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BANKRUPTCY-TEST OF FEASIBILITY UNDER CHAPTER XI ARRANGEMENT

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BANKRUPTCY—TEST OF FEASIBILITY UNDER CHAPTER XI ARRANGEMENT—The Slumberland Bedding Company started in business in 1952 with a capitalization of $13,000. Within less than one year the corporation was "clearly heavily insolvent,"[1] having debts in excess of $85,000 and assets valued "at least several thousand dollars *less* than $42,250."[2] Preferred creditor claims against the assets of the business amounted to more than $32,200. In this rather dismal context a petition for an arrangement under chapter XI of the Bankruptcy Act was filed. A plan was submitted which provided for independent capital to be put into the business to pay certain claims in full and to pay a twenty percent dividend to unsecured creditors. This twenty percent payment was to constitute complete and final satisfaction of all unsecured claims. The plan involved no substantial change which would reasonably tend to make an earning enterprise out of this floundering venture. However, the plan was in the best interest of present creditors since they would receive far more under this plan than they could hope to receive via liquidation; therefore, a majority of creditors approved the plan. But three general creditors petitioned to prevent court confirmation of the plan, basing their claim on the assertion that the arrangement did not comply with the statutory mandate that the plan be feasible.[3] *Held,* petition denied. The test of feasibility is fulfilled if there is a reasonable assurance that the unsecured creditors will get what is provided for them under the plan. To be feasible a plan need not embrace a probability of future financial and business success for the enterprise. *In re Slumberland Bedding Co.,* (D.C. Md. 1953) 115 F. Supp. 39.

The requirement of feasibility appears throughout the non-liquidation chapters of the Bankruptcy Act,[4] but court interpretation of the term has not been uniform. In the much litigated area of corporate reorganization,[5] case[6] and treatise[7] authority agree that a plan is not feasible unless the result is a solvent company which will have a reasonable prospect for future financial success. One judge graphically expressed the policy behind this interpretation: " . . . it was not the intention of Congress . . . to place crutches under corporate cripples, fit subjects for liquidation, and send them out into the business world

[1] This was the expression used by the court. Principal case at 40.

[2] Although apparently the court appointed appraisers, the opinion gives no more definite value to the assets than that stated in the quoted phrase. Ibid.

[3] "The court shall confirm an arrangement if satisfied that . . . (2) it is for the best interests of creditors and is feasible. . . ." Bankruptcy Act §366, 66 Stat. L. 433, §35 (1952), 1 U.S.C. Cong. and Adm. News 416 (1952).

[4] Corporate reorganization: 52 Stat. L. 897, §221(2) (1938), 11 U.S.C. (1946) §621(2); arrangement of unsecured indebtedness: note 3 supra; arrangement of secured indebtedness: 66 Stat. L. 435, §43 (1952), 1 U.S.C. Cong. and Adm. News 417 (1952); wage earners plans: 66 Stat. L 437, §50 (1952), 1 U.S.C. Cong. and Adm. News 419 (1952).

[5] Chapter X proceedings under the Bankruptcy Act.

[6] In re Barlum Realty Co., (D.C. Mich. 1945) 62 F. Supp. 81, affd. with opinion (6th Cir. 1946) 154 F. (2d) 562; Sophian v. Congress Realty Co., (8th Cir. 1938) 98 F. (2d) 499.

[7] 6 COLLIER, BANKRUPTCY, 14th ed., p. 3883 (1947, 1952 Supp.).

to be a menace to all who might purchase their securities or deal with them on credit."[8] However, as is demonstrated by the principal case, this interpretation under the corporate reorganization provisions of the statute is not necessarily carried over into subsequent chapters dealing with arrangements.[9] It might be questioned whether there is any basis in reason for such a distinction.[10] The premise underlying all non-liquidation provisions of the Bankruptcy Act is the desirability for continuing debtors in business. The meaning that the court gives to the requirement of feasibility will determine what kinds of debtors will be so continued. Thus in corporate reorganization the courts have ruled that none but corporations showing reasonable signs of health shall be allowed to adventure again into the competitive field. The same policy considerations should rule to prevent businesses having the advantages of court arrangements from being allowed to continue their existence until they show at least some prospect of mending their losing ways. Creditors dealing with the smaller enterprises which are engaging in arrangements have just as great a need for protection as do creditors dealing with the larger companies which go through reorganization; very likely the need will be even greater in the former case because the system of records from which credit information could be received may well be less complete.

Some support can be found in other sections of the act for the view taken by the court in the principal case. The statute provides that in arrangement cases where there is unanimous approval of the plan by creditors, the court should confirm without investigating feasibility.[11] From this it could reasonably be inferred that the feasibility standard is not for the protection of the outside business world, but only for the protection of those presently having an interest in the business. If the latter parties' interests are best served by the plan it should not be denied court approval because of probable future disaster of the enterprise. But the effect of this view is to read out of the statute the requirement of feasibility and leave only the consideration of the question of whether or not the plan is in the best interests of creditors.[12] Had

[8] Price v. Spokane Silver & Lead Co., (8th Cir. 1938) 97 F. (2d) 237 at 247.

[9] *Accord* with the interpretation of the principal case: Matter of Nathanson, (Ref. Ind. 1941) 50 Am. B. R. (n.s.) 465; In re Admiral Container Corp., (D.C. N.J. 1951) 95 F. Supp. 723, affd. per curiam (3d Cir. 1952) 193 F. (2d) 330; 8 COLLIER, BANKRUPTCY, 14th ed., p. 1171 (1947, 1952 Supp.).

[10] In an earlier arrangement case the Supreme Court, in interpreting the phrase "fair and equitable," had ruled that these were words of art and that an interpretation of them under one section of the Bankruptcy Act must be carried over to other sections. Case v. Los Angeles Lumber Products Co., 308 U.S. 106, 60 S.Ct. 1 (1939). Why the word-of-art analysis applies to "fair and equitable" but not to "feasible" is a question on which the courts have not yet spoken.

[11] The statute makes this provision by exclusion, not by direct statement. In the case of the unanimously approved plan the court is to confirm if certain conditions are met, and feasibility is not one of these conditions. 52 Stat. L. 911, §361 (1938), 11 U.S.C. (1946) §761.

[12] Whether or not the plan is in the best interests of creditors is made a concurrent test along with feasibility under §366 of the Bankruptcy Act. Note 3 supra.

it been the intent of Congress to apply this single criterion rather than the dual one, it probably would have left the second standard out of the act altogether.

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