Michigan Law Review

Volume 35 | Issue 6

1937

BANKRUPTCY - CORPORATE REORGANIZATION - PLAN - ADEQUATE PROTECTION OF CLAIMS - DUE PROCESS

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BANKRUPTCY — CORPORATE REORGANIZATION — PLAN — ADEQUATE PROTECTION OF CLAIMS — DUE PROCESS — In proceedings for reorganization under Section 77B of the Bankruptcy Act, the debtor held real property valued at $245,025, while outstanding against the property there were first mortgage bonds of $445,000, second mortgage notes for $40,250 and a third mortgage note for $27,000. The court confirmed a plan which made no provision for junior lienors or stockholders, and to which they had not given their consent. On certiorari, granted by the Supreme Court, it was *held*, that since there was no equity in the property above the first mortgage, the claims of the junior lienors and stockholders had no value. Therefore they were in no way deprived of property without due process by a plan, confirmed without their consent, which made no provision for them. Nor was the statute violated, for the protection of claims provided for is only "for the realization of the value of the interests" affected. *In re 620 Church St. Bldg.*, (U. S. 1936) 57 S. Ct. 88.

The bankruptcy power of the Federal Government is subject to the Fifth Amendment,[1] and in any plan under Section 77B [2] the creditor must obtain the indubitable equivalence of his security.[3] However, in order that any person may complain of a violation of the Fifth Amendment, he must show injury,

[1] Louisville Joint Stock Bank v. Radford, 295 U. S. 555, 55 S. Ct. 854, 97 A. L. R. 1106 (1935), noted 35 COL. L. REV. 1136 (1935); In re American States Public Service Co., (D. C. Md. 1935) 12 F. Supp. 667; In re Sherman, (D. C. Va. 1935) 12 F. Supp. 297; United States National Bank of Omaha v. Pamp, (C. C. A. 8th, 1936) 83 F. (2d) 493. See Silbiger, "The Limitations Imposed by the Fifth Amendment on Corporate Plans of Reorganization Under Section 77B," 2 CORP. REORG. 27 (1935).

[2] Bankruptcy Act, Section 77B, 48 Stat. L. 912, 11 U. S. C., § 207 (1934).

[3] In re Preble Corp., (D. C. Me. 1935) 12 F. Supp. 1002, affirmed Preble Corp. v. Wentworth, (C. C. A. 1st. 1936) 84 F. (2d) 73; In re Murel Holding Co., (C. C. A. 2nd, 1935) 75 F. (2d) 941.

that he had some property of which he could be deprived.[4] By no procedure, short of sorcery, could the junior lienors and stockholders in the principal case have realized anything on their claims, and "a dissenter may be constitutionally deprived of this nothingness." [5] In fact, not only is a failure to make provision for stockholders, in such a case, not a deprivation of property without due process of law, but according to the theory of the *Boyd* case,[6] any plan including them without additional contribution on their part would be defective.[7] Nor does compliance with the statute require more favorable treatment of the junior lienors and stockholders than the constitution demands. If the corporation is insolvent,[8] the consent of the stockholders need not be obtained [9] and they need not be included in the plan.[10] The same applies to a class of creditors whose

[4] Southern Ry. v. King, 217 U. S. 524, 30 S. Ct. 594 (1910); Standard Stock Food Co. v. Wright, 225 U. S. 540, 32 S. Ct. 784 (1912); Plymouth Coal Co. v. Pennsylvania, 232 U. S. 531, 34 S. Ct. 359 (1914).

[5] Heffernan, "Corporate Reorganization under the Bankruptcy Act," 10 IND. L. J. 386 at 396 (1935). See also, 34 MICH. L. REV. 1201 (1936), and 49 HARV. L. REV. 1111 at 1188 (1936). In In re Tennessee Publishing Co., (C. C. A. 6th, 1936) 81 F. (2d) 463, subsection (b) (5), providing for exclusion of creditors without their consent, was held unconstitutional. But the decision was modified in the Supreme Court, Tennessee Pub. Co. v. American National Bank, (U. S. 1936) 57 S. Ct. 85.

A comparable situation results when a dissenting minority of a single class complains of a denial of due process. See In re Hotel Gibson Co., (D. C. Ohio 1935) 11 F. Supp. 30, and Campbell v. Alleghany Corp., (C. C. A. 4th, 1935) 75 F. (2d) 947.

[6] Northern Pac. Ry. v. Boyd, 228 U. S. 482, 33 S. Ct. 554 (1913), which held that stockholders could not participate in a reorganization plan in which creditors had not received their full priority.

[7] See 49 HARV. L. REV. 1111 at 1190 (1936) to the effect that the doctrine of the Boyd case applies to reorganizations, under Section 77B. But see also the dictum to the contrary in Downtown Inv. Assn. v. Boston Metropolitan Bldgs., (C. C. A. 1st, 1936) 81 F. (2d) 314. Some cases have apparently allowed stockholders to participate, without consideration of the Boyd case. In re Celotex Co., (D. C. Del. 1935) 12 F. Supp. 1, and In re Prudence Bonds, (C. C. A. 2d, 1935) 75 F. (2d) 262. Junior creditors were given an interest, although they had no equity, in In re Georgian Hotel Corp., (C. C. A. 7th, 1936) 82 F. (2d) 917.

[8] Proof of insolvency is often difficult, and stockholders may often be included in the plan and their consent obtained even though the corporation might actually be insolvent. Dodd, "Reorganization Through Bankruptcy," 48 HARV. L. REV. 1100 at 1125 (1935). See also, 35 COL. L. REV. 391 at 399 (1935); Spaeth and Friedberg, "Early Developments under Section 77B," 30 ILL. L. REV. 137 (1935); and Sabel, "Recent Economic Developments in Corporate Reorganizations," 20 MINN. L. REV. 117 at 134 (1936).

[9] Bankruptcy Act, Section 77B (e) (1), 48 Stat. L. 912, 11 U. S. C., § 207 (e) (1) (1934); In re Reading Hotel Corp., (D. C. Pa. 1935) 10 F. Supp. 470; In re New York Rys. Corp., (C. C. A. 2d, 1936) 82 F. (2d) 739; Sabel, "Recent Economic Developments in Corporate Reorganizations," 20 MINN. L. REV. 117 at 133 (1936).

[10] Bankruptcy Act, Section 77B (b) (4), 48 Stat. L. 912, 11 U. S. C., § 207 (b) (4) (1934); In re Reading Hotel Corp., (D. C. Pa. 1935) 10 F. Supp. 470; In re New York Rys. Corp., (C. C. A. 2d, 1936) 82 F. (2d) 739.

security has completely depreciated.[11] And all that either can demand, in any case, is "adequate protection for the realization . . . of the value of their interests," [12] which here equals nothing at all. But assuming the constitutionality and legality of the proceedings, there still remains the question of the economic desirability of such a plan.[13] Whatever may be the purpose of Section 77B,[14] it would seem that when a business corporation is in such straits that the stockholders' equity has been completely consumed and liabilities far exceed assets the case is one for liquidation rather than reorganization.[15] However, since proceedings under Section 77B are more advantageous to senior creditors than ordinary proceedings in equity,[16] and since, as the principal case reveals, stockholders and junior creditors have little ground for objection, it appears likely that the practice will continue.

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[11] Bankruptcy Act, Section 77B (e) (1), (b) (5), (b) (10), 48 Stat. L. 912, 11 U. S. C., § 207 (e) (1), (b) (5), (b) (10) (1934), which provides that no provision need be made for creditors who are not materially and adversely affected by the plan. By analogy to the case of the stockholder with no equity [see Campbell v. Alleghany Corp., (C. C. A. 4th, 1935) 75 F. (2d) 947], a creditor whose security is of no value is not affected by any plan.

[12] Bankruptcy Act, Section 77B (b) (4) (5), 48 Stat. L. 912, 11 U. S. C., § 207 (b) (4) (5) (1934).

[13] The court may, in its discretion, confirm or refuse to confirm a plan. In re Georgian Hotel Corp., (C. C. A. 7th, 1936) 82 F. (2d) 917. And lack of economic feasibility would be sufficient grounds for refusal. Bankruptcy Act, Section 77B (f), 48 Stat. L. 912, 11 U. S. C., § 207 (f) (1934). See Dodd, "Reorganization Through Bankruptcy," 48 HARV. L. REV. 1100 at 1112 (1935).

[14] In Brockett v. Winkle Terra Cotta Co., (C. C. A. 8th, 1936) 81 F. (2d) 949 and in In re Dutch Woodcraft Shops, (D. C. Mich. 1935) 14 F. Supp. 467, it was held that Section 77B is intended only to aid temporarily embarrassed businesses, but its machinery has been adapted to the dissolution of hopelessly defunct corporations. In re Mortgage Securities Corp., (C. C. A. 2d, 1935) 75 F. (2d) 261 (1935), and In re Central Funding Corp., (C. C. A. 2d, 1935) 75 F. (2d) 256, comment in 83 UNIV. PA. L. REV. 914 (1935).

[15] In re Dutch Woodcraft Shops, (D. C. Mich. 1935) 14 F. Supp. 467; Sabel, "Recent Economic Developments in Corporate Reorganizations," 20 MINN. L. REV. 117 at 128 (1936); Gerdes, " 'Good Faith' in the Initiation of Proceedings under Section 77B of the Bankruptcy Act," 23 GEORGETOWN L. J. 418 at 422 (1935).

If the plan is not confirmed, the court has the power to proceed to liquidate as in ordinary proceedings in bankruptcy. Bankruptcy Act, Section 77B (c) (8), 48 Stat. L. 912, 11 U. S. C., § 207 (c) (8) (1934).

[16] See In re Surf Bldg. Corp., (D. C. Ill. 1934) 11 F. Supp. 295 at 296.