# A DEBTOR'S CHOICE OF A "CHAPTER" REHABILITATION PROCEEDING UNDER THE "BANKRUPTCY ACT"

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If one were to choose a year since 1938 (when the Bankruptcy Act of 1898[1] took its present form) in which to take an over-all view of the debtor-creditor system of this country, particularly as it affects the lawyer whose practice involves advising business debtors or creditors, one could not find a year more appropriate than the present. Bankruptcy statistics for the fiscal year ending July 31, 1975,[2] show that an all time record of 254,484[3] bankruptcy proceedings were initiated in that year. This figure, at least when compared with some 10,196 proceedings for 1946,[4] tells us that in recent years creditor-debtor relations have not always worked out as both parties had hoped.[5] And during the present year the respective Committees of the Senate and the House have been holding hearings on the first complete rewrite of the Bankruptcy Act.[6] It is probable that a bill

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1. Bankruptcy Act of 1898; 11 U.S.C. §§1 *et seq.* (1966) [hereinafter cited as Bankruptcy Act]. The Act has been frequently amended; major amendments were made in 1938 when the present chapters were added. *See* Act of June 22, 1938, Pub. L. No. 696, §§1 *et seq.*, 52 State. 840-940.

2. The Administrative Office of the United States Courts for years has published its Tables of Bankruptcy Statistics; these are not always fully comparable as to classifications, tables or information covered, particularly for years since 1970. Data for years prior to 1970 are generally more complete. References will be made throughout this article to Bankruptcy Statistics for particular years.

3. 1975 Bankruptcy Statistics.

4. *Id.* at tabulations; n. 69 *infra.*

5. 1975 Bankruptcy Statistics.

6. H.R. 31, 94th Cong., 1st Sess. (1975); H.R. 32, 94th Cong., 1st Sess. (1975). H.R. 31 is the product of the Commission on the Bankruptcy Laws of the United States, appointed pursuant to Pub. L. No. 91-354 (1970), *as amended*, Pub. L. No. 93-56 (1973). The report is published in three parts, Part I being the report itself and Part II being the proposed Bankruptcy Act of 1973 (basically identical to H.R. 31). H.R. 31 is the so-called Judges Bill, prepared by the National Conference of Bankruptcy Judges. Many sections are identical, with the major differences being in the treatment of sitting bankruptcy judges and in the Commission bill's merger of present Chapters X, XI, and XII into a proposed Chapter VII. Part III of the Report contains various studies.

will be reported out of those committees by the time this article appears in print.

The economic slow-down of the mid-'70's increased the importance of bankruptcy law, and particularly the importance of those chapters of the Bankruptcy Act which govern rehabilitation of business entities, but the need for a rethinking of the bankruptcy law was evident before the beginning of that economic downturn.[7] While it seems likely that a new Bankruptcy Act may become law in the near future, the rethinking represented by the new bills will have an effect on our thinking about debtor-creditor law even if one of them does not soon become the law of the land. And since we usually better understand the new if we understand its precursors, this article is being written in such a manner that it should be useful whether the present bankruptcy system remains in effect or whether Congress comes up with a new law.

There are two good multi-volume treatises which cover all aspects of Bankruptcy—Collier,[8] in thirteen volumes, and Remington,[9] in eleven volumes. There are also some excellent shorter texts or handbooks on bankruptcy.[10] Unfortunately the former are so thorough and so detailed that their maximum use is by the small group of lawyers engaged in actual bankruptcy, in reorganization proceedings, or in the wider area of debtor-creditor practices generally which demand a detailed knowledge of at least some areas not only of bankruptcy law but also of bankruptcy lore. Collier and Remington will hold their own with multi-volume texts in other fields, but like all multi-volume treatises, they leave room for works more useable to the non-specialist. The shorter texts do this fairly well for old fashioned bankruptcy—the process by which a debtor surrenders to a representative of his unsecured creditors all of his assets

7. Pub. L. No. 91-354 (1970) *as amended*, Pub. L. No. 93-56 (1973), long antedated the 1974-75 downturn.

8. COLLIER ON BANKRUPTCY (14th ed. J. Moore 1973).

9. H. REMINGTON, BANKRUPTCY LAW (15th ed. 1950).

10. *See, e.g.*, J. MACLACHLAN, LAW OF BANKRUPTCY (1956), a bankruptcy hornbook written by the late Professor MacLachlan, who contributed much to the drafting of the Chander Act. Although somewhat out-dated, this book is still good. *See also* FORMAN, COMPOSITION, BANKRUPTCY AND ARRANGEMENTS (5th ed. 1971); A. HERZOG, BANKRUPTCY FORMS AND PRACTICE (5th ed. 1974); G. HIRSCH, BANKRUPTCY (1966); S. KRAUSE, ARRANGEMENTS UNDER CHAPTER XI (1966).

other than assets which the law of his state allows him to keep as his exemptions;[11] and in return he obtains a discharge[12] of all or most of his debts. Unfortunately, these shorter texts largely neglect the area of insolvency practice which has the greatest impact on business thinking today—the various types of rehabilitation of a business entity.[13] There may be a need for a non-technical primer on the choice of a non-liquidation remedy for a business entity which is unable to pay its debts as they mature. That is the purpose of this brief article.

It may seem strange that this paper will concentrate primarily on the insolvency or other financial problems as seen from the viewpoint of one who advises creditors and those debtors who are engaged in business. The Bankruptcy Statistics[14] might indicate that the problem area is primarily the insolvency problems of the individual—the consumer. Out of the 254,484 persons involved in bankruptcy proceedings in fiscal year 1975, 224,354 involved non-business entities, including 184,178 employees.[15] To the individuals involved, individual bankruptcies present pressing social and economic problems. Of grave importance to the debtor and the debtor's attorney is achieving the primary objective of discharging the debtor from his debts. The creditor's recovery through a bankruptcy distribution is likely to be much less important than a bad debt write-off tax deduction. Prior to 1970, Bankruptcy Statistics furnished breakdowns, not published for recent years, on bankruptcy distributions to various classes of creditors. However, there is little reason to believe that post-1970 distributions would differ drastically from those for which breakdowns are available. Out of 190,742 bankruptcy cases terminated in 1969, in only 22,355 cases were there any assets to distribute to general creditors.[16] Total distributions to all creditors paid through the bankruptcy system were $113,136,826, of which only $30,810,542 went to unsecured creditors. These creditors

11. *See, e.g.*, J. MACLACHLAN, *supra* note 10, at 436.

12. *Id.*

13. For example, J. MACLACHLAN, *supra* note 10, at 436, gives only a sketchy treatment of rehabilitation proceedings.

14. *See* note 2 *supra.*

15. 1975 Bankruptcy Statistics.

16. 1969 Bankruptcy Statistics at Table F-5. Comparable figures are not available for later years.

held $397,152,793 in claims;[17] thus they received only 7.8% of their unsecured claims.

While no asset or nominal asset cases are more likely to involve non-business entities, these figures no doubt included some business bankruptcy as to which the distributions may have exceeded the average. But liquidation bankruptcy is attractive only to a business entity which is economically dead or dying. Reports from lawyers in various parts of the country who are insolvency and financial work-out specialists indicate that since the general adoption of the Uniform Commercial Code,[18] assets available to unsecured creditors are even less than they were in the pre-UCC days. It is not surprising therefore that these same lawyers report that at the present time very few business entities become involved in a straight liquidation bankruptcy proceeding at least without an attempt at a non-liquidation proceeding (usually under Chapter XI). To a creditor, a prospect of a minimal dividend typical in a liquidation bankruptcy is not attractive. To a business debtor a proceeding which will leave him with no assets is scarcely attractive, even if it leaves the business entity with no debt.

To the business lawyer whose client has a severe debtor-creditor problem, there must be a search for a solution less undesirable than a liquidation bankruptcy. There are remedies not dependent on any statute, such as a composition with creditors;[19] there are others dependent on state common laws or statutory law, such as an assignment for the benefit of creditors.[20] But in most cases before any statutory or creditor-debtor proceeding is considered the parties will attempt a negotiated readjustment of debt. An unpaid supplier will find it the better part of wisdom to defer payments on goods he does

17. *Id.* at Table F-6. Anyone who in 1974, 1975 or 1976 read the Wall Street Journal or the New York Times or any other paper with adequate financial pages will recall a number of recent Chapter X and XI cases in any one of which the debt to be adjusted exceeded these respective annual aggregate figures.

18. UNIFORM COMMERCIAL CODE (1972 version). *See, e.g.* testimony of former Bankruptcy Judge Dan Cowans, *Hearings on H.R. 31 and H.R. 32 Bankruptcy Act Revision*, Serial No. 27, Part 1, 94th Cong., 1st Sess. 308 et seq.

19. J. MACLACHLAN, *supra* note 10, at 371-421; 8 COLLIER ON BANKRUPTCY, *supra* note 8, ¶ 522, at 606.

20. 1 COLLIER ON BANKRUPTCY, *supra* note 8, at ¶ 3.401 *et seq.*; G. GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES §§208-09, 310(a), 391 (rev. ed. 1940).

not want to take back; a bank will, however unenthusiastically, decide to renew a loan about to become due, or already overdue. Particularly where the number of unpaid creditors is small, private negotiation is almost always the starting point, and often the only remedy necessary.

The common desire of debtor and creditor to avoid the loss of going concern value—the difference between the value of goods in use and goods on the auction block—will force an agreement which is not too unsatisfactory to either party. But where the number of creditors is large, resort to some legal mechanism may be necessary to bind a non-assenting minority of a class the majority of which is inclined to "go along" on some "work-out" solution. A common law or statutory assignment for benefit of creditors may require all creditors to accept something less than their full claims, but, like liquidation bankruptcy it will strip the debtor of his assets, and usually realize only liquidation values for creditors. A more promising solution would be a mutual agreement among creditors[21] to take less than their contracts entitled them to get. If less than all agree, the assenting creditors may permit a small minority to obtain a free ride in that the non-assenter retains his full claim while the assenters make some sacrifice. But if the class of non-assenters is more than minimal, the existence of non-assenters may present economic or psychological[22] hurdles which cannot be overcome.

It might also happen that the plan acceptable to the assenters could be carried out more advantageously under a "chapter" proceeding—*e.g.*, an issue of securities which could not be offered outside of a chapter proceeding without a costly registration under the Securities Act of 1933[23] would fall under an exemption if part of a Chapter XI arrangement or a Chapter X or XII plan.[24] Even if it seems probable that the necessary consents to a modification of the debtor's debt structure can eventually be obtained, it may well be that attaching creditors will wreck the company before that agree-

21. *See* note 19 *supra*.

22. Creditors *A*, *B*, and *C* may be willing to extend or reduce the debtor's obligations to them, provided that the obligations to other creditors are likewise extended or reduced, but be unwilling to do so if some creditors' claims are left intact.

23. Securities Act of 1933, 15 U.S.C. §§77(a) *et seq.* (1971).

24. *See* Bankruptcy Act §§264, 393, 518, 11 U.S.C. §§664, 793, 918 (1966).

ment can be reached. In that case, it may be necessary to resort to a chapter proceeding to buy time; in any chapter proceeding the mere filing of the petition will stop most creditor proceedings and give the debtor at least temporary immunity from dismemberment.[25]

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25. Bankruptcy Rule 11-44 reads:

*(a) Stay of Actions and Lien Enforcement.* A petition filed under Rule 11-6 or 11-7 shall operate as a stay of the commencement or the continuation of any court or other proceeding against the debtor, or the enforcement of any judgment against him, or of any act or the commencement or continuation of any court proceeding to enforce any lien against his property, or of any court proceeding, except a case pending under Chapter X of the Act, for the purpose of the rehabilitation of the debtor or the liquidation of his estate.

*(b) Duration of Stay.* Except as it may be deemed annulled under subdivision (c) of this rule or may be terminated, annulled, modified, or conditioned by the bankruptcy court under subdivision (d), (e), or (f) of this rule, the stay shall continue until the case is closed, dismissed, or converted to bankruptcy or the property subject to the lien is, with the approval of the court, abandoned or transferred.

*(c) Annulment of Stay.* At the expiration of 30 days after the first date set for the first meeting of creditors, a stay provided by this rule other than a stay against lien enforcement shall be deemed annulled as against any creditor whose claim has not been listed in the schedules and who has not filed his claim by that time.

*(d) Relief from Stay.* Upon the filing of a complaint seeking relief from a stay provided by this rule, the bankruptcy court shall, subject to the provisions of subdivision (e) of this rule, set the trial for the earliest possible date, and it shall take precedence over all matters except older matters of the same character. The court may, for cause shown, terminate, annul, modify or condition such stay. A party seeking continuation of a stay against lien enforcement shall show that he is entitled thereto.

*(e) Ex Parte Relief From Stay.* Upon the filing of a complaint seeking relief from a stay against any act or proceeding to enforce a lien or any proceeding commenced for the purpose of rehabilitation of the debtor or the liquidation of his estate, relief may be granted without written or oral notice to the adverse party if (1) it clearly appears from specific facts shown by affidavit or by a verified complaint that immediate and irreparable injury, loss, or damage will result to the plaintiff before the adverse party or his attorney can be heard in opposition, and (2) the plaintiff's attorney certifies to the court in writing the efforts, if any, which have been made to give the notice and the reasons supporting his claim that notice should not be required. The party obtaining relief under this subdivision shall give written or oral notice thereof as soon as possible to the trustee, receiver, or debtor in possession and to the debtor and in any event, shall forthwith mail to such person or persons a copy of the order granting relief. On 2 days' notice to the party who obtained relief from a stay provided by this rule without notice or on such shorter notice to that party as the court may prescribe, the adverse party may appear and move its

There are at least three forms of rehabilitation under the Bankruptcy Act which probably would be unavailable to a typical business debtor: A railroad reorganization under section 77,[26] a Composition of Certain Taxing Agencies or Instrumentalities under Chapter IX,[27] or a wage earner plan under Chapter XIII.[28] There are also three other chapter proceedings, X, XI and XII, one or more of which might be available to the typical business debtor.

Today the choice available to debtor or creditor is based largely on what now appears to be historical accident whether or not the original distinctions between the various chapters once made sense.[29] By posing a hypothetical case, and thereafter altering the facts, the choices available to one or more of the parties may be less difficult to understand.

### HYPOTHETICAL A

*D* is a partnership with one general partner and seventy limited partners. After the partnership funds had been substantially invested in other projects, the general partner negotiated for a lease by the partnership of a large fleet of trucks to Chain Store which was reputed to have unquestioned credit. The trucks were purchased by *D* on Chain Store's specifications. An appreciable part of the cost represented features particularly usable by a chain store. Bank *B* financed nearly the entire cost of the trucks on the strength of an assignment by *D* of its rights to obtain the lease payments from Chain Store, with a security interest in the trucks themselves as a back-up.[30] The chain, after having been weakened by competi-

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reinstatement, and in that event the court shall proceed to hear and determine such motion as expeditiously as the ends of justice require.

*(f) Availability of Other Relief.* Nothing in this rule precludes the issuance of, or relief from, any stay, restraining order, or injunction when otherwise authorized.

*See also* Bankruptcy Rule 10-601.

26. Bankruptcy Act §77, 11 U.S.C. §205 (1966).

27. *Id.* §§81-84, 11 U.S.C. §§401-04 (1966).

28. *Id.* §§601-86, 11 U.S.C. §§1001-86 (1966).

29. For a perceptive view of these different chapters see Rostow & Cutler, *Competing Systems of Corporate Reorganization: Chapters X and XI of the Bankruptcy Act*, 48 YALE L.J. 1334 (1939).

30. UNIFORM COMMERCIAL CODE §1-201(37) (1972 version). *See generally* UNIFORM COMMERCIAL CODE §§9-101 *et seq.* (1972 version).

tion from close-outs of competitors, was forced to shut up shop by a consumer boycott.[31] For two months no rental payments were made by Chain Store, and *D* had no funds to pay to the Bank an amount equal to the rent not being paid to it by Chain Store. Further, *D* had no credit which would enable him to borrow the funds needed to pay Bank *B*. Approximately $350,000 had been repaid through application of Chain Store's rentals, leaving over $3,000,000 unpaid. Chain Store went into default on its lease and *D* on its loan agreement. The Bank decided that it could not rely on Chain Store's survival, and the partnership credit, apart from that of Chain Store, was low. The $3,000,000 balance was declared due and payable. The bank then took possession of the trucks and served notice that the fleet would be put up at public auction ten days hence.[32] *D*'s general partner is convinced that a sale at public auction would leave the partnership with a deficiency[33] on the loan which would wipe out the partners' equity. He is interested primarily in postponing the sale of the trucks; he has at this time given no thought to a long-term rearrangement of *D*'s debt structure. Since *D*'s business is leasing equipment on a net lease basis, it has almost no unsecured debt. *D* has no real property and therefore can have no debt secured by real property.

1. *Can D hold off the secured party (Bank) from selling its trucks in the near future?*

A seasoned insolvency lawyer would probably advise *D* to start with an attempt to persuade the bank officer that a sale of a sizeable fleet of trucks at public auction would likely be disastrous to both *D* and the bank—that at worst, a sale, truck by truck, by the debtor, from time to time, would be likely to produce more than a public sale forced by the bank. Here *D* has the advantage and the disadvantage that he has a single secured party to deal with. The advantage is that if he can convince one bank officer that Chain Store can make it, or that *D* can find another chain store to take over the lease, he need go no further. He has the disadvantage that he cannot

31. *See* Kimball Foods v. Republic National Bank of Dallas, 401 F. Supp. 316 (N.D. Tex. 1975).

32. UNIFORM COMMERCIAL CODE §§9-503, 9-504 (1972 version).

33. *See* UNIFORM COMMERCIAL CODE §§9-501 to 507 (1972 version).

pursue a policy of divide and conquer. Were there say, three creditors, he might convince one of them, who would then use his influence on his peers in *D*'s behalf.

In a more typical situation, *D* could threaten to destroy itself, and with itself its creditors, by a resort to a liquidation bankruptcy, by holding up, perhaps indefinitely, the bank's right to sell the collateral.[34] Even though the secured party can enforce his security ultimately, delay alone can be costly. *D*'s situation is atypical, not only having only one creditor, but also in being in a poor position to use on the bank the threat that the partnership could destroy the creditor, along with itself, by filing a voluntary petition in bankruptcy, because here the bank has already gained possession of the trucks prior to threatened bankruptcy; having taken the collateral out of *D*'s possession, it has deprived a possible bankruptcy trustee of the power to enjoin the bank from selling.[35] If the bank had not previously taken possession of the trucks, a threat by *D* to file a petition in old fashioned "straight" bankruptcy might cause the bank to start talking some kind of settlement.

### 2. *Should D consider filing a petition for liquidation?*

The bank, or any secured party in possession of collateral, could conduct its sale outside of bankruptcy and prove a claim in its deficiency.[36] We must assume that unless the bank officer acted rashly, he has come to the conclusion that a sale at this time will produce less of a loss than some other alternative. For the reasons given in the discussion above as to why a threat by the debtor to file in liquidation bankruptcy is likely to be unconvincing in an effort at persuading the bank to withhold action, an actual filing

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34. Under Bankruptcy Rule 601,

"(a) The filing of a petition shall operate as a stay of any act . . . to enforce (1) a lien against property in the custody of the bankruptcy court. . . ."

That last phrase means in the possession of the debtor; here the trucks had been taken out of the debtor's possession by Bank B. True, had Rule 601 been applicable the creditor would have been entitled to relief from that stay, but obtaining relief may require time, during which the value of the trucks can deteriorate to the Bank's injury. In liquidation bankruptcy, rights may depend on who has possession of the collateral.

35. *Id.*

36. Bankruptcy Act, §57(h), 11 U.S.C. §93(h)(1966).

would be unattractive. If, however, *D* is in a position to file a chapter proceeding, the bargaining position may be different.

### 3. *Can D file under Chapter X?*

Unlike Chapter XI, Chapter X is available exclusively to corporations.[37] If we assume that the partnership could not fit the special definition of "Corporation" in Bankruptcy Act section 1(8),[38] we must exclude Chapter X as a possibility. (To make comparisons between Chapters X and XI more fruitful, we will later change our hypothetical.)

### 4. *Can D take advantage of Chapter XI?*

As stated above and more fully stated below, Chapter XI is not restricted as to the character of the debtor (except as some debtors are excluded from the provisions of the Bankruptcy Act generally).[39] However, *D*'s unusual absence of unsecured debt may effectively block it from filing for relief under Chapter XI. Under item 4 of a Chapter XI petition on Form 11-F1 or item 3 of Form F-2 the debtor is required to state that he or it is "entitled to the benefits of this chapter."[40] The primary purpose of Chapter XI is to enable a debtor to propose and obtain approval of an arrangement which must affect some or all of its unsecured debt.[41] We have made the somewhat abnormal assumption that *D*'s debt is all secured. While the stay provisions of Rule 11-44 are not limited to a case where a plan affecting at least some unsecured debt is likely to be confirmed, it

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37. In Chapter X, "debtor" under §106(5) means a corporation. In Chapter XI, "debtor" under §306(3) means "a person who could become a bankrupt under section 4. . . ."

38. Section (1) (8) of the Bankruptcy Act defines corporation as follows:

> "Corporation" shall include all bodies having any of the powers and privileges of private corporations not possessed by individuals or partnerships and shall include partnership associations organized under laws making the capital subscribed alone responsible for the debts of the association, joint-stock companies, unincorporated companies and associations, and any business conducted by a trustee or trustees wherein beneficial interest or ownership is evidenced by certificate or other written instrument.

39. Bankruptcy Act §4, 11 U.S.C. §22 (1966). For example, a bank, or an insurance company, could not be liquidated or reorganized under the Bankruptcy Act.

40. Bankruptcy Forms, 1975 Collier Pamphlet Edition, Bankruptcy Act and Rules, Part 1.

41. Bankruptcy Act §306(1), 11 U.S.C. §706 (1966).

would seem that no relief under Chapter XI should be available to a debtor who could not at least propose a plan which could be confirmed. Since here *D* could not propose a Chapter XI plan of arrangement, it would seem to follow that *D* should not be allowed to obtain relief preliminary to the confirmation of a plan of arrangement. If *D* could overcome the language in Form 11-F1 or F-2 in which it is required to assert that it is entitled to the benefits of the Chapter, it should lose out to a creditor who pressed for an indemnity bond under section 326.[42] It is seldom that one who is in need of filing under Chapter XI has the money or the credit to obtain an indemnity bond.

Suppose for sake of discussion that counsel for *D* has a hunch that the partnership was not always meticulous in complying with state or federal securities law and he fears if the limited partners face total loss of their investments, it is not unlikely that one or more will bring claim against the general partner and the partnership claiming fraud under section 10(b) of the Securities Exchange Act of 1934[43] and Rule 10b-5[44] promulgated thereunder. Would this contingent unsecured debt be enough to bring *D* within Chapter XI? Probably not; if *D* were to propose a plan which called only for an extension of unsecured debt, these claims might fit under the definitions of "creditors" under section 307(1) and "debt" under section 307(2).[45] For other Chapter XI purposes "debt" means any debt provable in bankruptcy under section 1(14).[46]

If *D* were to be allowed to file where it had only contingent debts of this character, obtaining the needed consents of a majority in number and amount of any class of contingent claims might be unusually difficult. It is not just any unsecured debt which may be altered or discharged in a Chapter XI arrangement, where more than an extension of the debt is called for. Debt, as defined in Bankruptcy Act, section 1(14) is a debt which is "provable" under section 63 of that Act. That debt, generally, is the kind of debt

42. Bankruptcy Act §326, 11 U.S.C. §726 (1966). *But see* the interesting decision of the district court: In The Matter of Frank J. Crimmins, 2 Bnkcy Ct. (Dec. 13 S.D.N.Y. 1975).

43. 15 U.S.C. §78(j)(b) (1971).

44. 17 C.F.R. §240.10(b)-5 (1975).

45. 11 U.S.C. §706(1) (1966).

46. 11 U.S.C. §1(14) (1966).

which is likely to arise in commercial transactions—particularly out of contracts. Under section 63 tort claims are generally provable only to the extent they arise out of litigation commenced before the filing of the bankruptcy petition.

On the somewhat unreal assumption that *D* has no unsecured debt, it is likely that *D* could not file in Chapter XI. If he were allowed to file thereunder, it would also be likely that a determined creditor could succeed in having the proceeding dismissed by way of demanding under section 326 an indemnity bond which *D* could not furnish. If *D* could properly file under Chapter XI, under Rule 11-44 the filing of the petition would give him at least a temporary stay of the Bank's enforcement of its truck collateral. Under Chapter XI, the Bankruptcy Court's jurisdiction would not be defeated by the debtor's lack of possession of the trucks. How long that stay would last is another matter. At a later point we will change the facts to illustrate what can and what cannot be done in a Chapter XI proceeding.

### 5. *Can D file under Chapter XII?*

In recent years we have been hearing about a third chapter under which some debtors have obtained relief from a creditor's enforcement proceeding: Chapter XII.[47] Can *D* file under Chapter XII? The short answer is that on the facts assumed *D* should not be allowed to file under Chapter XII, since *D* has no debt secured by real property. Whereas we have seen that an essential element of a Chapter XI plan is an alteration of some or all of *D*'s unsecured debt,[48] a "primary purpose" of a Chapter XII plan of arrangement must be a "modification of the rights of creditors . . . holding debts secured by real property . . . of the debtor."[49] Under Bankruptcy Form no. 12-F1, item 4, and under no. 12-F2, item 3, the debtor must state that he is entitled to the benefits of Chapter XII. On the reasoning given under the discussion of Chapter XI a debtor who is not eligible to receive permanent benefits of Chapter XII should not be allowed the benefit of its stay provisions.

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47. Bankruptcy Act §§401-526, 11 U.S.C. 801-926 (1966).

48. For a Chapter XI arrangement see Bankruptcy Act §306(1), 11 U.S.C. §706(1) (1966).

49. For a Chapter XII arrangement see Bankruptcy Act §406(1), 11 U.S.C. §806(1) (1966).

Hypothetical A was designed to show that not every debtor has a choice of chapters—in our somewhat unreal hypothetical, this *D* had no door to open for relief from the secured party's threatened foreclosure. *D* could not use Chapter X because this partnership is not a "corporation" within Bankruptcy Act Section 1(8); *D* could not resort to Chapter XI because it had no unsecured debt to alter in a plan of arrangement; and *D* could not resort to Chapter XII because it had no debt secured by real property.

A CHANGE IN THE FACTS OF OUR HYPOTHETICAL: HYPOTHETICAL B.

In order to have a debtor that might have a meaningful choice between chapters, let us change Hypothetical A. (i) We will assume that *D* is a corporation within the state's corporation statute (or at least a "corporation" within the meaning of Bankruptcy Act section 1(8)), and change the limited partners to stockholders. (Alternatively, we could likewise assume that it is the kind of a trust envisaged by clause (8) of Section 1.) *D* now becomes a potential candidate for a Chapter X proceeding—one initiated either by itself or by one or more of its creditors with the required qualifications. (ii) We will also assume that *D* operates some trucks of its own, and has some trade creditors, one of whom, a filling station operator, owns 45% of the unsecured debt. Further *D* has an issue of subordinated debentures which are publicly held by 301 holders. (iii) Assume that the bank debt is held, not by one bank, but by three banks, one of whom has substantial loans to Chain Store. (iv) The last change is that *D* is also threatened with foreclosure of an $800,000 mortgage on its garage, which secures payment to Savings Bank of the purchase price of the garage. Savings Bank has begun foreclosure action.

On these changed facts, how is *D*'s bargaining position changed with respect to its creditors? We will consider the out-of-court restructuring of debt and the various chapter proceedings in the order used in Hypothetical A.

1. *Out-of-court persuasion.*

*D*'s ability to bargain with his banks might be materially enhanced by the fact that one bank officer out of three has more information about Chain Store and probably an interest in keeping

*D*'s Chain Store lessee alive, and where it has already been buffeted around by other forces, he would hate to see its chances worsened by a loss of its trucks. *D* could at least count on that banker for a sympathetic ear. Perhaps because banker has more knowledge as to Chain Store, he may be able to convince his peers that Chain Store, the real strength of the credit behind the banks' loans to *D*, has a good chance not only of surviving but also of catching up on and maintaining its lease payments. Further, that banker may be able to say to his associate fellow-bankers something that *D* could not say with good grace—that if *D* made a mistake in taking on this lease, the decision of *D*'s bankers to supply *D* with almost the entire cost of the trucks would not look brilliant at the time the banks sold them at a substantial loss. If the positions were reversed—that the holders of 1/3 of the bank debt would give a sympathetic ear to *D*'s pleas, an out-of-court settlement might be very probable, in spite of an unhappy holder of 1/3 of the debt. If *D* could settle with his truck financing bankers, his chance of making his peace with Savings Bank on the $800,000 mortgage loan would be upped materially.

We can assume that one who acts as managing partner in a venture (whether called a partnership or a corporation) where his partners (shareholders) and financial institutions put up the lion's share of the capital is the type of business entrepeneur who will not be bashful in getting his principal unsecured creditors to apply whatever leverage they have on the unhappy banks. We have assumed that 45% of the unsecured debt is held by one gas station operator, who will be quite likely to balance his dislike for taking a loss on past debt against making a concession which will help to keep a big customer alive. Experienced credit officers are well aware of the shrinkage which is well nigh inevitable at forced sales, and often can be convinced that forbearance will avert or reduce their losses. Where, as here, the principal assets are security for the debts of others, the big unsecured creditor would anticipate little or nothing from a forced liquidation. But in this hypothetical we will assume that neither the truck financing banks nor the mortgage bank will postpone the threatened sales. In part 3 below in connection with possible use of Chapter X, we discuss further the reasons which should lead the interested parties to continue efforts for an out-of-court settlement, and the reasons which sometimes lead them to resort to a chapter proceeding.

2. *Resort by D to straight or liquidation bankruptcy.*

*D* is too late to get much help from a straight bankruptcy proceeding. Since the trucks are not in the possession of the debtor, and another court has taken jurisdiction in the mortgage foreclosure,[50] the Rule 601 stay order will do *D* little good in slowing down the sales. On our assumed facts, the corporate assets will be consumed by secured claims, and the corporation left with a deficiency. If *D* is a true corporation, discharge of corporate debt may not be essential; if the managing partner is liable for debt of the entity, the managing partner will still have a problem, but a discharge of his debt may require a personal proceeding.

3. CAN (AND SHOULD) D OR HIS CREDITORS FILE A CHAPTER X PETITION?

Chapter X on our Hypothetical B facts is clearly available to *D*, a corporation, and equally available to *D*'s creditors.[51]

(a) Should *D* file a Chapter X petition? A Chapter X proceeding could have great advantages to *D*. The mere filing of a Chapter X petition will act as a stay of pending as well as threatened lien enforcement proceedings; not only does the stay affect secured as well as unsecured creditors but unlike a Chapter XI arrangement, a Chapter X plan can alter rights of every type of claim, including secured creditors and stockholders.[52]

A review of some sample recent Chapter X cases might well convince *D* that filing a petition in Chapter X was the answer to his problem. Under Rule 10-601 the mere filing of his petition stays the hands of each of his creditors whether or not that creditor has taken possession of *D*'s collateral. Sometimes more important to the debtor, section 257 allows the trustee to reclaim possession of collateral no longer in his possession and to use that collateral in the business before a plan has been formulated, leaving the form of compensation to be decided later. The bankruptcy judge's power to protect *D* against creditor action seems abundantly clear from sec-

50. Isaac v. Hobbs Tie & Timber Co., 282 U.S. 734, 737 (1931) *cited in* note to Bankruptcy Rule 601.

51. Bankruptcy Act §126, 11 U.S.C. §526 (1966).

52. *See* Bankruptcy Act §§111, 113, 114, 115; *see also* Bankruptcy Rule 10-601.

tions 111 through 116. Further, this power is consistent with the scheme of Chapter X, which, unlike Chapter XI, allows a Chapter X plan to alter the rights of secured creditors with the consent of the holders of 2/3 of the class of debt involved. And Chapter X goes beyond changes with the consent of 2/3 of a class. Under section 216(7) the Chapter X plan may force a class of creditors (including a single creditor in a class by himself) to accept a modification not to the secured creditor's liking if the judge makes certain findings. Some cases may be of interest:

As far back as 1950, over strenuous opposition of the secured creditor, a court allowed a trustee in a Chapter X case to reclaim from Reconstruction Finance Company cash which had been paid over by the Debtor and was being held as cash collateral. That decision was affirmed by the Court of Appeals for the First Circuit in *Reconstruction Finance Co. v. Kaplan.*[53] Some lessors and conditional sellers of motor trucks were prevented from repossessing trucks supplied by them in *Yale Express System, Inc.*,[54] and *In re Bermec.*[55] In the latter case the court noted with approval that the trustee had offered to pay an amount equal to estimated depreciation on the trucks during the period before a plan was confirmed, but in the former, Yale Express was allowed to continue to use the trucks notwithstanding its inability to pay an amount equal to depreciation thereon. In *Wachovia Bank & Trust Co. v. Harris,*[56] a class of secured creditors made up of one bank found itself forced to finance a debtor for twenty years when it had expected to finance that debtor only during a relatively short construction period. The bank was not allowed to accelerate its loan when the debtor was unable to keep up its payments. These few cases illustrate the lengths to which a court may go in order to allow a corporate debtor in financial difficulties to rearrange its relationships with its creditors. But for a balanced view, one must also consider *In re Third Avenue.*[57] In this case the court insisted that the power to interfere with the secured party's rights was dependent, among other things, on the probability that a reorganization could be effected.

53. 185 F.2d 791 (1st Cir. 1950).
54. 384 F.2d 990 (2d Cir. 1967).
55. 445 F.2d 367 (2d Cir. 1971).
56. 455 F.2d 841 (4th Cir. 1972).
57. 198 F.2d 703 (2d Cir. 1952).

But Chapter X has disadvantages from *D*'s standpoint. When *D*'s chief executive learns that he will be displaced by a "disinterested" trustee[58] who will be advised by a "disinterested" lawyer,[59] he is likely to ask for another alternative. *D*'s counsel must inform its board of directors that, even if *D*'s creditors were willing to settle for less than the value of their claims in order to leave a pittance for the equity owners, the "fair and equitable" rule would not permit such action. And when the board is told that not it, but the trustee, will present a plan of reorganization,[60] and that plan, under Chapter X's "fair and equitable"[61] test will almost certainly end up on our assumed facts with no equity for the stockholder-partners, the members are likely to tell counsel that there are less unpleasant ways for equity holders to commit hari-kari.[62]

(b) Would any of *D*'s secured or unsecured creditors be likely to file a Chapter X petition against *D*? Since, with any sizeable corporation the directors cannot invoke the aid of this Chapter without thereby voting to have the management of the corporation turned over to an unknown disinterested trustee, it is not surprising that there are not many voluntary Chapter X petitions. But since Chapter X so zealously protects secured creditors and insists that their rights cannot be sacrificed to favor a junior class of debt or holders of the entity's equity, it might seem that secured creditors would frequently file to bring themselves under Chapter X's protection on our assumed facts.[63]

To a secured creditor, Chapter X seems to have apparent advantages which might prompt a resort by creditors to proceedings under this chapter. The old management will be replaced by a disinterested trustee, and that trustee presents the plan of reorganization. Equity owners and creditors down the line lose their power to exact concessions not due them because the fair and equitable rule

58. Bankruptcy Act §156, 11 U.S.C. §556 (1966). *See also* Bankruptcy Rule 10-202.

59. Bankruptcy Act §158, 11 U.S.C. §557 (1966). *See also* Bankruptcy Rule 10-202.

60. Bankruptcy Act §169, 11 U.S.C. §569 (1966).

61. Bankruptcy Act §221, 11 U.S.C. §621 (1966).

62. We assume that *D*'s management has no skeletons in the closet, and that the trustees' report under section 167 will show, at worst, bad judgment rather than managerial wrongdoing.

63. The small number of Chapter X filings is brought out in note 69, *infra*.

must result in full compensatory treatment to senior interests before junior interests can be recognized. But in this case, it is hard to see what advantage would be gained by a filing by any secured party unless that secured creditor had come to the conclusion that continuation of the business was both feasible, and essential, and that a Chapter X proceeding would be necessary to bring into line a non-consenting minority of some class whose rights would be materially and adversely affected by the plan. If the secured parties continue to believe that they were right in their decision that an immediate sale of their respective collateral would produce less of a loss than would a hoped for resumption of the lease payments, Chapter X has no attraction to them. If this is their belief, they would have opposed a debtor Chapter X filing as not having been filed "in good faith."[64] Further, even if they were now of a mind to take a chance on ultimately being made whole by continuance of the enterprise, experience of secured and unsecured creditors with Chapter X's deliberate, and therefore necessarily slow, process may cause them to look for an alternative method of keeping the enterprise alive.

The single mortgagee neither needs nor can use the forcing power of the majority of his class to bind a non-existent minority. Where, as here, the number of secured bank creditors is small, it is highly unlikely that the holders of 2/3 of the bank debt would need or use any forcing power against the holder of 1/3 of the bank debt. With time, they would almost surely reach a common ground on their own steam. (Had there been sixty banks, the reasoning might be different.) With the backing of the secured parties, it is very likely that an out-of-court composition could be reached with a limited number of trade creditors, particulary where as in this hypothetical forty-five percent of trade debt is held by one person.

This out-of-court process would probably take care of all classes—except the 301[65] holders of the subordinate debentures. This class presents a real problem, one which is often primarily mechanical in nature. Merely to reach 301 unrelated holders in

64. Under section 144, creditors may seek to have a Chapter X proceeding dismissed because, in substance, there is no showing that a plan is probable. 11 U.S.C. § 544 (1966).

65. The figure of 301 is suggested by the definition "Publicly Held Securities" in the proposed H.R. 31, §1-102(36) 94th Cong., 1st Sess. (1975). *See also* H.R. 31, §7-310 94th Cong., 1st Sess. (1975).

person, by phone, or by letter may turn out to be impossible. To get 301 persons to agree on one program may be even more difficult. Some debentures may be held by administrators of estates or trustees to whom doing nothing is the safest policy. Particularly if we assume that the debentures were issued pursuant to the Trust Indenture Act of 1939,[66] obtaining any agreement that binds the class is well nigh impossible. If the debentures represent an insignificant amount of debt, other creditors may agree that they will accept a plan which cuts down rights of the classes participating in the plans while the holders of one class of debt—the debentures—continue to hold their original claims, unadjusted to meet a common problem. If the amount is significant, but not overwhelmingly significant, other creditors, including those debenture holders who have been reached and have agreed to some change in their rights, will go along so long as the percentage of debentures of non-reachable or non-consenting debenture holders does not exceed, say, ten percent of the issue. Obtaining the consent of the holders of even ninety percent of the debentures may be impossible.

Obtaining that consent (or some other part of the restructuring plan) may involve an issue of securites which, outside a chapter proceeding, may involve a Registration under section 5 of the Securities Act of 1933,[67] or some state securities statute, which would be costly and difficult for a company in financial trouble. A reorganization under X or an arrangement under XI could provide an exemption under the applicable statute.[68]

For good reasons or bad, Chapter X has not met the test of the market place. In fiscal 1975, only 187 Chapter X petitions were filed, as compared to 3506 Chapter XI petitions.[69] Since we have assumed

66. Trust Indenture Act of 1939, 15 U.S.C. §§77(a)(a)(a) *et seq.* (1971).

67. Securities Act of 1933, 15 U.S.C. §§77(a) *et seq.* (1971).

68. Bankruptcy Act §264(A), 11 U.S.C. §664 (1966); Bankruptcy Act §393, 11 U.S.C. §793 (1966).

69. The exact figures for different types of bankruptcy filings for the years 1940-1975 are given in 1975 Bankruptcy Statistics. The number of total filings and filings for Chapter X's, XI's and XII's for selected years are as follows:

| Year | Total | X | XI | XII |
|---|---|---|---|---|
| 1940 | 52,577 | 320 | 990 | 149 |
| 1945 | 12,862 | 72 | 41 | 5 |

that the parties are not enthralled at the prospect of operating under Chapter X, we go on to explore Chapter XI.

4. *Is Chapter XI available under our Hypothetical B?*

Under Hypothetical A, because *D* had no unsecured debt, Chapter XI was unavailable. Does the existence of a substantial amount of unsecured debt entitle *D*, a chapter camel, to get its nose into the secured parties' Chapter XI tent where all of the parties, including *D*'s managing partner (or chief executive), have thought of *D*'s problem not in terms of an adjustment of *D*'s unsecured debt (which would be permitted in a Chapter XI plan) but rather in terms of holding off a sale of *D*'s garage by mortgagee Savings Bank and a sale of *D*'s trucks by the financing banks? The purpose of this line of thought is to prevent secured parties from realizing at this time whatever portion of their debt would be produced by sales of their respective bits of collateral in accordance with their contracts with *D*. It will be recalled that a Chapter XI arrangement can "affect" only unsecured creditors. Our question becomes can a chapter, the purpose of which is limited to rearrangement of unsecured debt, be used as a means of holding off secured creditors? The answer a decade ago would probably have been "no"; the answer today may be "yes," with qualifications.[70]

| | | | | |
|---|---|---|---|---|
| 1950 | 33,392 | 134 | 583 | 31 |
| 1955 | 59,404 | 73 | 547 | 19 |
| 1960 | 110,034 | 90 | 622 | 12 |
| 1965 | 180,323 | 88 | 1,022 | 49 |
| 1970 | 194,399 | 115 | 1,262 | 58 |
| 1975 | 254,484 | 189 | 3,506 | 280 |

The low for this period was 1946, when there were total filings of 10,196; 54 Chapter X's, 79 Chapter XI's, and 1 Chapter XIII. By way of comparison Chapter proceedings for wage earners under Chapter XIII varied from a low of 1,248 in 1945 to 41,178 in 1975. Fiscal 1975 was an all time high for total filings and for each chapter other than Chapter X, which reached its high of 320 in 1940, its low in 1956. One should, of course, take into consideration the total filings for the years involved.

70. Each chapter has a rough equivalent of Chapter X's section 144 "good faith" test. A creditor who believes that the filing has no purpose other than harassment of holders of secured debt would assert that a Chapter X was not filed in good faith "because there was no real probability of success"; in Chapter XI the procedure would be to demand that the debtor put up an indemnity bond under Section 326 and Rule 11-20(d). Few Chapter XI petitioners could furnish such a bond and failure to do so could result in adjudication. *Compare* §426 of Chapter XII §426 *and* R. 12-19(d). For a case in which the court went a

We have previously referred to the new Bankruptcy Rules. Those Rules with respect to Chapter XI proceedings were approved by the United States Supreme Court and became effective on July 1, 1974. One of those Rules is Rule 11-44, which reads, in part:

> (a) *Stay of Actions and Lien Enforcement.* A petition under Rule 11-6 or 11-7 shall operate as a stay of the commencement or continuation of any court or other proceeding against the debtor, or the enforcement of any judgment against him, or the commencement or continuation of any court proceeding to enforce any lien against his property, or of any court proceeding, except a case pending under Chapter X of the Act for the purpose of rehabilitation of the debtor or the liquidation of his estate.

True, subsection (d) sets out mechanics for relief from the stay. But if *D*'s primary objective in obtaining the stay was to prevent the sale of his trucks and his garage next week, a timely filing of a Chapter XI petition will most likely accomplish that objective. Whether and how long *D* stays in Chapter XI may be a different question, but *D*'s managing partner (or principal executive) may gamble on his ability to use the time bought by the filing in a way that makes relief by way of the stay a new lease on life. Nor can either secured party lightly assume that he will be allowed to sell his collateral in the near future.[71] *D* may be prepared to show that Chain Store is about to resume operations, or that *D* has another lessee just over the horizon. But neither can *D* be too cocky as to how long he can hold off the secured creditors. While the power of the bankruptcy judge over the debtor's assets appears to be the same in Chapter XI as it is in Chapter X, the bankruptcy judge may exercise his discretion over the secured party's collateral in a much

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long way in allowing an adjustment of secured debt over objections of the secured party, see Wachovia Bank & Trust Co. v. Harris, 455 F.2d 841 (4th Cir. 1972).

71. *Compare* the jurisdiction language of Chapter XI's sections 311-14 *with* comparable sections in Chapter X Sections 111-14, 116. For a fuller discussion of these points, *see generally* Coogan, Broude & Glatt, *Comments On Some Reorganization Provisions of Pending Bankruptcy Bills*, 30 BUS. LAW. 1149 (1975); Festerson, *Equitable Powers in Bankruptcy Rehabilitation: Protection of the Debtor and the Doomsday Principle*, 5 CREIGHTON L. REV. 221 (1972); Murphy, *Use of Collateral in Business Rehabilitations: A Suggested Redrafting of Section 2-703 of the Bankruptcy Reform Act*, 63 CAL. L. REV. 1483 (1975); Murphy, *Restraints and Reimbursement: The Secured Creditor in Reorganization and Arrangement Proceedings*, 30 BUS. LAW. 15 (1974).

more limited way under Chapter XI, under which the arrangement cannot "affect" secured creditors, than in Chapter X, where the plan can do just that. Some lawyers who typically represent debtors in Chapter XI proceedings say that they "can do a job" on secured creditors just as effectively under Chapter XI as they can in Chapter X. Mere power to delay enforcement rights may cause a secured creditor to change his tune.

A debtor's choice between Chapter X and Chapter XI is ordinarily easy. It is seldom that a board of directors will welcome Chapter X's displacement of management by an unknown trustee,[72] who, because he must be "disinterested,"[73] must be someone other than a member of management, and other than a stockholder or creditor. If the corporation is insolvent, equity holders must be wiped out, and junior creditors can be recognized only after all claimants senior to them have been compensated in full, in cash or in securities.[74] The disinterested trustee and his disinterested counsel[75] must take over the show, using or not using present management to the extent the trustee desires. While only a debtor can file a petition in Chapter XI,[76] a Chapter X petition can be filed by either the debtor or his creditors (assuming the prerequisites for creditor action)[77] and often creditors have the power to move a Chapter XI into Chapter X.[78] Why do not the reasons which make Chapter X unattractive to debtors make it attractive to creditors,

72. Bankruptcy Act §156, 11 U.S.C. §556 (1966).

73. *Id.* §158, 11 U.S.C. §558 (1966).

74. *Id.* §221, 11 U.S.C. §621 (1966).

75. *Id.* §§157, 158, 11 U.S.C. §§557, 558 (1966).

76. *Id.* §321, 11 U.S.C. §721 (1966).

77. *Id.* §126, 11 U.S.C. §526 (1966).

78. *Id.* §328, 11 U.S.C. §728 (1966). This article does not discuss the question of whether the Securities and Exchange Commission might move under Rule 11-15 to convert the case to a Chapter X proceeding on the theory that only a Chapter X proceeding is proper in a case which involves some publicly held securities. *See* Securities and Exchange Commission v. American Trailer Rentals Co., 379 U.S. 594 (1965) and the cases cited therein. *See also* The Report of the S.E.C. on Proposed Bankruptcy Legislation (H.R. 31 and H.R. 32) *submitted to* Subcommittee on Civil Rights and Constitutional Rights; House Comm. on the Judiciary, April 16, 1976. See especially the table on p.23 of the Report on the number of motions to transfer Chapter XI proceedings to Chapter X proceedings.

This paper likewise does not discuss the ability of the debtor or the debtor's trustee to reject "executory contracts, including leases" under Section 70b of the Bankruptcy Act and corresponding provisions of the different chapters.

and particularly to senior creditors? A reading of the financial pages of any metropolitan newspaper indicates that, except where the corporation is very large and suspected of being very corrupt, creditors seldom exercise their right to choose a Chapter X in the first instance,[79] or to move under section 328 for a shift from Chapter XI to a Chapter X.[80]

Part of the reason for this non-choice of Chapter X lies in the nature of the reorganization process. If a reorganization process, however theoretically desirable, takes too long, the debtor-patient may die on the operating table. Chapter X's process is almost certain to be time consuming in the shift from management to trustee. In business reorganization, creditors generally recognize that most corporations in financial difficulties got there through bad judgment or bad luck rather than bad morals. Creditors are likely to feel that deficiencies in management can more easily be met by informal persuasive efforts of creditors, or more formal authority of an official Chapter XI creditors' committee than by a new trustees' team.[81] True, a Chapter XI plan of arrangement can "affect" only unsecured creditors, while a Chapter X plan can restructure any kind of debt or stock interest. But the mere filing under a Chapter XI raises Rule 11-44's umbrella over the debtor and provides a time during which the debtor and its secured creditors can restructure their secured debt. Seasoned secured creditors are well aware of the power of the debtor (or of three junior creditors) to file a petition for liquidation bankruptcy, and thus reduce all claims, including secured creditors claims, to their liquidation value. True, the debtors' equity holders and junior creditors will be wiped out before secured creditors suffer their worst fate, but if junior interests are to be left with nothing either way, they may elect to bring the temple down over the entire crowd.

While it is true that a Chapter XI plan of arrangement may not "affect" shareholders, the pendency of a Chapter XI proceeding

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79. *See* note 69, *supra*.

80. A letter to the writer from the Administrative Office of United States Courts shows very few §328 removals from Chapter X to Chapter XI. *See In re* KDI, 477 F.2d 726, 477 F.2d 742 (6th Cir. 1973). This trend may be changing. See note 78, *supra*.

81. *See* Bankruptcy Act §§334, 335, 336, 338, 11 U.S.C. §§734, 735, 736, 738. (1966).

may drastically affect shareholders as well as secured creditors. To settle with his creditors, a debtor may offer them authorized but unissued stock in such quantities that the original stockholders are severely diluted. And it is not unusual for a recapitalization plan to be accomplished under the state's corporation law contemporaneously with the Chapter XI restructuring of unsecured debt.

Another reason for the popularity of Chapter XI over X is that the former places fewer restrictions on the respective parties' power to bargain. Ultimately, any plan of reorganization is the result of agreement (and resulting compromises) between the interested parties—between the various classes of creditors and between the creditors and equity owners. Chapter X imposes restrictions on the methods by which that agreement can be reached. The plan is formulated not by the parties but by the disinterested trustee,[82] and no solicitations for approval of a plan may be presented until after the judge approves the plan and the solicitation.[83] The plan cannot be confirmed unless the holders of 2/3 of the claims vote in favor thereof, and notwithstanding that approval cannot be confirmed unless the plan provides to each senior class of claimants the full equitable equivalent of its pre-reorganization rights before any junior class can be given anything.[84] Each of these processes takes time, and during that time the debtor may financially bleed to death.

Chapter XI gives the parties much more freedom to bargain between themselves. With no court approval, a debtor may obtain consents of the necessary parties even before it files a Chapter XI plan.[85] If a majority of the holders of unsecured debt give their consents thereto, the court will approve it if it is found to be in the "best interest of creditors, and feasible."[86]

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82. *Id.* §169, 11 U.S.C. §569 (1966).

83. *Id.* §§175, 176, 11 U.S.C. §§575, 576 (1966).

84. This is the well known requirement that every Chapter X plan must be "fair and equitable." Bankruptcy Act §221, 11 U.S.C. §621 (1966). For an interesting argument that rights of persons who are not secured creditors should also be considered, see Rosenberg, *Beyond Yale Express: Corporate Reorganization and the Secured Creditor's Rights of Reclamation*, 123 U. PA. L. REV. 509 (1975). This provocative article is aimed at a different but not totally unrelated problem.

85. *See* Bankruptcy Rule 11-37 which supersedes Bankruptcy Act §§361-362. *See also* Coogan, Broude & Glatt, *supra* note 71.

86. Bankruptcy Act §362, 11 U.S.C. §762 (1966). See also § 366 and Rule 11-38(d).

### 5. *Can D make use of Chapter XII?*

The statistics in note 69 indicate that in some years in the past Chapter XII[87] has been little used.[88] While the number of Chapter XII's has increased in recent years, Chapter XII proceedings are still very small compared with the number of Chapter XI's.[89] As we have previously pointed out under Hypothetical A, a requirement for a Chapter XII plan is that it alter some debt secured by real estate. A recent case in Boston illustrates the use of Chapter XII to hold up action of a real estate mortgagee who desires to foreclose his mortgage. *In re Colonial Realty Investment Co.*[90] involved a partnership with three general partners and over 7,000 limited partners with investments of over $30,000,000. The partnership owned seventy to eighty apartment complexes. After the bank had taken possession of one of the properties, the partnership filed in Chapter XII. The district court enjoined continuation of the foreclosure action—an action which could not be enjoined under a liquidation bankruptcy.[91]

On our factual assumptions in Hypothetical A, Chapter XII might well be considered—except for the fact that on those assumptions *D* had no debt secured by real property. In Hypothetical B, however, Savings Bank's having started foreclosure on *D*'s garage might suggest Chapter XII. Under Hypothetical B, *D*'s true corporate status disqualifies him for aid under Chapter XII, which is limited to non-corporate entities. We need only remark that in some ways a Chapter XII is like a Chapter X, and in some ways more like a Chapter XI, but we need go no further. (We pass up the intriguing possibility that an entity might be a "corporation" within section 1(8) but a non-corporate entity under Chapter XII.)

### 6. *Reorganization of a Business Entity Under Proposed New Bankruptcy Act*

Congress now has before it two versions of a complete rewrite

87. Bankruptcy Statistics, *supra* note 69.

88. *Id.*

89. *Id.*

90. 516 F.2d 154 (1st Cir. 1975).

91. Isaacs v. Hobbs Tie & Timber Co., 282 U.S. 734, 737 (1931). This case is cited in the note to Rule 601.

of the Bankruptcy Act.[92] A prominent feature of that bill is its combination into a new Chapter VII the proceedings now distributed between Chapters X, XI and XII. This writer has elsewhere described some of the features of that proposed new chapter. This article may be helpful in evaluating that earlier discussion.

92. H.R. 31, 32, *supra* note 6.