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Fair, Feasible and in the Public Interest

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"REORGANIZATION" is a specific example of that prospective application of legal process of which a constantly increasing number of illustrations may be cited.¹ Its primary interest is not in what certain persons ought to have done in past time and in the assessment of damages or penalties on them for having failed to do so, but in what they should do in the future in their own best interests, with only a limited reference to what they ought to have done or might have done in the past. The retrospective reference, although subordinate, is, however, always present and cannot wholly be dispensed with.

Reorganization is rightly enough incorporated into our bankruptcy procedure. It has been forcefully argued that it has no place there—if indeed, anywhere—and that the essence of bankruptcy is liquidation.² This is historically quite true so far as the first developments of bankruptcy both in England and on the continent are concerned. But terms, concepts, categories and institutions have histories of their own and expand and modify—sometimes before our offended eyes. This has demonstrably happened to bankruptcy, of which it can nevertheless be said that its essence has changed little, even if the occasions for calling it into operation have been transformed almost beyond recognition.³

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¹ RADIN, *LAW AS LOGIC AND EXPERIENCE* (1940) 64-99.

² Mr. Garrard Glenn, who speaks with an authority in these matters second to none in the United States, is inclined to consider liquidation as the primary and original purpose of bankruptcy. Glenn, *Essentials of Bankruptcy: Prevention of Frauds and Control of Debtor* (1937) 23 VA. L. REV. 373.

³ Radin, *The Nature of Bankruptcy* (1940) 89 U. OF PA. L. REV. 1-9.

Reorganization, also, has a history even if a briefer and more recent one. It began as a larva, a loathly caterpillar, in the "equity reorganization"; it passed through the pupa-stage in section 77B and it finally burst forth as a resplendent imago in chapter X of the Chandler Act.⁴ In all these stages, the avowed purpose has been the same. That purpose is not to satisfy demonstrably existing claims, even to the extent that bankruptcy liquidation attempts to do so, but to compel all or some of the persons concerned in a substantial business enterprise to readjust their mutual and conflicting claims, so that the enterprise may continue. And in all stages, reorganization has been based on the theory that the result must be "equitable". That this does not mean merely a result reached in accord with chancery practice, an examination of the statute into which the reorganization is incorporated will show.

The National Bankruptcy Act,⁵ the fourth in our history, was passed in 1898, and has been in continuous effect for nearly forty-three years. This is by many years longer than the duration of any of the three bankruptcy acts which were passed before it.⁶ But the act of 1898, although continuously in force, has been amended in almost every session of Congress. In 1926, it was so substantially amended as almost to be a new act.⁷ In 1934 and the following years and especially in 1938, so much was changed and added that the final form was reissued completely and was renamed the Chandler Act, popularly as well as with legal permission.

We can imagine what this tinkering did to the legislation. We may add that many of the amendatory acts have passed through committees of experts who revised and rearranged substance and wording and gave their special turns of expression to it. The Chandler Bill was worked over, we are told, by no less than forty experts.

All these many hands have written on the statute book an extraor-

⁴ 52 STAT. (1938) 840, 11 U.S.C. SUPP. V (1939).

⁵ 30 STAT. (1898) 544.

⁶ The first Federal Bankruptcy Act was passed April 4, 1800 and repealed December 19, 1803. The second was passed August 19, 1841, and repealed March 3, 1843. The third was passed March 2, 1867, and repealed June 7, 1878, after having been materially amended June 22, 1874. For the background of these acts see WARREN, *BANKRUPTCY IN UNITED STATES HISTORY* (1935).

⁷ Colin, *An Analysis of the 1926 Amendments to the Bankruptcy Act* (1926) 26 COL. L. REV. 789-808; McLaughlin, *Amendment of the Bankruptcy Act* (1927) 40 HARV. L. REV. 341-391, 583-618. This act of 1926 was prepared with the coöperation of the committees of the American Bar Association, the National Association of Credit Men, the Commercial Law League of America, and other organizations.

dinary and complicated enactment. If a statute is something whose very words must guide courts and administrators, forty years of editing should have produced something fairly polished and terse. I fear that these adjectives can hardly be used of the final result. But there could be no better illustration of what, under modern conditions, the problem of "statutory interpretation" can become.

The requirement of fairness in reorganization is a special example. Reorganization is a part of general bankruptcy and bankruptcy is an equity proceeding. We know this not only from the many decisions on the point, but from the statute itself, which contains more numerous references to fairness and equity than any other statute I know. The following enumeration—probably not complete—will make this abundantly evident.

As one might expect, the words "fair" and "equitable", both singly and in combination, occur over and over again. But if anyone remembers ancient canons that differences in statutory terms are significant, he will be somewhat puzzled.

We hear of "present fair equivalent value" [sections 21g, 60b, 67d (6)] of property; then, of "fair value" (sections 40a, 48f and g); again of "present fair salable value" [section 67d (1) (d) (twice)]; and finally of "fair and reasonable market value" (sections 75k, s). There are many references to "fair consideration"⁸ [sections 67d (1) (e), d (2) (a), d (2) (b), d (4), d (6)], or "fair value of consideration" (sections 48f, g), and specifically in reorganization, to a "fair upset price" [sections 77b (5), 216 (7) (b), (8) (a), (10), 461 (12)]. And there are general references to fairness and unfairness [sections 77c (4), e (1), p, 178, 212, 216 (9) (b)].

Besides fairness we have references to "equitableness". There must be an "equitable distribution of the property" (section 5h), and "equitable treatment" [section 77e (three times)]; the phrase "as may be equitable" occurs often [sections 228 (3), 259, 372, 662]; expanded to "as in the particular case may be equitable" [sections 116 (2), 334, 446]. Or else we hear of the "equities of the case" (section 57k).

Next, there is the combination of fairness and equitableness. We have the words "fair and equitable" used of a number of situations [sections 48f, g, 63a (9), 77e (1), 216 (12) (a)]. Doubtless the ful-

⁸ Section 67 is taken over in part verbatim from the Uniform Fraudulent Conveyance Act where the requirement of a fair price as a test of a bona fide purchaser is essential.

lest forms are such expansive statements as: "fair, equitable, and for the best interests of the creditors and does not discriminate unfairly in favor of any creditor or class of creditors" [section 83e (1)], or "under and consistent with the circumstances of the particular case equitably and fairly" [section 216 (7) (d)]. To this must be added the phrase "fair and equitable, and feasible" in the newer sections of the law [sections 174, 221 (2), 366 (3), 472 (3), 65a (3)]. Once it is merely "equitable and feasible" (section 75i). A kindred negative term "impracticable" [section 77c (6)].

We get the general impression that procedure in bankruptcy must be fair.

Fairness certainly involves the "best interests" of the parties concerned. These are, however, specially mentioned in sections 75e, 75i, 472 (2), 481 (2), 482 (2) and 656a (2). Again expedition is an element of fairness. Consequently, things in bankruptcy must be done "promptly" [section 39a (8)]; "forthwith" (section 41b); "as soon as practicable" [section 47a (6)]; "as expeditiously as its nature will permit" (section 5i); "as expeditiously as is compatible with the best interests of the parties in interest" [section 47a (1)]; without "undue delay in a reasonably expeditious" reorganization (section 77g). Parties must not be "guilty of undue laches"⁹ (section 15). Sometimes "reasonable diligence" (section 83b) is demanded.

Indeed reasonableness comes into the picture often. Courts may give a "reasonable fixed extension of time" (section 57n). A "reasonable time" is often referred to [sections 59d, g, 67a (4), 75e]. We hear of "reasonable cause to believe" [sections 14c, 60b, 70d (3)]; a "reasonable market value" (sections 75k, s); "reasonably justified" (section 77e); "reasonable rules" [section 77c, (13)]; a "reasonable opportunity to be fully heard" (section 14b); an "unreasonably small capital" [section 67d (2) (b)]. But for the most part "reasonable" is used of fees or compensation [sections 60d, 77c (12) (three times), e(2), p, 83b (twice), 242, 243, 244, 245, 246, 472 (6), 494, 495, 508]. Sometimes it is used of costs [sections 57j, 64a (3), 258, 259], but generally "proper" is the word for costs¹⁰ [sections 77p,

⁹ The term "undue laches" is somewhat significant of the desire to emphasize the requirement of expedition. It does not imply, we may safely assume, that there is such a thing as "due laches".

¹⁰ The question of reasonableness of allowance to attorneys and committees has been made the special point of a number of recent cases. A tendency to strictness is quite evident. A few typical illustrations are given in such cases as *In re Mercantile Arcade Realty Corp.* (S.D. Calif. 1937) 20 Fed. Supp. 297, in which \$10,000 was

243 (twice), 244, 245, 246 (twice), 494, 495, 508], to which we must add the fact that once "costs" are just "costs", without either the words "reasonable" or the word "proper" (section 69a).

In almost all—but not quite all—these instances, the word "reasonable" or "proper" if omitted would seem to take nothing whatever away from the sense of the phrase, as the last instance (section 69a) shows. And this is especially the case since in section 2a (21) there is a general requirement of "propriety and reasonableness of all disbursements".

It seems hardly necessary to add that claims must be "justly owing" (section 57a); that purposes must be "lawful" [section 77c (3)], or "not forbidden by law" (section 77e); that courts may act "for good cause shown and in the interests of justice" (section 75b), or merely "for cause shown" (section 75e); that they must give "due consideration" to demands upon them. Nor again is it surprising that besides the more or less technical "good faith" defined in section 146, there is a fairly general requirement of "good faith" [sections 77a (three times), 83a, e (5), 221 (3), 366 (5), 467, 472 (5), 651].

And to all this is added the public interest, chiefly in the later sections. The United States Attorney may intervene in discharges if "the public interest so warrants" (section 14d). Then there are phrases like the following: "impracticable and contrary to the public interest" [section 77c (6)]; "as the public interest may require" [section 77c (13)]; "compatible with the public interest" (section 77d); "without unduly or adversely affecting the public interest" (section 77o); "desirable to promote the public interest" (section 77p); "unfair and not consistent with public policy" (section 77p); "certified as to the public interest" (section 178); "not consistent with public policy" (section 212); "equitable, compatible with the interests of creditors and stockholders, and consistent with public policy" [sections 216 (11), 221 (5)]; "unfair or not consistent with public policy" (section 456).

It is almost a culmination to find that a railroad reorganization

considered reasonable for a committee of four bondholders who had received \$1,700,000 of bonds. But it is expressly stated that the amount involved is not controlling. *In re Albert Dickinson Co.* (C.C.A. 7th, 1939) 104 F. (2d) 771, *aff'd*, *Dickinson Co. v. Cowan* (1940) 309 U.S. 382. *Cf.* also *Woods v. City Nat. Bank & Trust Co. of Chicago* (Feb. 3, 1941) 61 Sup. Ct. 493, 85 L. ed. Adv. Ops. 478, *rev'g In re Granada Apartments* (C.C.A. 7th, 1940) 111 F. (2d) 834. The word "proper" was there applied to the purpose for which the expenses were incurred. If they were only partly for the benefit of the estate, they were not "proper", even if "reasonable" by a quantitative standard.

must conform to the "requirements of the law of the land" [section 77e (twice)]. Since the "law of the land" is the "*lex terre*" of Magna Carta and the ancestor thereof—by adoption, if not by legitimate birth¹¹—of "due process of law" in the Constitution, one wonders why this should be demanded only of railroad reorganizations.

These many changes rung on three or four ideas are not the only things that distinguish our much reëdited enactment from most others. The phraseology is much more like that of ordinary speech and discussion.¹² We could have no better example than is furnished here of how irrelevant the old rules of statutory interpretation are, which are derived from the practice of theologians and canonists.¹³ These men were required by the presuppositions of their faith to regard some of the texts they interpreted as verbally as well as substantially inspired. Our statutory texts are certainly not verbally inspired, whatever else may be said of them.

Nevertheless we may not speak abusively of the prolixity of the statutory language and the urgent need of better legislative drafting. That need, no doubt, exists. But the attempt at any time to make of statutes forms of expressions which approach mathematics and in which every term has its precisely definable denotation, is doomed to failure.

We speak of "the legislature" as a quasi-corporate body which expresses its will and thought in statutes. We refer to this body as "it". French and German practice refer to it as a person, "*le législateur, der Gesetzgeber*". We are in the presence in either case of one of those personified abstractions who do so much harm in the social sciences, like the *homo economicus*, "the economic man". Just as he had impulses, purposes and interests that were strangely different from the ordinary flesh and blood man we actually meet, so the *homo legislativus* was equipped with intentions and a character that were rarely combined in actual persons. The *homo legislativus* always acted reasonably, always meant different things when

¹¹ RADIN, *ANGLO-AMERICAN LEGAL HISTORY* (1936) 165-167. Professor Charles McIlwaine in reprinting his article, *Due Process of Law in Magna Carta* (1914) 14 COL. L. REV. 27, has commented on the conclusions I reached in the book cited above. 1 SELECT CONSTITUTIONAL ESSAYS (1938) 174, 197-203.

¹² We may note such phrases as "by any mischance" (§ 55a); "in any form or guise" (§§ 62c, d).

¹³ Mr. Thurman Arnold in his *Apologia for Jurisprudence* (1935) 44 YALE L. J. 729, 737-751, has given a number of citations in which the methods of legal and theological interpretation are compared. These could be almost indefinitely multiplied.

he used different words, always acted for the public interest, rarely or never contradicted himself, was always aware of other statutes passed on the same subject matter, and knew and took account of decisions and administrative practice about previous enactments of this character.

But that the *homo legislativus* is not altogether an abstraction is shown by the way he expresses himself in the National Bankruptcy Act. He is a very human individual there. He unnecessarily repeats himself. He uses synonyms and doublettes for purposes of ornament and emphasis and, just as in the case of other persons, we often need to find out the general sense of what he says, without constant insistence on his exact words.

In the matter that especially concerns us, the variations of expression which the statute uses have a real significance, after all, in bringing home the notion that the whole purpose and essence of bankruptcy in all its forms is to take a mass of property interests, and reassign claims, liabilities, powers and privileges¹⁴ in such a way that all persons concerned, and in many instances large groups of the public only indirectly concerned, shall derive from our reassignment all the advantages that reasonable and honest men ought to desire. The result must be "fair", "feasible", "in the best interests of all concerned" and "consistent with public policy". These are quite correctly called the "Key-words".

With the decision in the case of *Consolidated Rock Products Co. v. Du Bois*¹⁵ the Supreme Court has advanced a further step in the development of the principles and practice of corporate reorganization. Upon the broad foundation of *Northern Pacific Railway v. Boyd*,¹⁶ which is made more solid by this additional stamping down, we may say that the Court has erected columns, consisting of *National Surety Co. v. Coriell*,¹⁷ *First National Bank v. Flershem*,¹⁸ and most compactly and recently, *Case v. Los Angeles Lumber Co.*¹⁹ These four

¹⁴ I use unabashedly the Hohfeldian terminology, even if in a somewhat filed version. Radin, *A Restatement of Hohfeld* (1938) 51 HARV. L. REV. 1141. The discrimination of demand and privilege rights together with an understanding of the relation of powers to them is still a primary objective for clarity in legal expression.

¹⁵ (March 3, 1941) 61 Sup. Ct. 675, 85 L. ed. Adv. Ops. 603.

¹⁶ (1912) 228 U.S. 482.

¹⁷ (1933) 289 U.S. 426.

¹⁸ (1934) 290 U.S. 504.

¹⁹ (1939) 308 U.S. 106. The case was made the subject of a special article by Dodd, *The Los Angeles Lumber Products Company Case and Its Implications* (1940) 53 HARV. L. REV. 713, and forms a large part of the discussion in Mr. Gerdes' article

columns will support the still to be constructed roof of the edifice. Or, if we wish to shift metaphors, the five cases, beginning with the *Boyd* case, are successive steps upward to a platform on which dwell in perpetual sunshine the Platonic archetypes of "fairness", "feasibility" and "the public interest".

The first element of fairness Justice Douglas assures us again and again is the principle of "absolute priority" as established in the *Boyd* case—the "full and absolute priority rule", he calls it, which precludes "participation by equity interests in any of those [unmortgaged] assets until the bondholders have been made whole".²⁰ By the "equity interests", as the context shows, the Court means the stockholders.

The circumstances of the *Boyd* case are too well known to need examination here. It was one of the most widely discussed cases at the time and since.²¹ It has taken its place with landmarks like *Pennoyer v. Neff*²² and *Haddock v. Haddock*.²³ The law of reorganization is dated as before or after the *Boyd* case.

It is not often remembered that the *Boyd* case was decided by a vote of five to four and that the minority opinion written by Justice Lurton was concurred in by Holmes as well as by Chief Justice White and Justice Van Devanter.²⁴ What stuck in their crop was no doubt the fact that after a purchaser had been in undisturbed possession of the railroad property for more than ten years, Boyd, who had actual knowledge of all the proceedings, came forward for the first time to upset the sale.

But although laches is the basis of the main objection of the

Corporate Reorganization (1940) 26 VA. L. REV. 99, 1019. Mr. Gerdes believes it will supersede the *Boyd* case as a "landmark". It is enthusiastically approved by Mr. Garrard Glenn in his 2 FRAUDULENT CONVEYANCES AND PREFERENCES (1940) § 610.

²⁰ *Supra* note 15, at 682, 85 L. ed. Adv. Ops. at 609.

²¹ The bibliography of the *Boyd* case is far too extensive to be cramped within a footnote. Only a few of the important discussions can be cited. DEWING, FINANCIAL POLICY OF CORPORATIONS (3d ed. 1934) Bk V; SOME LEGAL PHASES OF CORPORATE FINANCING, REORGANIZATION AND REGULATION, Lectures delivered in 1916 before the Association of the Bar of the City of New York (1922) 201-203; and its supplementary volume, 8 LECTURES ON LEGAL TOPICS (1931) 35, 133; Frank, *Some Realistic Reflections on Some Aspects of Corporate Reorganization* (1933) 19 VA. L. REV. 541-570, 698-718; Friendly, *Some Comments on the Corporate Reorganizations Act* (1934) 48 HARV. L. REV. 39; Rosenberg, *Reorganization—The Next Step* (1922) 22 COL. L. REV. 14; Spaeth and Winks, *The Boyd Case and Section 77* (1938) 32 ILL. L. REV. 769; Swaine, *Reorganization—The Next Step: A Reply to Mr. James N. Rosenberg* (1922) 22 COL. L. REV. 121.

²² (1877) 95 U.S. 714.

²³ (1906) 201 U.S. 562.

²⁴ *Supra* note 16, at 511.

minority, Justice Lurton says at the beginning:

"Nor do I agree that every plan of reorganization which in any way includes stockholders of the reorganized company is for that reason alone to be regarded as an illegal withholding from creditors of corporate property which should go to the payment of corporate debts. That corporate property must be applied to corporate debts before shareholders can participate, is plain. But I think every case should stand upon its own facts, and the remedy be shaped to do justice and equity in the particular case, and not tried out by any hard and fast rule such as indicated when this court says that the invalidity of a judicial sale must turn upon the character of the reorganization agreement and is not affected by actual consequences to creditors."²⁵

The rule of *absolute* priority of bondholders means in effect, priority of all creditors, because in these extensive masses of capital and property, creditors who need consideration and are not paid off in full, like small merchandise creditors, wage earners and taxing agencies, are either secured by specific property or are bondholders.

It is, to be sure, somewhat strange that a principle so unmistakably fixed, a rule so clearly absolute, did not get itself enunciated into a statute which has been so often revised and which both in section 77B of the old Act and in the Chandler Bill was so freely written and rewritten in a style so large and conversational. It would almost seem that the framers had intended once and for all to make the Bankruptcy Act conform in words to what in judicial and administrative practice it had in fact come to be.

The following may serve as examples of the way in which the law of generally accepted decisions has been formally brought into codification. We may begin with *West Co. v. Lea*,²⁶ one of the earliest cases under the Act of 1898. In that case, it was held, somewhat against the wording of section 3b, that proof of insolvency was not always a condition precedent of bankruptcy proceedings.²⁷ No one has challenged this rule since 1899, but in the Chandler Act, which rewrote so much, the doctrine of *West Co. v. Lea* is explicitly made part of the law. It can hardly have been called imperative to do so, since there was no likelihood whatever that any court would interpret section 3b otherwise than had been done in *West Co. v. Lea*.

²⁵ *Ibid.*

²⁶ (1899) 174 U.S. 590.

²⁷ Section 3b of the statute read: "A petition may be filed against a person who is insolvent and has committed an act of bankruptcy . . ." *West Co. v. Lea*, *supra* note 26, decided that insolvency was not a condition precedent unless the specific act of bankruptcy as defined in section 3a required it.

In the many amendments of the Act, no one before 1938 had thought of making the statute conform to this generally received interpretation of the section.

In the same way, section 57n was amended in the Chandler Act to extend within the court's discretion the time in which the United States or a state might file its claim. It had, however, already been so decided in *New York v. Irving Trust Co.*²⁸

Similarly in section 59e, secured and preferred creditors are excluded from the number of creditors counted in an involuntary petition. This also had already long been the law, if decisions make the law.²⁹ Section 67a(1)b was recast to make explicit the construction given to the corresponding section in the old act by the case of *Dean v. Davis*.³⁰ Section 67a(3) does the same for the case of *Chicago, Burlington & Q. R. R. v. Hall*,³¹ although that case has been sharply criticized. And section 67b was worked over to adopt the rules established by cases concerning liens under state law.³²

Besides these, there have been a number of changes which have, let us say, overruled existing and established constructions. It is impossible to go into all of them. The rejection of *Taubel-Scott-Kitzmiller Co. v. Fox*³³ on plenary proceedings [section 67a(5)] is one example. A great many more could be cited. Perhaps the ones practically most important are the repudiation of such "leading cases" as *Carey v. Donohue*³⁴ by section 60a, and of *Richardson v. Shaw*,³⁵ *Gorman v. Littlefield*³⁶ and *Duel v. Hollins*³⁷ by section 60e. Another verbal clarification removed the famous "*caveat* to all the world, and in effect an attachment and an injunction" of *Mueller v. Nu-*

²⁸ (1933) 288 U.S. 329. Cf. also *United States v. Kaplan* (C.C.A. 2d, 1935) 74 F. (2d) 664.

²⁹ *Stevens v. Nave-McCord Mercantile Co.* (C.C.A. 8th, 1906) 150 Fed. 71; *Ermine v. Tarault* (C.C.A. 6th, 1915) 219 Fed. 68. The decisions on this point in the circuits had been uniform.

³⁰ (1917) 242 U.S. 438.

³¹ (1913) 229 U.S. 511.

³² *Henderson v. Mayer* (1912) 225 U.S. 631; *New York-Brooklyn Fuel Corp. v. Fuller* (C.C.A. 2d, 1926) 11 F. (2d) 802.

³³ (1924) 264 U.S. 426.

³⁴ (1916) 240 U.S. 430. Cf. also *Bailey v. Baker Ice Machine Co.* (1915) 239 U.S. 268; *Martin v. Commercial Bank* (1918) 245 U.S. 513. Most of these cases and many others besides, are cited in Professor J. A. McLaughlin's article, *Aspects of the Chandler Bill to Amend the Bankruptcy Act* (1937) 4 U. OF CHI. L. REV. 369, in which the changes made by the Chandler Act are fully and critically presented.

³⁵ (1908) 209 U.S. 365.

³⁶ (1913) 229 U.S. 19.

³⁷ (1916) 241 U.S. 523.

gent,³⁸ a rhetorical phrase that was simply not a true statement of the law as it was applied under the predecessor of section 70c, and has now been rectified by the Chandler Act version of section 70c as well as of section 21g.³⁹

We are, therefore, not remitted merely to the dignified presumption that when a statute is amended, it is done with cognizance of the cases that had been decided on the sections amended.⁴⁰ There is overwhelming proof that the *homo legislativus* who rewrote the Act into its Chandler form was highly literate and that he was fully conscious of an extraordinary number of cases, some of which he adopted and others of which he almost explicitly rejected.

If that is so, why did he not adopt formally the "fixed principle", the "absolute rule" of the *Boyd* case? That he knew the *Boyd* case is not subject to reasonable doubt. That he could have inserted it in any one of half a dozen places is clear. The silence is all the stranger because it is generally assumed that Mr. Douglas, then the chairman of the Securities and Exchange Commission, counted for much in the mind of our *homo legislativus* when he was writing chapter X.

The *argumentum ex silentio* is not of much value for determining historical facts, but it is evidentiary for mental states, even the mental states of an abstract but not wholly unreal person. And yet it is Justice Douglas who in the *Los Angeles Lumber* and *Consolidated Products* cases demands of us unreserved acceptance of the *Boyd* doctrine.

That in the five cases which may be taken to be the basis of our new law of reorganization, the rule of priority of bondholders over

³⁸ (1902) 184 U.S. 1, 14.

³⁹ This last provision, section 21g, involves a situation which more than anything else illustrates the untenability of the "caveat" rule. A bona fide purchaser from the bankrupt at a place remote from the court where the adjudication took place, is now specifically protected. There had apparently been only three cases on this point, two disregarding the rule of implied notice, *Beach v. Faust* (1935) 2 Cal. (2d) 290, 40 P. (2d) 822; *Vombrack v. Wavra* (1928) 331 Ill. 508, 163 N.E. 340; and one enforcing it, *Hull v. Burr* (1911) 61 Fla. 625, 55 So. 852. Cf. (1935) 23 CALIF. L. REV. 627.

It is to be noted, however, that the bona fide purchaser under the Chandler Act must fulfill the equitable requirement of a "present fair equivalent value", a demand not ordinarily made of bona fide purchasers. To this extent, therefore, the attachment-injunction effect of bankruptcy still holds.

⁴⁰ *Hoffman v. McNamara* (1929) 102 Cal. App. 280, 285, 282 Pac. 990, 991: "The rule is well settled that the legislature is presumed to know the decisions of appellate courts and to have them in mind when adopting amendments to statutes which the courts have construed." See also the elaborate study of such a situation by Justice Andrew Cochran in *In re Frost* (E. D. Ken. 1925) 9 F. (2d) 128, *rev'd* on other grounds, (C.C.A. 6th, 1926) 12 F. (2d) 1.

any one of the sort of stockholders there in question, was properly applied may be readily conceded. Can we be sure enough about it to make it quite so fixed a principle as Justice Douglas wishes? Can we be convinced that corporations may not be brought before the courts in which the roles of bondholders and stockholders in respect of equities may be reversed? We have already been warned that financiers and corporation technicians are prepared to devise forms and patterns that will evade the *Boyd* case.⁴¹ I have no doubt that where the purpose of evasion is evident, courts will pierce the sham and call persons and things by their right names, but it may be more than a matter of names.

What, after all, is the actual difference between stockholders and those bondholders who are not secured by specific property? Are they really creatures of different species, one fundamentally inferior to the other in regard to equity? It may be so. But in experience, it is a little doubtful. Both are groups of persons who have paid out money in the hope of getting a return and both have based their hopes, not on the possible proceeds of specific security, but on the success of an enterprise. The only real difference is that the stockholders have done so at the beginning of the enterprise and the bondholders somewhat later.

Now, if the maxim *prior tempore potior iure*⁴² could be transferred from security transactions to situations of this sort, we should have a superior equity established in the stockholder. Clearly that is an untenable proposition, but it does invite a closer inspection of the circumstances under which investors become stockholders and bondholders.

The superior equity of the bondholder can, to be sure, be supported, if by nothing else, by the specific contract made—not merely by the actual purport of the words used, but by the real intention of the parties. When bonds are offered for sale to the public, the risk taken is assumed to be less than the risk taken by stockholders. It is definitely

⁴¹ Cutcheon, *An Examination of Devices Employed to Obviate the Embarrassments to Reorganizations Created by the Boyd Case*, 8 LECTURES ON LEGAL TOPICS, *loc. cit. supra* note 21.

⁴² This rule, originally a rule of the Roman law (Gaius, D. 20, 4, 11 pr.) is applied much more precisely at the common law than in the civil law. At the civil law the rule of maritime law that the security-holders are to be satisfied in the order of their effect on the conservation of the *res* is quite general. Cf. Ulpian, D. 20, 4, 5: *Interdum posterior potior est priori ut puta si in rem ipsam conservandam impensum est quod sequens credit.* The rule of the *Boyd* case so enthusiastically maintained by many members of the common-law bar, might therefore be a wicked Romanistic intrusion in our law.

known that stockholders exist and that they live in lively anticipation of dividends, but the issuance of bonds admittedly postpones both for the stockholders and the bondholders the realization of dividends to the payment of interest on the bonds, and in case of default, to the payment of the bond. There is no question that the stockholders take the risk that they can be paid at best only out of what is left after the bondholders are satisfied.

If the terms of the contracts actually made by bondholders and stockholders are to be considered, there is, therefore, no question that their obligations are assumed to have an order of precedence, and that this precedence is in favor of the bondholders. But does that sufficiently conclude the matter to make further search for fairness unnecessary? The strict enforcement of obligations, precisely as they are assumed, is not usually taken to be the summation of equity.⁴³

There is in one sense no doubt about it if stockholders were what in an older background they undoubtedly were, the reality behind the corporate veil. I use this expression with full acknowledgment of the prior rights to it in those earnest persons who have urged us so vehemently to pierce the veil.⁴⁴ There was a time when the stockholders were in fact the persons with whom the bondholders made their bargain by means of the corporate scheme. In that case neither in equity nor in law ought the stockholders both have their cake and eat it.

But that is not the situation in modern corporations. The stock is sold to a public scattered over a wide area. The real person behind the corporate veil is the management whose actual stock interest might be slight enough.⁴⁵ But even when it is large, there is always a considerable group of stockholders who have been brought into the enterprise by exactly the same methods as those which were used to secure bond-purchasers, with precisely the same end in view, and on the whole with less likelihood of knowing fully what they were letting themselves in for.

Of one thing we may be certain. The stockholders not actually concerned with the management had little or nothing to say about the desirability or need of bond-issues, and took no active part in arrang-

⁴³ That the court will rearrange and reform private obligations in reorganization procedure without regard to what the parties stipulated is axiomatic. If the contract were controlling, there would be no justification for reorganization.

⁴⁴ Professor I. M. Wormser has been particularly insistent on the phrase. *WORMSER, FRANKENSTEIN, INCORPORATED* (1931).

⁴⁵ *BERLE and MEANS, MODERN CORPORATION AND PRIVATE PROPERTY* (1937) ought to have permanently dispelled the notion which sometimes masks itself as realism that the stockholders are jointly the equivalent of the corporation.

ing that postponement of their claims to the corporate profits in favor of bondholders, which under the *Boyd* case is apparently to be the beginning, if not the end, of fairness.

Is it completely impracticable to distinguish between stockholders and bondholders on the basis of fairness? That it is difficult to do so may be conceded and that there are enough difficulties in determining what is equitable without adding to them may well be the case, but on that understanding, the doctrine of the *Boyd* case is not a fixed principle or an absolute rule but a rough approximation which it is hoped will work equity more often than not.

A system of corporate organization is conceivable which consists exclusively of stockholders all in the same class and all with the same rights and in which bondholders would be merely additional stockholders. This system has an engaging and delightful simplicity. There is no reason to suppose that it would not work in practice and none whatever to believe that it would deter people from investing in corporate enterprises. It, however, is certainly not the system now in operation, nor can it safely be used as a standard for reorganization when any given corporation is in such difficulties that it is as unlikely to provide interest on its bonds as dividends to its stockholders. But its possibility is something to consider as a remote ideal, and it may make us wonder whether our rule can be quite so fixed and absolute as we are somewhat peremptorily required to believe.

If we may take the rough yardstick of absolute priority, we begin with the two requirements of the *Boyd* case: first, there must be something of value in the corporate property after the secured and unsecured creditors are paid in full, and, second, this value may not be transferred to shareholders without new consideration that has a quantitative relation to the value received.

We may further gather from the *Boyd* case that value will not be determined by the mere result of a sale, even one "at public outcry".⁴⁰ In this instance, the secured debts were \$157,000,000 and the railroad sold for \$61,000,000—at public auction, to be sure, but one in which only one bid was made. But since the new company that paid \$61,000,000 at once issued \$190,000,000 in bonds and \$155,000,000 in stock, of which \$144,000,000 was declared to be fully paid up, the existence of a value over and above the amount of the secured and unsecured debts was properly enough deemed to have been fully proved.

Some years after the decision of the *Boyd* case, the case of the

⁴⁰ *Supra* note 16, at 501.

*National Surety Co. v. Coriell*⁴⁷ was decided, and one particular dictum—or perhaps assertion—in that case has been constantly quoted. The case dealt with the reorganization of a corporation called “Morris White, Inc.” The petition alleged that the company’s assets exceeded \$4,000,000 and that its liabilities were about one million. There were no quick assets, but a receiver, it was confidently expected, could continue the business with substantial profits. The plan to which the bank creditors and the large merchandise creditors all assented, was that all but small creditors—who were to be paid in full—were to receive twenty per cent in unsecured notes and eighty per cent in preferred stock. Morris White, who founded the company, was to be manager for three years at not more than \$60,000 a year, and he and his wife were to own all the common stock. There was no appraisal of the assets and no itemized report of liabilities. The district court approved the plan. The circuit court modified it by holding that the “dissenting creditors were entitled to an aliquot share of what, a year later, it might be estimated the property would have brought at a public sale and authorizing them to recover that amount, if assets to satisfy their claims were then available”.⁴⁸

The Supreme Court, speaking unanimously by Justice Brandeis, reversed both decisions and remanded the case to the trial court. Justice Brandeis noted the absence of any estimate of the value of the assets and of figures to indicate the course and result of the business while under the informal supervision and control of the banks. He did find, however—doubtless through facts presented by the appellants to the Supreme Court itself and not sufficiently controverted—that the statement that the assets exceeded \$4,000,000 was a gross overvaluation, that they really equalled, at most, one million. Among other things in the four million total there was included an item of \$2,277,714.89, consisting of obligations and securities of associated and subsidiary companies, which were probably worthless.

The much quoted statement of the Court was based chiefly on the astonishing supineness of the trial court in accepting the fact of the assent of the important creditors as relieving it of any duty of examination. “Every important determination by the court in receivership proceedings calls for an informed, independent judgment.”⁴⁹

Fairness is therefore quite definitely dependent on getting closer

⁴⁷ *Supra* note 17.

⁴⁸ *National Surety Co. v. Coriell*, *ibid.* at 436, paraphrasing *Coriell v. Morris White, Inc.* (C.C.A. 2d, 1931) 54 F. (2d) 255, 261.

⁴⁹ *Supra* note 17, at 436.

to the facts than a written document and the signature of a number of persons.

The *Coriell* case was discussed in law reviews as it left the circuit court,⁵⁰ but apparently was only twice examined in its final form.⁵¹ The circuit court decision apparently interested commentators more on the question of the absence of a judicial sale than on any other, but it is apparent that little was added to help the determination of what treatment of creditors would be sufficiently fair to justify the confirmation of a plan for reorganization.

When in the next year the case of *First National Bank v. Fler-shem*⁵² was decided, the question of method of determining fairness was again brought forward. The company involved was the National Radiator Company which owned ten manufacturing plants which were located in five states and were valued at \$26,000,000. The company had been organized in 1927 out of merger of six independent companies. In 1931, the company decided that a revision of its capital structure was desirable in order to effect a drastic reduction of its debenture liability and the elimination of all fixed charges. The company therefore hit upon the somewhat startling plan of making itself deliberately insolvent—in the equity sense, not the bankruptcy one—by defaulting on its debenture interest, although fully able to pay it. It then urged the trustee to declare the entire principal due—which under the bonds he had the legal right to do. A judgment was obtained which the company of course was unable to pay.

Ninety-five per cent of the debenture holders assented to the plan—whether willingly or with reluctance, of course, does not appear. A judicial sale was made of the entire assets of the company and the upset price was fixed at \$2,500,000. A new company was organized which was to continue the business and scale down the debentures by more than fifty per cent on principal and interest. Holders of preferred stock were to get common stock; the common stockholders were to get stock-warrants. No new additional capital was contemplated.

Here there was no question of disregarding the priority rights of the creditors. As in the *Coriell* case, the question of fairness arose as a matter of method. Can anyone in ignorance of the facts be fair to any group? The frequently cited phrase of Justice Brandeis called

⁵⁰ Notes (1932) 45 HARV. L. REV. 697; (1932) 18 VA. L. REV. 784; (1932) 41 YALE L. J. 577.

⁵¹ (1934) 9 IND. L. J. 466. It became the subject of a special article by Stone, *The Case of the Ladies' Handbags* (1938) 24 VA. L. REV. 831.

⁵² *Supra* note 18.

for an "informed" judgment and just as in the *Coriell* case, Justice Brandeis calls attention to some curious matters from the record itself. "The cash on hand was \$1,257,381. The overdue interest amounted then to \$709,395."⁵³ The difference, \$547,986, was so clearly more than the amount required for working capital, that two months after their appointment the receivers asked for permission to invest their cash, and did invest more than one million in government and other securities.

Secondly, the corporation sold at scrap value all their properties as an entirety, a wholly unnecessary thing in a situation in which six factories had until recently been operating independently, even if a single sale of the entire property might be desirable in the case of a railroad.

Fairness, the Court feels, cannot be arrived at in this way. The deliberate creation of a state of insolvency in order to create jurisdiction, the fraudulent conveyance—it is specifically and correctly so denominated⁵⁴—of the assets of the old company to the new one, the deliberate failure to get the highest value possible for the company's plants, presented a situation out of which no fair plan could possibly be effected.

What was particularly encouraging in the *Flershem* and *Coriell* cases was the determination of the Court not to let a judgment of fairness depend on the mere wooden fact that a huge percentage of the persons concerned—ninety-five per cent in the *Coriell* case—have declared themselves satisfied. For decades, courts presented with such a situation, have shrugged their shoulders and declined to examine searchingly an arrangement which so overwhelming a majority of the people affected have found adequate. Are not businessmen—are not all men—the best judges of their own interests?

The answer is "No". Anyone familiar with the way these assents are obtained knows that in many cases—we dare not say in most cases—assent is given because of a general discouraged feeling that this may be the only method of salvaging even a fraction of the investment. Of one thing we may be sure, the assenting bondholders had even less opportunity to know the facts of the situation than the court was given, even if we discount high-pressure salesmanship on the part of the solicitors for the management. Their assent is no evidence whatever that they thought the plan fair, even if their judgment of its

⁵³ *Ibid.* at 513.

⁵⁴ *Supra* note 18.

fairness was conclusive on the court. It is at most evidence that they thought the plan was better than nothing.

It was notable at once that the phrase "informed, independent" judgment of fairness, imposed on the court not so much a new task, as a formal recognition of a task that for many generations courts have performed, if at all, somewhat surreptitiously. Information may be polite acquiescence in what people choose to tell us, and lawyers have been very insistent that what is stipulated in a written document must be taken without investigation. But if the judgment of fairness is to be "independent" a court must do much on its own mere motion that which it formerly could have dispensed with comfortably.

Our theory of litigation has long been that if two opposing sides do their best to controvert each other's statements, from that welter of opposite claims a modicum of incontrovertible data may be culled. Evidently where the judgment is to be one of fairness, the Supreme Court does not think this to be enough. The court must make up its own mind.

Has the court the machinery for doing so? It is hard to see why not. Chancery courts have been appointing masters and referees for centuries, persons who are their officials, whose reports may be based on investigations quite independent of the claims of the litigants and who may present results that none of the litigants approves of. All that is imposed on the courts by this requirement of an "informed, independent" judgment, is something quite of the same nature.

But what has disturbed a great many gentlemen is that both the independent acquisition of this information and its proper use in preparing a fair reorganization demand of the court an activity that may be called and has been called "administrative".⁵⁵ When we keep in mind that we are in the midst of a violent struggle concerning administrative agencies which presume to function as courts, it seems an added horror to find courts acting as administrative agencies.

Unfortunately for the peace of mind of those who have swallowed undigested the Aristotelian tripartite division,⁵⁶ the common-law

⁵⁵ "Congress has delegated throughout the Act wide and unusual administrative power to the courts." Beer, 1 CORPORATE REORGANIZATION (1934) 90. A more general ground of complaint is derived from an objection to the fundamental doctrine that the purpose of reorganization is the contrivance of a business and not its liquidation. Cf. (1932) 18 VA. L. REV. 784, which bases its objection on the case of *Phipps v. Chicago, R.I. & P. Ry.* (C.C.A. 8th, 1922) 284 Fed. 945, discussed by Rosenberg, *Phipps v. Chicago, Rock Island & Pacific Ry. Co.* (1924) 24 COL. L. REV. 266.

⁵⁶ The division of political power into three types is explicitly set forth in ARISTOTLE'S POLITICS, IV, 14, and is frequently enough referred to in later discussions.

courts were in their origin administrative agencies in various degrees and never wholly ceased to be so. That was particularly true of the Chancery. The imposition therefore of tasks that demand administrative effort ought not to frighten a court, especially an equity court. When it is asserted loudly that the courts have no facilities to perform these tasks, the sufficient answer is that they are performing them, and have always to some degree done so.

Now, the priority which by the fixed and absolute rule of the *Boyd* case must be given the bondholders over the stockholders, had a chance to be further illustrated in another of the cases that serve as successive steps to our understanding of fairness. This was *Case v. Los Angeles Lumber Co.*⁵⁷ There were two classes of stockholders, *A* and *B*, and there were bonds outstanding to an amount of nearly four million dollars. The assets were found to be worth \$850,000. The plan was to create a new corporation which was to have 811,375 shares of preferred stock and 188,625 shares of common. 170,000 shares of preferred stock were reserved to raise money for the rehabilitation. The rest of the preferred stock was to be issued to the bondholders. The common stock was to go to the Class *A* stockholders of the old company. Class *B* stockholders were not provided for. The stockholders were not required to make any payment. It will be noticed that the par value of the stock distributed was exactly the present value of the assets of the company.

The Court declared this to be unfair. In this case the relative priority of bondholders and stockholders is maintained. No tears are shed over the elimination of Class *B* stockholders. Class *B* and lower divisions of stockholders are animals destined by nature for slaughter, although that was probably not made too evident when the stock was sold by jaunty stock-salesmen in the purple lustrum before the Big Crash.

But although a relative priority was maintained, was it enough? It was urged that if the bondholders foreclosed they might get even less. Under this scheme, if the new company were successful, they might get considerably more. And the stockholders offered to give a certain prospect of success by continuing the Class *A* stockholders in control who had "financial standing and influence in the community" and could give "continuity of management" to the new company.

Cf. Radin, *The Doctrine of the Separation of Powers in Seventeenth Century Controversies* (1938) 86 U. OF PA. L. REV. 842, 859-860. What Montesquieu insisted on was that these three powers must never be united in one person.

⁵⁷ *Supra* note 19.

These considerations had convinced nearly ninety-three per cent of the bondholders. Indeed the only objectors owned merely \$18,500 of a large bond issue.

The Court rides roughshod over these pleas. The fact that the bondholders on foreclosure might—indeed in all likelihood would—get substantially less than the appraised value of their security (\$830,000) was irrelevant. "Such a proposition would not only drastically impair the standards of 'fair and equitable' as used in section 77B; it would pervert the function of the Act."⁵⁸ It would amount to coercion. And that it is an attempt at coercion seems self-evident. The consent of more than ninety per cent of the bondholders clearly does not prove its fairness, as has been pointed out in many cases. Nor does the small holding of the objecting bondholders prove the unfairness of the objections. That a bondholder may profess recalcitrance as a form of black-mail is evident. That implies, however, that he is using his bond to prevent a fair reorganization and the fairness of the plan is what we are trying to determine.

But what the *Boyd* case stated was in effect not merely that the bondholders must be preferred to stockholders, but that the latter must not share at all in the advantages present or prospective of the new enterprise until the bondholders are satisfied in full.

Obviously the old stockholders can buy stock, and if they do so, the fund created will directly help the bondholders. But it is expressly conceded that actual contribution in money is not absolutely necessary. The question then arises whether the Court did not too summarily dismiss the contention of the stockholders that their continued management of affairs was a real contribution. The Court did not think it was a real contribution. These items "have no place in the asset column of the balance sheet of the new company. They reflect merely vague hopes or possibilities."⁵⁹ But if the only reason for excluding them is the case cited,⁶⁰ we cannot be so sure of that. In *In re Barclay Park Corp.*⁶¹ the court rejected the suggestion because there was no binding agreement of the old managers to remain. If there had been such an agreement, would their contract have been a new value that added to the prospective values what on other terms could not be had?

It may be that the record threw grave doubts on these prospective values. Perhaps the "financial standing" of a management that man-

⁵⁸ *Ibid.* at 123.

⁵⁹ Case v. Los Angeles Lumber Products Co., *supra* note 19, at 122.

⁶⁰ *In re Barclay Park Corp.* (C.C.A. 2d, 1937) 90 F. (2d) 595.

⁶¹ *Ibid.*

aged to run a business into insolvency was, on good grounds, questionable. But since we are seeking fairness, it will hardly do to deal with a matter like this quite so drastically. The phrase "under and consistent with the circumstances of the particular case, equitably and fairly" although it occurs only once in the Chandler Act,⁶² is after all merely an expansion of the word "fairly". One cannot be fair except in a particular case.

The most recent examination of the question is the case of *Consolidated Rock Products v. DuBois*,⁶³ in which, once more, Justice Douglas spoke for a unanimous Court. The company was a holding company and owned the stock of two others, Union and Consumers. The mortgage indebtedness of Union was \$2,208,000; that of Consolidated \$1,358,000. Three witnesses asserted that the valuation of Union—including good will—was \$2,200,000 and that of Consumers, \$1,150,000. These valuations were, in the mind of the Court, subject to grave doubts. The district court had found that the total fair present value of the assets was in excess of the indebtedness, and that the present fair values of the properties subject to the two mortgage indentures of Union and Consolidated were separately insufficient to meet the face value of the bonds, but that it was impossible to segregate the assets of the two companies because of the commingling caused by unified management.

The plan was to form a new company and transfer all the assets of Consolidated, Union and Consumers to it. Bondholders were to receive new bonds and preferred stock. Preferred stockholders were to receive common stock and common stockholders merely warrants to purchase a limited number of shares of common stock. The preferred stock (held by old bondholders) was to elect four directors; the common stock, five.

The plan was rejected both by the circuit court and the Supreme Court. There was not enough information to make an independent judgment possible by the court. The system of valuation was defective. The value of the claims of the subsidiaries against Consolidated had not been properly ascertained. If they were substantial, the subsidiaries might even be "solvent" in the bankruptcy sense. Nor had prospective earnings been adequately considered.

But in any case, the conditions of the *Boyd* case, which applies to solvent as well as insolvent corporations, had not been met. The

⁶² § 216(7) (d).

⁶³ *Supra* note 15.

accrued interest, which is as much a debt as the principal, was cancelled. Next, the bondholders received merely the face amount of their claim in inferior securities. This was inadequate compensation for the surrender of their rights to be paid in full before stockholders—in this case, the preferred stockholders—were allowed to participate at all.

In *Kansas City Terminal Railway v. Central Union Trust Co.*⁶⁴ the plan of reorganization—which of course long preceded section 77B—had to deal with eighteen outstanding bond issues. The Supreme Court was asked for instructions and found the request lacking in clearness and precision. Its answer, confined necessarily to generalities, did not pass on the fairness of this particular plan, but made some assertions that are valuable guiding posts.

These were: 1. No plan is fair unless the whole claims of all creditors are given priority over any claims of stockholders. This does not mean that the creditors must necessarily be given securities superior in grade, if the creditors are given priority in some other way.

2. If the right of stockholders to participate is conditioned on substantial cash contributions, they may receive the same grade of securities as the bondholders.

3. Practical exigencies under the informed discretion of the chancellor⁶⁵ must govern the final determination.

These practical exigencies were applied to the case when it came back to the court, more or less as follows.⁶⁶ They were dealing with a railroad system of over 3,000 miles, valued at \$321,000,000. It was in a state of hopeless insolvency. A market for the entire system was of course non-existent. The unsecured creditors could have got nothing by attempting to enforce their claims by judgment. They were offered as an alternative more than twice as much stock per face value of their claims as the stockholders got and the latter were required to contribute twenty to twenty-five per cent in cash in order to get the new stock.

This, said the circuit court—and the Supreme Court refused to

⁶⁴ (1926) 271 U.S. 445.

⁶⁵ Mr. McReynolds' expression "the informed discretion of the Chancellor" prefigures the phrase "informed independent judgment of the court" which was used by Justice Brandeis in the *Coriell* case and has been so widely used since.

⁶⁶ The Supreme Court opinion confines itself to answering the request for instructions. The details of the plan in regard to which instructions were asked and the plan finally approved are given in *Kansas City Terminal Ry. v. Central Union Trust Co.* (C.C.A. 8th, 1928) 28 F. (2d) 177.

disturb the finding⁶⁷—was fair and in accordance with the instructions of the Supreme Court.

From these most quoted cases in the Supreme Court, how much specific guidance may be obtained? There is first of all a very definite rule of method. The judgment of fairness must not be second-hand. What is fair is necessarily a matter of opinion, but it must be the court's opinion, not accepted supinely on the basis of the judgment of other people, not acquiesced in out of deference to financial standing, even of persons who deserve financial standing.

Nor may the court deal with this matter by intuition or inspiration. If it does, it must be—shall we say—a superinduced intuition which arrives after an immersion in a difficult and doubtless tedious examination of data—a great many different kinds of data. Not only must the court's opinion be reached after an investigation, but it must be more or less apparent how it was reached. The court has no right to an opinion on the fairness of a plan until it has worked hard to get the right. If the expression is permissible, it may be said that a lazy court cannot be a fair one.

To be sure, the judgment of fairness will remain to some extent a matter of opinion, since it depends so often on valuation, and valuations even of physical properties when the valuers are freed from any suspicion of interest or incompetence, have shown extraordinary discrepancies.⁶⁸ That the court will indicate a polite and aloof skepticism whenever the valuation emanates from those who will directly or indirectly profit from it, is evident. But sometimes no other valuation is obtainable.

We begin then with a requirement realistic in the highest degree. It is not a matter of procedure. The court is not merely to hear a witness or an accountant render an opinion and assume that there was basis for it. It must be clear on what data the opinion was based and on the accuracy of the data and the validity of the opinion the court must have an independent view.

When the court is ready to judge the fairness of the plan, has it any additional precise guidance? Twice in recent cases the Supreme Court has reasserted the "fixed principle", the "absolute rule" of the

⁶⁷ *Cert. den.*, (1929) 278 U.S. 655.

⁶⁸ The problem of valuation in reorganization is fully examined in FINLETTER, *THE LAW OF BANKRUPTCY REORGANIZATION* (1939) c. VII. Cf. further Bonbright, *The Problem of Judicial Valuation* (1927) 27 COL. L. REV. 493; and Friday, *An Extension of Value Theory* (1922) 36 Q. J. OF ECON. 197. BONBRIGHT, *VALUATION OF PROPERTY* (1937) is an exhaustive treatment of the topic.

Boyd case. It is not asserted that the *Boyd* case is an affirmative norm. It contains, however, at least two negative ones. First, shareholders and creditors may under no circumstances share *pari passu* in the prospective advantages of the new enterprise. Second, the share of bondholders must not be merely superior. If it is feasible, creditors must be assured complete satisfaction before the shareholders are allowed to participate at all.

In both the *Los Angeles Lumber* and the *Consolidated Power* cases⁶⁹ the fact that the bondholders were given a superior share did not establish the fairness of the plan. In the *Kansas City Railway* case⁷⁰ the superiority was in part mathematical. The creditors got twice as much as the shareholders. But the latter were further required to buy their way in by a substantial cash contribution. It is impossible to assess this condition in terms of arithmetical ratios. Many stockholders may well have been deterred from claiming any interest at all. In any case, the funds so secured may have been sufficient to put the company on its feet and so make profits possible.⁷¹

But there are two additional rules of guidance that come from the cases. The ratio of two to one or any other fixed ratio—in favor of creditors—will not of itself make a plan fair. The proportion of the contribution must either assure the creditors of being paid before the stockholders get anything, or if that cannot be assured, it must create a reasonable prospect that this will happen.

⁶⁹ *Supra* note 19 and 15, respectively.

⁷⁰ *Supra* note 66.

⁷¹ In all these cases the court must estimate feasibility as well as fairness on the basis of prospects. The whole theory of reorganization as a substitute for liquidation is that there is a reasonable chance for profits to be made. Every case is bound to be unique and the court can merely conjecture, even if its conjectures are based on a careful examination. But since reorganization has a history, it might be helpful to know just what happened to these plans approved for fairness and declared to be practicable.

In this case the railroad system involved was the huge Missouri-Kansas-Texas Co. which is still operating roads over 3,293.91 miles. As has been stated, the final approval of the plan did not take place until 1928, just before the financial crash. The company survived the year 1929 but no profit has been derived from its common stock since 1930 nor from its preferred stock since 1931. In September 1939 the arrearages on its preferred stock amounted to \$37,000,000. It borrowed substantial sums from the R.F.C. in 1936, 1938 and 1940. The last available volume of Poor's *Manual* declares its securities to be "highly speculative" and suggests that the Company might seek reorganization or "arrangement" under the Chandler Act.

It is a record of this sort that ought to be available to courts in determining comparable problems. Perhaps standard works of reference on these things like the valuable manuals of Mr. John Gerdes on CORPORATE REORGANIZATION (1936) and Mr. T. K. Finletter, *op. cit. supra* note 68, might carry appendices with this information.

At all events, the reorganization continued a system in operation for a definite time. This of itself is a measurable economic advantage.

And again it is specifically stated in the *Boyd* case that the contribution need not be in cash. I fear it will be inferred from the *Los Angeles Lumber* decision that financial services in the management will never be enough and that nothing will be enough that cannot be an item in a ledger. "Goodwill" is often made such an item. Its valuation is particularly difficult and it is something that the new corporation is likely to get without any help from the stockholders.

If it need not be a cash contribution or other tangible assets and if experience in management and financial skill are somewhat too imponderable, what else can it be? In the rare situation in which large profits are so likely that regular interest payments and amortization of bonds are fairly certain, it might be permissible to admit stockholders—properly subordinated—without contribution or any other condition—to share in a surplus over and above the creditors' claims. In the *Flershem* case, it is not certain that such a situation might not have presented itself after a thorough examination of the facts. But clearly it will not happen often.

Can we get anything else out of our experience with reorganization that will help us guarantee the fairness that is so persistently and repeatedly demanded by the statute? The accrued interest is as good and as urgent a debt as the principal. But must the interest rate be continued? There is a divergence of authority. If the continuance of the interest at the old rate is so great a burden that liquidation is likely, there may be a good reason for scaling it down. But that affects feasibility rather than fairness.

The word "feasible" occurs in the statute several times in a completely literal sense.⁷² Notice must be sent, if there is some one to send notice to, and the like. But it is bracketed with "fair" and "equitable" and the question of whether it adds something important may be briefly adverted to.

It is in the first place a warning. We are not dealing with abstract or theoretical problems. It is a particular situation with which we are confronted, unique in space and time. Feasibility is clearly understood even when it is not mentioned. Unless it is feasible, it does not merit discussion at all.

The question of feasibility is really more difficult than that of fairness. It means in effect that the court must seek the means for an informed judgment on whether a proposed business organization is likely to succeed. There are a multitude of commercial advisors avail-

⁷² Cf. § 120.

able, but in that multitude of counsellors there is no assurance of safety. The court is not required to offer a real prophecy of commercial success. A fair probability is enough and that can be attained.

"Fair and feasible", however, enters as a phrase in another connection. There may be several feasible plans in the sense that in several plans there may be a reasonable chance of success. What the combination of fair and feasible implies, consequently, is that of the various feasible plans, the most equitable is to be selected. In the light of the cases, "most equitable" is the one that follows the methods indicated in the *Flershem* and *Coriell* cases in establishing the court's opinion and gives nothing to any stockholder, preferred or common, until creditors have been completely satisfied. Since it is generally impossible that the creditors can be paid at once, the fairest among several feasible methods is one that gives the creditors the largest amount of disposable assets, and offers the greatest likelihood that the creditors will be soonest paid out of prospective assets.

One of the commonest features of a plan is to turn the bondholders into preferred stockholders, and the preferred stockholders into common stockholders. That means, of course, that a bond issue of the new company will jeopardize whatever security the old bondholders hope to find in the prospective earnings of the new company. If the management is continued—as it usually is—the new preferred stockholders will have nothing to say about the need or the advisability of a new bond. Would the fairness of a plan be rendered more likely if they were given some control of such matters? They cannot be given control of the general management—usually for physical reasons—and therefore they cannot prevent obligations from being created against the company. But there is no reason why by a prescribed majority the preferred stockholders may not be placed in a position to demand that justification for new bond issues be shown. Or it may be that a ceiling might be set for new bond issues as is done in the Public Utilities Holding Company Act of 1935.⁷³ At any rate, since the real security for the old bondholders whose paramount interest is so often and so authoritatively emphasized, is the prospective earnings of the new company, it seems strange that plans in which these bondholders retain mere "equity" interests do not more often safeguard this prospective security.

⁷³ 49 STAT. (1935) 838, 15 U.S.C. SUPP. V (1939) § 79. Cf. also the provisions of Investment Advisers Act of 1940, 76th Cong. 3d Sess. (Aug. 22, 1940) No. 768, c. 686, 15 U.S.C.A. APP. (1940) § 80a.

And finally we have the question of the public interest. The statute makes most frequent reference to it in connection with railway reorganizations.⁷⁴ The exact words "public interest" occur only there, with one exception.⁷⁵ But in section 77—the section dealing with railway reorganizations—"public interest" is equated with "public policy" and "public policy" is used not only in relation to public utility corporations,⁷⁶ but quite generally as an element of all corporate reorganizations.⁷⁷ Besides, there is a very general reference to the public interest in all discharges in bankruptcy.

It can scarcely be doubted that the bankruptcy legislation assumes that besides the persons who are actually concerned, the creditors and the debtor, the public is concerned in a fair adjustment of the mutual claims of these persons. This is obvious and is expressly and repeatedly stated in regard to railway and public utility companies. It is made quite general as a requirement of a proper plan of reorganization and is symbolized with special force by the position accorded to the Securities and Exchange Commission in chapter X.⁷⁸

What is the public's interest in the matter? The presence of the United States Attorney at discharges might be due simply to the desire of preventing crimes from going unpunished. But in the case of ordinary corporate reorganizations, what is it that involves the public outside of those general considerations under which it might be said that it is a matter of public policy that all cases be decided justly and fairly?

The point seems to be that in corporate reorganizations, the new company will in all probability make a public offering of its securities. The requirements of the Securities and Exchange law for registration, while loudly denounced as excessively stringent, do not in fact warrant the quality of the securities at all. The protection afforded investors by the various corporation Blue Sky laws varies enormously from state to state. It is eminently proper for the court and for the Securities and Exchange Commission to decline to confirm a plan feasible enough—perhaps too feasible—and fair enough so far as relative priorities are concerned, but one which will place upon the market speculative securities at a time when the public is altogether too ready to invest in them. There have been no cases in

⁷⁴ §§ 77c(6), c(13), d, o.

⁷⁵ § 14d.

⁷⁶ § 178.

⁷⁷ § 221(5).

⁷⁸ § 172, and other sections of chapter X.

which the public interest has been made a reason for refusing a plan otherwise shown to be fair and feasible, but the occasion might well arise.

But evidently the presence of the Securities and Exchange Commission makes it clear that no reorganization deserves confirmation unless the new corporation or the new phase of the old corporation is immune to the kind of objection which the Securities and Exchange Commission may make to corporations that offer securities for public sale. This is the case even when no public sale is immediately contemplated, since corporate organization on the scale generally involved here, is almost certain to necessitate sooner or later a contact with the investing public.

At all events, the specific addition of public policy to fairness and feasibility—while practical illustrations are as yet conjectural—must be taken as a serious and deliberate innovation of this much-innovating legislation.

I think we should have to admit that even if the *Boyd* case turns out to be as completely fixed as Justice Douglas says it is, our leading cases give us only an imperfect guide even to fairness and feasibility. After all, the protection of the bondholders which the *Boyd* case emphasizes depends on the evaluation of data which is not easy to get nor easy to estimate. It comes to this. Will the reorganized corporation be successful? If it will not, it will not be able to pay its former creditors, even if they are given a better chance to get at the profits of the company than the old stockholders. If there is no prospect of success, it might be as well to liquidate—not necessarily at once, of course—as to attempt to reorganize.

But it is possible that a new and larger view is implicit in the Chandler Act, so far as reorganization is concerned. It is based on the notion that every going concern is an economic asset, a source of prospective profit to investors, of prospective incomes to managers, of prospective wages to labor. Besides that, other economic opportunities are created in large corporations by the existence of continued profits, incomes, wages and the maintenance of the community life implied in a background in which so many persons function.

It might well be that a reorganization which offers a chance for successful operation of a large corporation for a considerable time is thereby feasible even if no evidence is forthcoming that the corporation will run long enough to pay off to all the bondholders their entire principal and accrued interest. It will at any rate—even for the bond-

holders—often be better than liquidation. If this result cannot be effected except by giving existing management a share—a lesser and subordinate share—even before all bond creditors are completely satisfied, considerations of fairness do not seem to negate such an arrangement.

Far be it from me, however, to blaspheme against the *Boyd* case. As an effective, if somewhat crude, guide, it is doubtless safer than over-subtilization about the value of continuity of management and the importance of financial standing. Perhaps, if newer safeguards are devised, the *Boyd* case may turn out to be no less fixed, but somewhat less absolute.⁷⁹

⁷⁹ For a full discussion of the changes made in the law of reorganization by the Chandler Act as well as on earlier phases of the problem see Foster, *Conflicting Ideals for Reorganization* (1935) 44 YALE L. J. 923; Gerdes, *A Fair and Equitable Plan of Corporate Reorganization under Section 77B of the Bankruptcy Act* (1934) 12 N.Y.U.L.Q. REV. 1; *General Principles of Plans of Corporate Reorganization* (1940) 89 U. OF PA. L. REV. 39; Gerdes, *op. cit. supra* note 19; Graham, *Fair Reorganization Plans under Chapter X of the Chandler Act* (1938) 8 BROOKLYN L. REV. 137; Heuston, *Corporate Reorganization under the Chandler Act* (1938) 38 COL. L. REV. 1199; Levi, *Corporate Reorganization and a Ministry of Justice* (1938) 23 MINN. L. REV. 3; Levi and Moore, *Bankruptcy and Reorganization: A Survey of Changes* (1937-1938) 5 U. OF CHI. L. REV. 1, 219, 398; McCaffery, *Corporate Reorganization under the Chandler Bankruptcy Act* (1938) 26 CALIF. L. REV. 643; Payne, *Fair and Equitable Plans of Corporate Reorganization* (1933) 20 VA. L. REV. 37; Rosenberg, *Reorganization Yesterday, Today and Tomorrow* (1938) 25 *ibid.* at 129; Swaine, "Democratization" of *Corporate Reorganization* (1938) 38 COL. L. REV. 256; Swanson, *Stockholders' Participation in Reorganization* (1939) 28 GEO. L. J. 336. Dean, Arthur H., *A Review of the Law of Corporate Reorganization* (Privately printed, New York, 1941). Since Justice Douglas has had much to do with the framing and the interpretation of the Act, it might be valuable to note several of his recent brief papers: *Improvements in Federal Procedure for Corporate Organizations* (1938) 24 A.B.A.J. 875; *The Lawyer and Reorganizations* (1937) 1 NAT. LAW GUILD Q. 31. Cf. also Weiner, *The Securities and Exchange Commission and Corporate Reorganization* (1938) 38 COL. L. REV. 280; and (1939) 39 COL. L. REV. 1030. Since 1934 the subject of corporate reorganization has a special periodical devoted to it, which is an expansion of the American Bankruptcy Review. Some valuable older material can still be gleaned from DOUGLAS and SHANKS, *CASES AND MATERIALS ON THE LAW OF CORPORATE REORGANIZATION* (1931).