Liberty Baking Corp.*,\(^62\) that the proceedings should be transferred from Chapter XI to Chapter X. In reversing the district court, the appellate court indicated that the lower court's decision antedated the *General Stores* case;\(^63\) and the court distinguished *Wilcox-Gay* on the ground that, among other things, it had previously been in Chapter X.\(^64\) Another area of distinction which the court of appeals indicated was controlling, and which had not been present in either *Transvision* or *Wilcox-Gay*, was a modification of the claims of public debenture holders.\(^65\) In the former cases, the modification was only of the obligations of trade and commercial creditors, whereas in the latter, public investors were being affected. Insofar as the machinery of Chapter XI was concerned, it would appear that this distinction was unsound because a plan can affect unsecured creditors, whether public or private.

**C. Several Miscellaneous Cases**

Following *Wilcox-Gay* and *Liberty* were a trio of cases reflecting the adverse effects of the adherence to a strict interpretation of *United States Realty* and *General Stores*. In *In re Lea Fabrics, Inc.*,\(^66\) the Commission moved to transfer the proceeding to Chapter X even though the plan sought only to scale down unsecured obligations and did not affect public security holders. The debtor emphasized that a transfer would mean an adjudication in bankruptcy. The Third Circuit, in its refusal to transfer, stated: "Even if a plan evolved under Chapter X which was 'fair and

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\(60\) Id. at 861.
\(61\) Id. at 860-61.
\(62\) 240 F.2d 511 (2d Cir.), cert. denied, 353 U.S. 930 (1957).
\(63\) 240 F.2d at 511 n.1.
\(64\) Id. at 516 n.10. For the fallacy of these arguments, see Weintraub & Levin, Practical Guide to Bankruptcy and Debtor Relief 160 (1964).
\(65\) 240 F.2d at 514.
\(66\) 272 F.2d 769 (3d Cir. 1959), vacated as moot per curiam, 363 U.S. 417 (1960).
equitable’ . . . the shareholders would stand little chance of profiting by it.”

Again, in In re Herold Radio & Electronics Corp.,68 the debtor’s plea was that a transfer would mean an adjudication in bankruptcy because there would be no cash flow to support continued operations by a trustee in Chapter X. The court, however, transferred the proceeding, and bankruptcy followed.

The danger that a debtor will be adjudicated a bankrupt because of a transfer, as resulted in Herold Radio, is coupled with another fear, a frustrating possibility, i.e., that the consummation of a plan in Chapter X may result in the elimination of the public stock interest when the debtor is found to be insolvent.69 Under such circumstances, outside interests will compete for the purchase of the stock of the reorganized company.

A variant of this situation occurred in In re Dilbert’s Quality Supermarkets, Inc.70 In transferring the proceeding to Chapter X, the court agreed with the Commission’s contentions that the financial and capital structure of the debtor required a complete reorganization and that there was a question of fairness to public holders of debt securities in the treatment of the subsidiaries’ debentures which had been guaranteed by the parent. The district court relied upon United States Realty and General Stores, among others. However, the plan of reorganization which was ultimately consummated provided for an elimination of the interests of the common stockholders, and the formation of a new corporation since the debtor was found to be insolvent. Stockholders, both common and preferred, were held not to be entitled to any equity in the reorganized corporation. The new issue of stock was issued to unsecured creditors. Thus, the ultimate aim of reorganization for the benefit of the public investor resulted in the public stockholders losing the practical benefits of reorganization.

Grayson-Robinson Stores, Inc. v. SEC71 gave vitality to some of the standards which Mr. Justice Frankfurter enunciated in General Stores.72 The court stated:

This is a case where no publicly held securities are being readjusted, the creditors have had vigorous independent representation, stockholder interests have offered substantial contributions, and rights to pursue claims for dereliction remain unaffected. In such circumstances a court can hardly ignore a substantially uncontradicted

67. 272 F.2d at 772. (Citation omitted.)
70. 2 Bankr. L. Rep. § 69, at 799 (E.D.N.Y. March 8, 1963). For other cases see Weintraub & Levin, op. cit. supra note 64, at 162.
71. 320 F.2d 940 (2d Cir. 1963).
72. 350 U.S. at 471 (dissenting opinion).
factual showing that Chapter XI affords some hope of paying off creditors whereas Chapter X offers none.\textsuperscript{73}

An analysis of the \textit{Grayson-Robinson} case indicates that there were no public securities being affected; that the recommendation of the creditors' committee was being given consideration; that management was making a contribution; that the right to prosecute claims against officers and directors could be pursued; and, finally, that Chapter XI offered some hope of paying creditors, whereas Chapter X offered none.

Two recent courts of appeals cases are to be considered before arriving at the last of the Supreme Court cases. In \textit{SEC v. Crumpton Builders Inc.},\textsuperscript{74} the Fifth Circuit held that the district court exceeded the proper limits of its discretion in denying the motion to dismiss the Chapter XI proceeding. In reviewing the history of the chapters, the appellate court summarized the advantages of Chapter X, indicating the safeguards for public investors therein contained,\textsuperscript{75} and the necessity for the utilization of the fair and equitable doctrine.\textsuperscript{76} The court also indicated that, although the fair and equitable doctrine had been eliminated from Chapter XI proceedings, nonetheless, the fairness and equity of any Chapter XI plan that provided for participation before the dissenting creditors received full payment was a relevant consideration.\textsuperscript{77} Moreover, the court also indicated that in \textit{General Stores} the fairness of the reorganization was subordinated to the needs of the debtor and the feasibility of the arrangement.\textsuperscript{78}

An interesting observation of the court was its comment: “In spite of the Supreme Court's clear mandate for a case by case approach, there have been many and various calls for absolute rules.”\textsuperscript{79} Two of the demands which were rejected by the court were: (1) a requirement of a Chapter X proceeding whenever the securities are publicly held; (2) a requirement that Chapter X is the only proper proceeding when, as in the

\textsuperscript{73} 320 F.2d at 950. The court noted: “The developments are reviewed in a series of articles, Weintraub, Levin, and Novick, Chapter X or Chapter XI: Coexistence for the Middle-Sized Corporation, 24 Fordham L. Rev. 616 (1956); Weintraub and Levin, A Sequel to Chapter X or Chapter XI: Coexistence for the Middle-Sized Corporation, 26 Fordham L. Rev. 292 (1957); Weintraub and Levin, Availability of Bankruptcy Rehabilitation to the Middle-Sized Corporation: The Third Circuit's Interpretation, 14 Rutgers L. Rev. 564 (1960).” Id. at 948 n.10. See also Weintraub & Levin, Reorganization or Arrangement: An Analysis of Contemporary Trends in Recent Cases, 37 Ref. J. 103 (1963).

\textsuperscript{74} 337 F.2d 907 (5th Cir. 1964).

\textsuperscript{75} Id. at 909.

\textsuperscript{76} Id. at 910.

\textsuperscript{77} Id. at 910-11.

\textsuperscript{78} Id. at 911; see text accompanying notes 48-50 supra.

\textsuperscript{79} Id. at 911.
Corporation debt relief instant case, some of the unsecured debt is publicly held in the form of debentures rather than in the form of trade debt. Finally, the court endeavored to set its own criteria for a refusal to transfer: (1) "the proposed arrangement should be fair and equitable to all interests on its face," (2) the proposed arrangement should be feasible; (3) no need should exist for capitalization or replacement of management; (4) there should be no irregularities; (5) a good prospect should exist for future business; (6) an unstable financial history will militate against a sound future; and (7) adequate and full information is to be supplied to all who assent to the plan.

As against these factors which favored "caution and supervision," the court must weigh the time and money consumed by a Chapter XI proceeding; the possibility that disruption of needed credit may result from a transfer; the possibility that an effective reorganization will not emerge from a Chapter XI proceeding; and, finally, since the bankruptcy court is a court of equity, it must make sure that the Bankruptcy Act is used to achieve the equitable ends for which it was designed.

Following the Crumpton case, the Second Circuit decided SEC v. Canandaigua Enterprises Corp. In analyzing the "needs" test, the court observed that, although the results were fairly accurate and predictable "in cases at the ends of the spectrum, it is a highly erratic guide in the broad middle range. Corporations such as the debtor require the features of both chapters. After commenting on the benefits to be obtained from both chapters, the court stated:

The "needs" for the two chapters are not only conflicting but largely imponderable; we know of no scale sufficiently sensitive to weigh the near certainty of achieving a Chapter XI arrangement that may not be altogether fair and equitable against the possible emergence of a better plan from a Chapter X proceeding during which the patient may die before an operating room is ready or for which the fees of the surgeon and others in attendance may exceed the patient's means. In the absence of studies of the workings of the two chapters, decision by the district judge is almost bound to reflect his particular experience and predilections.

In an effort to obtain some degree of absoluteness in transfer cases, the

80. Ibid.
81. Id. at 911-12; see commentaries cited note 73 supra.
82. 337 F.2d at 911-12.
83. Ibid.
84. Id. at 912.
85. Ibid.
86. 339 F.2d 14 (2d Cir. 1964). Judge Friendly, who wrote the opinion, had also written for the court in the Grayson-Robinson case.
87. Id. at 18.
88. Id. at 18-19.
89. Id. at 19.
court considered a provision of setting a ceiling on debt in Chapter XI cases, which would require the appointment of a mandatory trustee, and concluded that this was a matter for congressional action;\textsuperscript{90} the court also commented that readjustment of corporations with publicly held securities as requiring resort to Chapter X was disapproved by \textit{General Stores}.\textsuperscript{91} However, \textit{General Stores} did not preclude the court from ruling that the need for a readjustment of publicly held debt creates a presumption in favor of Chapter X, whereas a case calling only for modification of the claims of trade creditors or others who have had private dealings with the debtor is presumptively to be handled under Chapter XI.\textsuperscript{92}

\textbf{V. \textit{The American Trailer Rentals Case}}

The propriety of the transfer was succinctly stated by Mr. Justice Goldberg, in \textit{SEC v. American Trailer Rentals Co.},\textsuperscript{93} as a determination whether the debtor's attempted rehabilitation under the Bankruptcy Act materially affected "the rights of widespread public investor creditors"\textsuperscript{94} or "whether dismissal or . . . transfer [was] . . . required."\textsuperscript{95} The facts indicated that American Trailer Rentals Company was engaged in the automobile trailer rental business which was financed largely through the sale of trailers to investors and their simultaneous lease-back. The Court indicated that between 1959 and 1961 hundreds of small investors, dispersed throughout the western states, had purchased and leased back 5,866 trailers.\textsuperscript{96}

The lease-back agreement provided that the trailer owners would receive a two per cent return of their investment per month for ten years. These trailers were placed by the debtor at gasoline stations and the operators of these stations acted as the debtor's rental agents. There were about 500 of such service stations in operation at the time that the petition for an arrangement was filed. The further offering of these sale and lease-back arrangements to the public was halted in 1961. The Commission notified the debtor that these sale and lease-back arrangements were securities which could not be sold to the public until the debtor filed the necessary registration statement. The debtor filed a statement with the SEC, which never became effective, and suit was commenced to stop the distribution of the debtor's prospectus on the ground that it contained false and misleading statements.

\textsuperscript{90} Ibid.
\textsuperscript{91} Ibid.
\textsuperscript{92} Ibid.
\textsuperscript{93} 379 U.S. 594 (1965).
\textsuperscript{94} Id. at 597.
\textsuperscript{95} Ibid.
\textsuperscript{96} Id. at 598.
After this attempt to register failed, an officer of the debtor and other persons organized a corporation named Capitol Leasing Corporation which offered American’s investor-creditors an exchange of Capitol’s stock for their trailers on the basis of one share for every two dollars that the investor-creditors had paid for the trailer. When a certain number of the trailers had been acquired, the Commission revoked the exemption from registration of small offerings upon which Capitol had relied. The ground for the suspension was that there was reasonable cause to believe that there were false and misleading statements in the offering material.

The debtor then filed the petition under Chapter XI. At the time of the filing, the debtor listed its total assets to be 685,608 dollars and its liabilities to be 1,367,890 dollars, of which 710,597 dollars was owed to trailer owners.

The plan provided that the investor-trailer owners were to exchange their entire interest for stock of Capitol on the basis of one share of stock for each two dollars of remaining capital invested in the trailers. The debtor’s officers and directors, as well as trade and other general creditors, were to receive one share of stock for each three dollars and fifty cents of their claims. The debtor itself received 107,000 shares for the transfer of its trailer rental system to Capitol. American would then distribute the stock to its stockholders. Finally, unsecured obligations to two banks totalling 55,558 dollars were to be paid in full, presumably because the officers and directors of American were subject to liability as guarantors.

The ultimate results of the plan, as summarized by the Court, indicated that, if the plan were approved, a total of 866,000 shares of Capitol stock would be issued to trailer owners, but approximately 81,500 shares would be issued directly to the officers and directors, 22,400 to the trade and other general creditors, and 107,000 to the debtor itself to be distributed to its stockholders.97

The district court recognized the fact that, in view of the wide distribution of the individual holdings, the proposed plan’s issuance of approximately fifteen per cent of Capitol stock to debtor’s officers would mean that they, rather than the investor-trailer owners, would have effective control over Capitol, and expressed disapproval of such a result, as well as the preferential treatment to the banks.98 However, the district court adopted the referee’s findings and denied the motion to transfer. The Tenth Circuit affirmed, basing its decision upon the district court’s discretion.99

In reversing the lower courts, the Supreme Court agreed with both

97. Id. at 602.
98. Id. at 602-03.
parties that the principles of United States Realty and General Stores applied. The court rejected the argument raised in Wilcox-Gay that Chapter X must be used in all of the cases involving the rights of public investor creditors and that, in every case involving such investors, the fair and equitable doctrine must be applied. Furthermore, as part of its argument, the Commission stated that it had no right to intervene in Chapter XI cases except for the transfer section. The Court rejected this argument and stated that the Commission had a right to intervene and to be heard in a Chapter XI proceeding.

Although there was no absolute rule requiring that Chapter X was to be utilized in every case in which the debtor was publicly owned or publicly held debt was to be adjusted, the Court, nevertheless, citing the Canandaigua case, stated that "as a general rule Chapter X is the appropriate proceeding for adjustment of publicly held debt." In commenting on the General Stores case, the Court stated that the holdings of that case indicated that there were narrow limits to the exception of the general rule: (1) simple compositions may be effected under Chapter XI even where public debt is directly affected; (2) "even though there may be no public debt ... affected, Chapter X is ... the appropriate proceeding where the debtor has widespread public stockholders and the protections of the public and private interests involved afforded by Chapter X are required ..." In reversing the lower courts, the Supreme Court rejected the appellant's argument that language in General Stores indicated that the district court's decision was not an abuse of discretion, and held:

Nothing in that opinion supports respondent's view that the issue of whether Chapter X or Chapter XI is required permits open-ended discretion by a district court to decide on a case-by-case basis, without reliance on the principles which we have here reaffirmed, whether in its opinion it would be better for a particular debtor to be in Chapter X or Chapter XI. We agree with the statement of the Court of Appeals for the Second Circuit in a recent decision that such open-ended discretion would be bound to result in decisions reflecting the "particular experience and predilections" of the district judge involved. SEC v. Canandaigua Enterprises Corp.

The first of the appellate cases following the decision of American Trailer Rentals was SEC v. Burton. The lower court had denied the
Commission's motion to dismiss and, while an appeal was pending, American Trailer Rentals was decided by the Supreme Court. The Commission then moved for a remand to the district court to reconsider its opinion in the light of the criteria set up in United States Realty and General Stores. The court granted the remand for the lower court to reconsider the orderliness of the plan of arrangement and the economy of Chapter XI proceedings, and [to give] . . . sufficient weight to the need for new management, the need for investigation by a disinterested trustee of alleged past management inefficiency, lack of skill and even wrongdoing, and the need for application of the "absolute priority" rule of Chapter X but not of Chapter XI.

On remand, the district court denied the motion to dismiss and carefully considered the criteria of American Trailer Rentals, distinguishing them from the instant case: (1) the waiver of interest of public debt as provided in the plan was a minor adjustment; (2) "investigations of the affairs of the debtor [by the receiver and special counsel failed] . . . to uncover any misconduct or wrongdoing on the part of past management," (3) new management had operated the business since the filing of the Chapter XI petition; (4) the plan is feasible and future operations will be profitable; (5) a transfer to Chapter X would be costly "and protracted proceedings of Chapter X, where the rule of strict priorities prevails, could well lead to disaster for the subordinated creditors and stockholders of the debtor."

VI. CONCLUSION

The fundamental thrust which emerges in all these cases is the position of the Commission that it protect the public investor against a plan which is not fair because of the failure to adopt the fair and equitable doctrine or because of the failure to hold management accountable for its misdeeds. Particularly in those cases which do not need a reorganization of its capital structure, the machinery of Chapter XI provides adequate relief at a quicker pace, with less disturbance and cost.

Along these lines, some established principles should be re-evaluated:

(1) Where a debtor is insolvent in the bankruptcy sense, transfer to Chapter X will be meaningless, since the stockholder's equity will be

110. 342 F.2d at 785.
112. Id. at 327.
113. Ibid.
114. Ibid.
115. Ibid.
116. Ibid.
117. Ibid.
eliminated. It may be sounder to protect the public by allowing a debtor to remain in Chapter XI, thereby avoiding the stringency of the fair and equitable doctrine.

(2) Since the Commission may intervene in Chapter XI proceedings, protection of the public investor is assured since it is not necessary in every case to have the meticulous surveillance of a Chapter X proceeding.

(3) Since existing management is often the only source of attracting new capital and credit to the operations, the courts should consider as a precondition to a transfer, the continuance of such a source.

(4) Proper weight should be given to the importance of irregularities which may be minor in some instances and major in others.

(5) More weight should be given to the interests of creditors who, notwithstanding their superior position vis-à-vis stockholders, may still prefer a subordinate position in Chapter XI as being in their best interests.

(6) The motion to transfer should be made before the referee in bankruptcy who is in charge of the Chapter XI case because of his greater familiarity with the case.\(^{117}\)

Finally, it may be that the conflict cannot be resolved even with the aid of all of the guiding principles enunciated by the courts. Indeed, some thought exists that the answer may only be found in a new chapter for the middle-sized corporation, in between Chapter X and Chapter XI.\(^{118}\) However, until such a chapter is enacted, the foregoing proposals are presented for a more equitable disposition of corporate debtor proceedings.

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117. See Committee on Arrangements and Reorganization of the National Bankruptcy Conference, Proposal No. 1 (1963).

118. National Bankruptcy Conference, Resolution No. 3 (1965): “Resolved, that the Conference approves the proposal that the Committee on Arrangements and Reorganization study the desirability of including another chapter in the Bankruptcy Act to satisfy the needs of the so-called ‘middle-sized corporation.’”
<table>
<thead>
<tr>
<th>Case and Year Decided in Court of Last Resort</th>
<th>Transferred to Chapter X</th>
<th>Securities (approximate)</th>
<th>Number of Public Investors</th>
<th>Listing on Exchange</th>
<th>Assets and Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td><em>United States Realty</em> (1940)</td>
<td>Yes</td>
<td>900,000 shares of common stock</td>
<td>7,000</td>
<td>New York Stock Exchange</td>
<td>A—$7,075,515, L—$5,051,416 Contingent—$3,710,500</td>
</tr>
<tr>
<td><em>Mecca Temple</em> (1945)</td>
<td>Yes</td>
<td>membership corporation, 2,800 members</td>
<td>1,834 bondholders</td>
<td>None</td>
<td>A—Income from real property, L—$1,200,000</td>
</tr>
<tr>
<td><em>Transvision</em> (1955)</td>
<td>No</td>
<td>385,000 shares of common stock (250,000 owned by management); all preferred owned by management</td>
<td>425</td>
<td>None</td>
<td>A—$998,041, L—$633,817</td>
</tr>
<tr>
<td><em>General Stores</em> (1956)</td>
<td>Yes</td>
<td>2,322,422 shares of common stock</td>
<td>7,000</td>
<td>American Stock Exchange</td>
<td>A—$6,600,000, L—$4,500,000</td>
</tr>
<tr>
<td><em>Wilcoz-Gay</em> (1956)</td>
<td>No</td>
<td>1,600,000 shares of common stock (no par held by management); 1,614,865 shares of $1.60 par common (held by management and public)</td>
<td>3,000</td>
<td>None</td>
<td>A—$8,910,606, L—$1,472,949</td>
</tr>
<tr>
<td><em>Liberty Baking</em> (1957)</td>
<td>Yes</td>
<td>$1,602,420 debenture issue; $23,760 preferred stock; $65,000 common stock (60% held by management)</td>
<td>198</td>
<td>None</td>
<td>A—$3,069,783, L—$3,373,000</td>
</tr>
<tr>
<td><em>Grayson-Robinson Stores</em> (1963)</td>
<td>No</td>
<td>$1,500,200 subordinated debenture; $33,507 shares (32% held by management)</td>
<td>3,470</td>
<td>American Stock Exchange</td>
<td>A—$33,600,000, L—$33,600,000</td>
</tr>
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<td>Crumpton Builders (1964)</td>
<td>Yes</td>
<td>1,425,660 debentures; 1,250,000 shares of common stock (495,000 shares held by management)</td>
<td>630, 2,000</td>
<td>None</td>
<td>A—$3,408,928 L—$3,422,364</td>
</tr>
<tr>
<td>Canandaigua (1964)</td>
<td>Yes</td>
<td>$3,921,000 convertible debentures; 607,730 class A stock; 376,429 class B stock; 59,946 warrants; (management held 6% of class A and 73% of class B, or 30% of total)</td>
<td>2,800, 3,200, 130</td>
<td>None</td>
<td>A—Racetrack on 490 acres and miscellaneous assets L—Unsecured: $850,000; Secured: $1,500,000</td>
</tr>
<tr>
<td>American Trailer Rentals (1965)</td>
<td>Yes</td>
<td>Sale and lease-back agreements of trailers (approximately $600 per trailer)</td>
<td>5,866</td>
<td>None</td>
<td>A—$685,608 L—$1,367,890</td>
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