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BANKRUPTCY - REORGANIZATION UNDER SECTION 77 B - DETERMINATION OF AMOUNT OF CLAIMS FOR PURPOSE OF VOTING ON APPROVAL OF REORGANIZATION PLAN

BANKRUPTCY — REORGANIZATION UNDER SECTION 77B — DETERMINATION OF AMOUNT OF CLAIMS FOR PURPOSE OF VOTING ON APPROVAL OF REORGANIZATION PLAN — In proceedings under Section 77B of the Bankruptcy Act for the reorganization of the Philadelphia Rapid Transit Company, a special master was appointed by the court, to ascertain and classify the creditors. Interested parties petitioned the court to instruct the master to require the "underliers," the class of creditors composed of the former owners of the various car lines taken over by the debtor Transit Company, to produce their books and papers to establish the fair amount of their claims, asserting that their properties were acquired by the debtor at grossly inflated prices; that their real value did not exceed $30,000,000, as against the $87,000,000 claimed, and that the "underliers" will have an unfair voting weight in the approval or rejection of a plan of reorganization if such inflated claims are allowed. *Held*, that this question was being raised prematurely; that the consideration before the master was simply whether the corporation had a defense against the claims as presented. If not, the claims should be allowed for voting purposes only, further consideration of allowing the claims in the reorganization being reserved for the court upon consideration of the plan. *In re Philadelphia Rapid Transit Co.*, (D. C. Pa. 1935) 11 F. Supp. 865.

Section 77B of the Bankruptcy Act permits plans for reorganization to be submitted by the debtor corporation, or by its stockholders if the corporation is not found to be insolvent, and also by the creditors; but in the case of the last group, the proposal must be approved by creditors whose claims would be affected by the plan, "being not less than 25 per centum in amount of any class of creditors, and not less than 10 per centum in amount of all the claims against the debtor." [1]

[1] Bankruptcy Act, Section 77B, par. (d). 48 Stat. 912; U. S. C. tit. 11, § 207 (1934). This provision does not seem at all clear; as to the 25 per cent, must it be all of one class, or of various classes aggregating 25 per cent of one? And in either event, may it be the largest or smallest class? Likewise, it is not clear as to whether the "10 per cent of all claims against the debtor" refers only to claims affected by the plan. Weiner, "Corporate Reorganization: Section 77B of the Bankruptcy Act," 34 COL. L.

In order to ascertain and classify the creditors to satisfy these voting requirements, the debtor corporation may be required to file with the court a schedule of the claims against it,[2] or the court may require the creditors to file their claims, within an allowed period, with the court.[3] The practice has arisen, however, of appointing a special master to receive the claims of creditors and classify them for this purpose.[4] The petition of instruction in the principal case, directed to such a master, sought to require him to go exhaustively into the basis of protested claims to determine whether such claims were unduly inflated. Since the proposal of any plan by the creditors, as well as the final creditors' approval of a plan, had to be by a certain percentage of the claims in amount,[5] such an inquiry into the fairness of the amount would apparently be pertinent to the determination of the proper vote of each creditor. However, the court was faced with the obvious limitations upon what could be undertaken by such an official at that stage of the proceedings. If the petition were allowed, it would virtually mean that the whole complicated question of what, and to what extent, claims were allowable, would have to be determined by the master as a preliminary matter to determine who might vote, and then gone into again by the court, whom the act requires to determine whether the proposed plan is fair to all creditors,[6] and whether it has been finally approved by two-thirds in amount of the claims of each class whose claims have been allowed and who would be affected by the plan.[7] Hence the practical necessity of avoiding this duplication, and resultant expenditure of time and money, appear to justify this ruling which restricts the consideration of the master to the one of whether or not the corporation has a defense to the claim as presented, and if not, holding such claimants to be creditors, for original approval voting purposes, to the extent of the claim filed.[8] This is probably but one of a great many procedural problems which will be presented to the courts before the 77B reorganization procedure, if it survives the constitutional test, is worked out in its entirety;[9] and

REV. 1173 (1934), raises these questions among many others on various phases of the section. He suggests that the above percentage requirements must be restricted to claims actually affected by the plan, as otherwise a greater percentage might be required to propose a plan than to give final acceptance. (Id., 1182.) See also Kaplan, "Corporate Reorganization Under Section 77B of the Bankruptcy Act," 33 MICH. L. REV. 77 (1934).

[2] Bankruptcy Act, Section 77B, par. (c), cl. (4a).

[3] Bankruptcy Act, Section 77B, par. (c), cl. (6).

[4] Weiner, "Corporate Reorganization: Section 77B of the Bankruptcy Act," 34 COL. L. REV. 1173 at 1186 (1934).

[5] Bankruptcy Act, Section 77B, par. (d).

[6] Bankruptcy Act, Section 77B, par. (f).

[7] Bankruptcy Act, Section 77B, par. (e).

[8] Principal case, (D. C. Pa. 1935) 11 F. Supp. 865 at 867.

[9] For discussions of some of the problems presented see Kaplan, "Corporate Reorganization under Section 77B of the Bankruptcy Act," 33 MICH. L. REV. 77 (1934), and Weiner, "Corporate Reorganization: Section 77B of the Bankruptcy Act," 34 COL. L. REV. 1173 (1934). A good picture of the actual fact set-up involved in the principal case is found in In re Philadelphia Rapid Transit Co., (D. C. Pa. 1934) 8 F. SUPP. 51, affd. in Wilson v. Philadelphia Rapid Transit Co., (C. C. A. 3d, 1934) 73 F. (2d) 1022, which dismissed a prior petition for reorganization of this corporation. For discussions

it would seem that the tests of expediency and practicability, as followed in this decision, must govern if effective use is to be made of this important adjunct to the Bankruptcy Act.

J. E. G.

of the purpose, effect, and constitutionality of Section 77B see Campbell v. Alleghany Corp., (C. C. A. 4th, 1935) 75 F. (2d) 947; In re Central Funding Corp., (C. C. A. 2d, 1935) 75 F. (2d) 256. See also Swaine, "Federal Legislation for Corporate Reorganization; An Affirmative View," 19 A. B. A. J. 698 (1933), and Morford, "Federal Legislation for Corporate Reorganization; A Negative View," 19 A. B. A. J. 702 (1933); Gerdes, "Constitutionality of Section 77B of the Bankruptcy Act," 12 N. Y. UNIV. L. Q. REV. 196 (1934).