CORPORATIONS-"FAIR PLAN" UNDER SECTION 77B-
APPLICABILITY OF Boyd CASE

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CORPORATIONS—"FAIR PLAN" UNDER SECTION 77B—APPLICABILITY OF Boyd Case—Few controversies can arise that present so many variables and require such delicate balancing of not easily ascertainable
economic and legal interests as the one occurring when it becomes necessary for a court to pass on the fairness of a reorganization plan. The recognition of this is clearly seen in the provision of Section 77B of the Bankruptcy Act which reads in part: “after hearing such objections as may be made to the plan, the judge shall confirm the plan if satisfied that it is fair and equitable and does not discriminate unfairly in favor of any class of creditors or stockholders and is feasible.” The problem presented is obvious although it seems possible to phrase it in several ways. To what extent must the court today go back to the Boyd case and its successors in determining whether the reorganization plan is fair and equitable? Can it be argued that Congress intended this provision to set up a new standard of fairness? Is the problem of the fair plan under Section 77B in any way a new one? Although the form of these questions could be varied indefinitely, it is felt that answers to these will furnish a background against which the chief difficulties can be resolved.

Commentators on Section 77B have been practically unanimous in

1 Joline, Lectures Delivered before the Graduate School of Business Administration, Harvard University (1909), quoted in Dewing, Financial Policy of Corporations 902-3 (1926):

“You may deduce rules of law easily enough, but it is not as easy to deduce rules of business having a general application, except a very few simple ones; for a reorganization is a mass of details, differing in each instance, varying with all the conditions, presenting novel questions of finance often wholly unanticipated. If in your own minds you think at times that you have evolved some important general principles to be followed, you will probably find it wise to forget them on the first occasion where you attempt to apply them.”

Although this was said in reference to the business man’s problem rather than the lawyer’s, both would properly seem to be part of the judge’s problem under Sec. 77B of the federal Bankruptcy Act. Even if the rules of law in this field are comparatively simple, that would not appreciably lighten the court’s task because their very simplicity will make them difficult of application; nor can rules of law in these cases be separated from rules of business policy. This latter statement becomes particularly evident in the light of the requirement that a plan must not only be fair but also “feasible” as an examination of cases discussed later will show.


4 “Boyd case and its successors” may be understood to stand for the body of case law that developed under equity foreclosure and receivership as administered by the federal courts. In certain places “Boyd case” alone, as the leading case in this field, has been employed to stand for this same body of law.

5 The precedents are of value to counsel to the extent that a court will use them, for it is counsel’s duty to satisfy the court; the use the court makes of these, however, will largely depend on counsel’s judicious employment of them since, as will be later observed, there are practical limits to any independent investigation a court can pursue. Thus the question of their value to one group is interrelated with their value to the other.
declaring such precedents still in full force. The fact that in the few cases in which the fairness of the plan was squarely presented the court followed this earlier law without citation of a single such precedent should in no way militate against this conclusion; rather it is felt to be the best possible proof. Is it not reasonable to assume that this very lack of authority is to be explained by the court's justifiable assumption that the words "fair and equitable" were intended to incorporate these previous cases in which the same type of words had been so often used in approving the sale made pursuant to the foreclosure decree? If such is the case would not citation be superfluous?

6 Spaeth and Friedberg, "Early Developments under Section 77B," 30 Ill. L. Rev. 137 at 154 (1935); 35 Col. L. Rev. 391 (1935); Friendly, "Some Comments on the Corporate Reorganization Act," 48 Harv. L. Rev. 39 at 74 (1934); Dodd, "Reorganization Through Bankruptcy," 48 Harv. L. Rev. 1100 (1935); Glenn, Liquidation 606 (1935); Montgomery, "The Corporate Reorganization Act," 1 Corp. Reorg. 15 (1934); Gerdes, "A Fair and Equitable Plan of Corporate Reorganization under Section 77B of the Bankruptcy Act," 12 N. Y. Univ. L. Q. Rev. 1 at 22 (1934). Although this last writer feels that the rule of the Boyd case is applicable under 77B, it is his opinion that 77B goes still further. He limits the Boyd case to a situation where there has been stockholder participation to the exclusion of creditors. This article has adopted the view stated by Swaine, "Reorganization of Corporations," Some Legal Phases of Corporate Financing, Reorganization and Regulation 133 at 142 (1926-1930), where he says:

"I do not believe that the doctrine applies only to reorganizations in which stockholders are permitted to participate. The rule as I see it, and as I believe it will ultimately be developed by the courts, is that the relative priorities of the old securities, senior to the most junior securities which have any interest in the property, must not be inequitably disturbed. Stockholders cannot be put ahead of creditors. Unsecured creditors cannot be put ahead of bondholders. Junior bondholders cannot be put ahead of senior bondholders; and, it is submitted, common stockholders cannot unite with bondholders in a plan that will put them ahead of preferred stockholders."

In the light of this different view of the Boyd case it would seem that there is no real disagreement among commentators as to the fact that Sec. 77B incorporates the broad principle of the Boyd case.

Although Mr. Swaine's interpretation of the Boyd case has not received universal acceptance [cf. Frank, "Some Realistic Reflections on Some Aspects of Corporate Reorganization," 19 Va. L. Rev. 541 at 553-560 (1933) and Friendly, "Some Comments on the Corporate Reorganizations Act," 48 Harv. L. Rev. 39 at 79 (1934)] it has been selected as the clearest statement of the working rule underlying the old reorganization structure.

7 These cases are discussed infra.

8 For a discussion of the use to which these words were put in the foreclosure decree of reorganization prior to Sec. 77B, see Swaine, "Reorganization of Corporations," Some Legal Phases of Corporate Financing, Reorganization and Regulation 133 at 140-148 (1926-1930).

9 Sutherland, Statutes and Statutory Construction, Lewis ed., 757 at 758 (1904): "Where a statute uses a word which is well known and has a definite sense at common law or in the written law, without defining it, it will be presumed to
A suggested approach to the problem is to consider the defects that Section 77B was designed to remedy. Foremost among these was the inability to bind dissenters, thus putting a premium on obstructive tactics. The Boyd case made apparent the vulnerability of a sale to collateral attack. Although the year 1926 saw the perfection of a device to escape this danger, the security was short-lived, for in 1928 there was handed down a decision that reflected unfavorably on the entire equity procedure. Succeeding cases did little to allay doubts as to the validity of the old method. To these flaws may be added that of the ancillary receivership. Also the investing public and corporate management were beginning to feel that a reorganization was a needlessly lengthy and expensive occurrence coming at a time when the unfortunate business could least afford it.

Among these weaknesses in the former process we search in vain for any real criticism of the structure of the plans evolved. Such criti-

be used in that sense and will be so construed, unless it clearly appears that it was not so intended. Words having a precise and well settled meaning in the jurisprudence of a country are to be understood in the same sense when used in statutes unless a different meaning is clearly intended.

"It acords with Lord Coke's rule (Heydon's Case, 3 Co. Rep. 7A, 76 Eng. Rep. 637; Case of the Marshalsea, 10 Co. Rep. 68, 77 Eng. Rep. 1027), and a rational sense of what is suitable to ascertain what were the circumstances with reference to which the words of the statute were used and what was the object appearing from those circumstances which the legislature had in view.... It is proper to consider the origin and history of the law and the general policy and course of legislation. "There are few guides to construction more useful than that which directs attention to the prior condition of the law to aid in determining the full legislative meaning of any statutory change thereof." The legislative department is supposed to have a consistent design and policy and to intend nothing inconsistent or incongruous. The mischief intended to be removed or suppressed or the cause or necessity of any kind which induced the enactment of a law are important factors to be considered in its construction."

The lack of such a power was a defect in the old procedure that had for many years greatly vexed those engaged in reorganizations; it increased the need of new money over today's requirements in that dissenters would have to be paid off in cash. For an illustration of some of the difficulties presented by "objectors," see Cravath, "Reorganization of Corporations," SOME LEGAL PHASES OF CORPORATE FINANCING, REORGANIZATION AND REGULATION 153 at 220 ff. (1916).

This was the phase of the case that made it so objectionable to the bar.

See Swaine, "Reorganization of Corporations," SOME LEGAL PHASES OF CORPORATE FINANCING, REORGANIZATION AND REGULATION 133 at 144 (1926-1930). Here he refers to the foreclosure decree of the Chicago, Milwaukee and St. Paul Ry. as the most carefully worked out means of circumventing the threat of the Boyd case.


cism as was forthcoming cannot be said to have been directed at the standard of fairness as established by the *Boyd* case, but rather at the inability of the majority to bind dissenting minorities and thus give the *Boyd* case its true application.\(^{17}\) It is not easy to conceive of any fairer method of sharing in the corporate remains than Mr. Swaine's enunciation of the broad principle of the *Boyd* case.\(^{18}\) This becomes even more apparent when one considers the problem of rehabilitation that the reorganizers face.\(^{19}\) The lack of a definite congressional standard and the presence of the words "fair and equitable," so often used as to have become words of art, bear strong proof that these earlier cases still exist with their former vigor.\(^{20}\) Were these words to be taken without the guidance of decided cases, an invaluable judicial aid to interpretation would be lost. Even with the help of this earlier law the difficulties involved in these controversies are real enough;\(^{21}\) without them it would seem that the situation might well become hopeless. To suggest that this accumulated experience should be abandoned at a time when it was never more required is to fail to appreciate the size of the burden that Section 77B has put on the federal district judges.\(^{22}\)

Although all available signs point in the direction already indicated, it is on the cases themselves that a final decision must be based.\(^{23}\) It is not enough to declare that no decision has run counter to the *Boyd* case;\(^{24}\) the implications to be drawn from the opinions should be considered in that they reflect the judicial attitude toward this newly

\(^{17}\) Prior to 77B discriminations of two types were possible: inter class and intra class. The fact that the court now has the power to bind dissenters limits possible discriminations to the former type.

\(^{18}\) See Swaine, "Reorganization of Corporations," *Some Legal Phases of Corporate Financing, Reorganization and Regulation* 133 at 142 (1926-1930). This is quoted supra, note 6.

\(^{19}\) See *Dewing, Financial Policy of Corporations* 901 et seq. (1926) for a discussion of the economic problems involved.

\(^{20}\) See supra, at note 9.

\(^{21}\) There is probably no field of the law which involves so many intangible and minor variations on which the success of the entire process may depend yet, in reference to which, no definite principles may be laid down. See also Joline, *Lectures Delivered before the Graduate School of Business Administration, Harvard University* (1909).

\(^{22}\) See *1 Corp. Reorg.* 3 (1934) in which an editorial points out: "By the passage and approval of the Corporate Reorganization Act, the Congress and the Executive have undoubtedly resolved to place the burden and responsibility of resurrecting American business life on the judges of the federal courts."

\(^{23}\) Only cases in which there was an actual controversy as to the fairness of the plan between some of the parties in interest have been selected. It was not thought worthwhile to outline the plans here since, with the exception of the Studebaker plan, they are all included in the reported cases and may be considered there; the Studebaker plan will be found in *Moody's Industrial Manual* for 1935.

\(^{24}\) See note 6, supra.
conferred discretion. Conceding that “mathematical exactness is not required and is not possible,” 25 what refinements within the rule of the Boyd case have the courts attempted in their efforts to attain this ideal result? Has any court imposed its own conception of fairness on the plan or have circumstances compelled it to merely reflect the work of counsel? Admitting the presence of the rule, these are questions that arise within the rule.

The first pertinent case is that of the Studebaker Corporation, 26 whose plan came up for hearing after about twenty-one months of receivership. Judge Slick appropriately depicts the situation: “for two years this court and its receivers have struggled on hoping for the impossible; it has not happened. We are now faced with stern realities.” 27 Either new money had to be raised to pay off existing indebtedness and raise working capital or liquidation would be ordered. Since the debtor was insolvent, the stockholders’ alternatives were not attractive. The court contrasted the two courses of action showing a clear appreciation of the social desirability of preserving the business intact. The wisdom of a reorganization was clearly indicated, but immediate action was required. Any force that the stockholders’ protests might have had was greatly weakened in that they had suggested no plan during the entire two years, nor had they given any reason to believe that they might be able to raise the necessary money. The only thing for the court to do was to adopt the plan offered. This it did, saying: “the plan is not perfect, but it is the best—in fact, the only feasible one offered. To refuse the plan spells disaster; to accept it offers a good opportunity for success.”

It is felt that this case will be found to be quite typical of the judicial approach to a problem of this sort, that of an insolvent corporation where economic pressure, demanding immediate action of one type or another, must necessarily militate against any independent investigation. 28 The fact that the court is frank to admit that the plan is not perfect indicates that the millenium has not yet been reached. It would seem evident in these cases that both fairness and feasibility are not

27 Ibid. at 428.
28 The extent of an independent inquiry by the court will depend largely on the individual case and the capacities of the judge. The present case furnishes an illuminating example as to how the exigencies of the situation must necessarily limit any investigation a court would otherwise undertake. For these reasons the success of a reorganization will often depend as much on the ability of counsel as that of the judge. Corporate reorganizations have been conspicuous instances of the dependency of the bench on the bar for the attainment of a desirable result.
completely possible.\textsuperscript{29} The former, being the more flexible requirement, must relax to a certain extent, for if a plan is not feasible, the entire process will fail with a loss to all rather than a sacrifice from a few. Compromises, which are the very essence of a reorganization, have ample room to transpire within the rule of the \textit{Boyd case}.\textsuperscript{30} Opposition to confirmation of the plan proposed for the \textit{Consolidation Coal Co.}\textsuperscript{31} again came from the common stockholders who were allotted stock purchase warrants giving them the right to subscribe for new common stock at $25 per share within ten years. As in the \textit{Studebaker} case they were standing on a vanished equity. Among other securities the bondholders were given some common stock which would have to rise to a value of $40 per share before the bondholders would recover the equivalent of the principal and accrued interest on their bonds.\textsuperscript{32} For this reason the court was favorably impressed by their contention that common stockholders should not be allowed to subscribe below $40 per share.\textsuperscript{33} Although the $25 rate was actually confirmed, this argument obviously greatly weakened the stockholders' bargaining power.

The most significant part of the opinion, however, did not involve any real issue but is well worth consideration in that it gives one answer as to how far a court will go in making an independent investigation. After discussing the points actually in dispute, the court went on to say: "finally we turn to the question of control of the corporation because, although there has been no serious objection raised to this part of the plan, it is a vital one in all such reorganizations and therefore should not be approved by the court, even though not objected to by any party in interest, if not believed by the court to be fundamentally

\textsuperscript{29} Although the statute contemplates that a plan be both fair and feasible, these cannot be determined independently; thus in most cases the necessity that the plan be feasible will be found to impose certain practical limitations on ideal fairness. It was for this reason that Cravath observed: "Plans of reorganization are rarely strictly logical." Cravath, "Reorganization of Corporations," \textit{Some Legal Phases of Corporate Financing, Reorganization and Regulation} 153 at 183 (1916).

\textsuperscript{30} Swaine, "Reorganization of Corporations," \textit{Some Legal Phases of Corporate Financing, Reorganization and Regulation} 133 at 150 (1926-1930), where the statement is made: "Every reorganization plan of necessity represents a compromise." The concern of the entire body of law in this field is as to whether the proposed compromise is fair in the light of the particular situation.

\textsuperscript{31} In re \textit{Consolidation Coal Co.}, (D. C. Md. 1935) 11 F. Supp. 594.

\textsuperscript{32} A value of $40 per share would enable the bondholders to come out even only if the other securities they received were worth par; that they actually were worth par the court said was an unjustifiable assumption.

\textsuperscript{33} The bondholders' argument can be reduced to the contention that they should be made whole before the stockholders salvage a penny. Such a procedure would be a strictly logical reorganization or more properly a liquidation.
sound." 34 This statement would seem to be declaratory of the statute operating ideally; 35 it is the express denial of the rubber-stamp criticism. 36 Neither the presence of the necessary assents nor lack of objection prevented the court from continuing its inquiry. 37

The reorganization of the United Railways & Electric Co. of Baltimore 38 presented a more complicated problem but still received equally thorough treatment. 39 The plan was presented by a bondholders committee and its approval recommended by the special master, 40 trustees and receiver. 41 In referring to the fact that the necessary acceptances had been received, the court said: "[this] is highly significant of the plan's fairness although the court would not approve of any plan, regardless of the extent of assents thereto, unless the court felt that such plan formed the best available basis for actual and not merely theoretical rehabilitation of the company within a reasonable period of time." 42

Not only did the judge here give the most careful consideration to the plan, but he also had the special master undertake a very detailed survey in reference to certain extraneous conditions affecting the debtor. This was done, and the court embodied them in its opinion, thus mak-


35 The language used in this case may be contrasted with the judicial attitude under the old system. See Cravath, "Reorganization of Corporations," Some Legal Phases of Corporate Financing, Reorganization and Regulation 153 at 190 (1916), where he says: "There is an erroneous impression that the Federal Courts exercise supervision over reorganizations." He then refers to the case of Merchants Loan and Trust Co. v. Chicago Rys., (C. C. A. 7th, 1907) 158 F. 923 at 929, where in referring to a plan of reorganization that a court attempted to force on unwilling bondholders, Mr. Justice Brewer said in part: "Every man in this country decides questions in respect to his own property for himself."

36 48 Harv. L. Rev. 39 at 74 (1934).

37 A discussion of the bondholders' objections to the constitutionality of Sec. 77B has been omitted.


39 Some of the problems present in a railroad reorganization existed here, e.g., those of underlying and divisional bonds.

40 The special master chosen was a specialist in this field, being president of the Indianapolis street railways.

41 This corporation was clearly insolvent. Only one type of stock existed here, in referring to which the court said: "There is little even prospective value that can be assigned to the now outstanding common stock." During the year 1934 it sold on the market between 1c and 15c.

42 In re United Rys. and Elec. Co. of Baltimore, (D. C. Md. 1935) 11 F. Supp. 717 at 718. This paragraph indicates a more penetrating inquiry than was possible in the Studebaker case.
ing certain constructive criticisms which, if followed, would work strongly against a repetition of the disaster.\footnote{43}

The financial structure of the \textit{Celotex Co.}\footnote{44} required new money at the bottom. The stockholders challenged the fairness of the plan, both in reference to their treatment and to the compensation allotted to the new subscriber. The picture is the familiar one. The debtor being insolvent, the alternative of liquidation would leave preferred shareholders nothing although bondholders would receive payment in full.\footnote{45} The problem might be stated: “the plan must take this shape if it is to be feasible, but does the requirement of fairness prevent it?”\footnote{46} Clearly it does not, because, as we have seen, the courts have consistently realized that the raising of new money requires a recognition of the interests of those who contribute. This has uniformly been considered as one of the real problems of both court and counsel.\footnote{47} Actually, treatment of a new subscriber would not at first seem to be properly within the rule of the \textit{Boyd} case since that only required the maintenance of the same order of priorities in the new corporation as existed in the old.\footnote{48} However, on closer examination there appears to be no real distinction as to whether this new money comes from a new subscriber, who clearly had no equity in the old company, or from the stockholders of the old insolvent who also had no equity at the time of contribution. It but carries Mr. Swaine’s conception of the \textit{Boyd} case one step further to say that the broad principle is still applicable here and that the opportunity to share in the future prosperity of the debtor, in consideration of a contribution, must be first made to the old shareholders in recognition of their past equity. If they show no interest, it may then be made to one who will furnish the needed money.\footnote{49} That the court so handled the problem here and understood the need of giving an adequate reward to one willing to invest in a doubtful enterprise with the possibility of restoring the corporation to health shows an

\footnote{43} These recommendations demonstrated how the debtor could give a better service if the city made certain changes in its traffic regulations; it was also suggested that the debtor had not been treated fairly in reference to local taxes.

\footnote{44} In \textit{re Celotex Co.}, (D. C. Del. 1935) 12 F. Supp. 1.

\footnote{45} Any recognition of stockholders’ rights would be a concession on the part of bondholders. Nevertheless, such concessions are the basis of any reorganization in which stockholders are allowed to participate in the future welfare of an insolvent corporation.

\footnote{46} See note 29, supra.


\footnote{48} See note 6, supra.

\footnote{49} As a matter of practice, the offer will first be made to the old stockholders because, in an effort to save their original investments, they are the most likely source of new money. See also note 47, supra.
understanding of the manner in which the problem was met prior to Section 77B, and which would still seem to be the only means. A confirmation of this plan is clearly in accord with former reorganization practices. It is the use of the device that has always been criticized by bondholders who do not get paid in full, but no improvement would yet seem possible.

The reorganization plan of the *McCrory Stores Corporation* was denied confirmation because of preferential treatment to a creditor who was an assignee of certain claims. As partial payment for these claims he was to receive certain stock at a more favorable rate than the one at which the common stockholders could subscribe. The creditor attempted to justify himself on the ground that he was underwriting the offering to the common stockholders without any charge. The court recognized that these underwriting activities were worthy of recognition, but it also realized that the compensation claimed was so high that it was actually cloaking an unconscionable profit under this guise. The opinion shows a clear analysis of the creditor’s true position coupled with the court’s willingness to reward a subscriber of new funds at a fair rate.

These cases, it is felt, do not indicate that Section 77B has introduced any important changes in the fair plan. Some of the earliest cases under the amendment intimate that stockholders might expect to receive better treatment now than formerly. But in the light of the frequent criticism of stockholder participation in the old system, one feels hesitant in attributing any intention to Congress to better their condition directly, although it was clearly hoped that the statute as a whole would lend aid to distressed American businesses and thus indirectly redound to the stockholders’ benefit. The fact that stockholders have not always been excluded when a corporation is not insolvent, and their consents are not strictly necessary, should be attributed not to any more protected status that they enjoy but rather to a recurrence of the old problem of raising new money and the difficulty that creditors face in attempting to prove insolvency.

51 These claims seem to have been acquired suspiciously in that one of the directors of debtor got them for this creditor.
52 In the case of In re Laclede Gas Light Co., (D. C. Mo. 1934) 1 Corp. Reorg. 50, Judge Faris said: “[77B] was primarily and largely intended for the benefit of those corporations who voluntarily might desire to take advantage of the provisions.”
53 See supra, at note 48, for a discussion of the need of new money. For the
Section 77B may be said to have transformed the court’s power from a negative one to a positive one; that which was formerly a bare veto power is now enlarged into an authority to control the entire plan. That this has not changed, and was not intended to change, rules of substantive law, we have seen; but it appears equally evident that it does subject the fairness to a more searching inquiry coupled with the judge’s power to attempt refinements in order to meet the exigencies of the particular situation. The statement might be made that under Section 77B the Boyd case gives the working formula while the more searching judicial control that may now be expected shows the court’s attempt to work out niceties within the rule of the Boyd case. It is a striving for the unattainable mathematical certainty always limited by the requirement of feasibility. Although a court could have done this under the old system by its refusal to confirm a sale, it was not done to the extent that will occur today with the courts now directly charged with this responsibility.

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difficulties involved in the proof of insolvency, see 30 ILL. L. REV. 137 at 165 ff. (1935). Even if the insolvency can be proved, the bondholders’ troubles would not yet seem to be over. See In re Reading Hotel Corporation, 10 F. Supp. 470 at 471 (1935), where, in discussing the effect of insolvency on the rights of stockholders, the court said: “It is sufficient to say that the act clearly does not intend them [the stockholders] to be wholly disregarded for every purpose from the moment a finding of insolvency is made.”

64 Cf. Swaine, “Reorganization of Corporations,” SOME LEGAL PHASES OF CORPORATE FINANCING, REORGANIZATION AND REGULATION 133 at 142 ff. (1926-1930), for a discussion of the manner in which, through its power of refusing to confirm a sale made pursuant to a foreclosure decree, the court could control the fairness of a reorganization plan.

65 Cf. cases considered supra.

66 See supra at note 29.

67 Cf. note 22, supra.

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