Cornell Law Review

Volume 19
Issue 1 *December 1933*

Article 3

Creditor Control of Corporations Operating Receiverships Corporate Reorganizations

Chester Rohrlich

Recommended Citation

Chester Rohrlich, *Creditor Control of Corporations Operating Receiverships Corporate Reorganizations*, 19 Cornell L. Rev. 35 (1933)
Available at: http://scholarship.law.cornell.edu/clr/vol19/iss1/3

CREDITOR CONTROL OF CORPORATIONS; OPERATING RECEIVERSHIPS; CORPORATE REORGANIZATIONS*

CHESTER ROHRLICH†

A corporation is, on a smaller scale (in some instances on a larger scale), like the political state, in that beneath the cloak of its unity there is a continuous, at times active but more frequently passive, struggle for power among the various groups in interest. Some of these groups, such as the public that deals with it or the employees who work for it, have as yet achieved only the the barest minimum of legal right to control its destinies.[1] In the arena of the law, the traditional conflict is between the stockholders[2] and the creditors. There is an increasing convergence of interest between these two groups as the former become more and more "investors" rather than entrepreneurs, and the latter less and less inclined, or able, to stand on the letter of their bond;[3] both are in the last analysis dependent

*This article is the substance of one of the chapters of the author's forthcoming book THE LAW AND PRACTICE OF CORPORATE CONTROL.

†Member of the New York bar.

[1]See Dodd, *For Whom are Corporate Managers Trustees?*, (1932) 45 HARV. L. REV. 1145; Berle, *For Whom Corporate Managers are Trustees*, 45 HARV. L. REV. 1365 (1932); O'LEARY, CORPORATE ENTERPRISE IN MODERN ECONOMIC LIFE (1933) Chap. V. In April 1933, New York Railways Corporation and Fifth Avenue Coach Company, in order to increase their "good-will" elected to their Boards "Public Directors". It has been suggested that the effect upon labor should be considered a factor in determining between immediate liquidation and continued operation by receivership, DOUGLAS AND WEIR, EQUITY RECEIVERSHIPS, (1930) 4 CONN. B. J. 1, 8–9. This is by analogy to the continued operation of utilities for the public's benefit. See Central Bank & Trust Co. v. Cleveland, 252 Fed. 530, 533 (C. C. A. 4th, 1918). But "a devotion to public use does not mean devotion to public consumption or destruction", Birmingham Trust & Sav. Co. v. Atlanta, B. &. A. Ry. Co., 271 Fed. 731, 738 (N. D. Ga. 1921). *Cf.* BANKRUPTCY ACT, 47 Stats. 1474, 11 U. S. C. A. §205 (o), (p), (q) (1933). In the final analysis the public at large does of course control through the instrumentality of the political state.

[2]These may also be divided into hostile groups. See the following articles by the writer: *Protective Committees*, (1932) 80 U. PA. L. REV. 670; *Suits in Equity by Minority Stockholders as a Means of Corporate Control*, (1933) 81 U. PA. L. REV. 692; *Corporate Voting: Majority Control*, (1933) 7 ST. JOHN'S LAW REV. 218.

[3]This has reference primarily to the holders of long-term evidences of indebtedness. See, BERLE AND MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932) 120, 278 *et seq.*; Isaacs, *Business Security and Legal Security* (1923) 37 HARV. L. REV. 201. *Cf.* Berl, *The Vanishing Distinction between Creditors and Stockholders* (1928) 76 U. PA. L. REV. 814, where any tendency to "permit investors to be treated as creditorsfor the purposes of security and as stockholders for purposes of profit" is decried.

upon the success of the corporation as a going concern.[4] Even in reorganization, when creditors are legally entitled to dominate,[5] this economic factor cannot be gainsaid.[6]

CREDITOR RIGHTS

In this section we shall examine the legal rights,[7] if any there be, of creditors[8] to control the management of the debtor corporation while it continues a solvent, going concern.[8a]

This limitation largely excludes from our purview the two subjects which have been the chief topics discussed in the law of corporate-creditors: the "trust fund" doctrine[9] and the right of creditors to enforce stockholders' liability.[10] The first is excluded because it properly becomes applicable only when a corporation is insolvent[11]

---

[4]The idea is not new. Almost forty years ago it was said (Greene, *The Commercial Basis for Railway Receiverships* (1894) 33 AMER. LAW REG. & REV. 417, 425); "Railway mortgages are not sacred because of the strong legal terms in which they are drawn, but are dependent upon success in the business of transportation. . . " [5]*Infra.*

[6]"The letter of the railroad mortgage bond has come to be nothing more than mere legal verbiage, but if the property covered by the mortgage has earned its charges, the mortgage is allowed to remain and the bondholders are not asked to make sacrifices. If, on the other hand, the property behind the mortgage has failed to earn its charges the bondholders are forced to accept a lessening, perhaps a total extinction of their rights to demand a fixed income. They may object, but they are powerless to resist, except by acquiring the actual property itself at foreclosure sale; and the failure of their property to earn its charges prior to the receivership gives little promise that its earnings would be better after the bondholders themselves have exercised the letter of their legal rights . . . " DEWING, THE FINANCIAL POLICY OF CORPORATIONS (1926) 996–997.

[7]A factual control is of course exercised by the need to keep available sources of new credit.

[8]Limited to the holders of unmatured obligations. The holders of past due obligations have well-defined legal rights. See GLENN, THE RIGHTS AND REMEDIES OF CREDITORS RESPECTING THEIR DEBTOR'S PROPERTY (1915). The exercise of these rights tends to force liquidation, a subject outside the scope of this article.

[8a]In seeking the "principles" we may be forced to use dicta in cases which arose after the corporation had become insolvent.

[9]We shall of course be unable to avoid the underlying notion of this doctrine to the effect that creditors have a prior claim to the assets.

[10]In so far as "fraudulent conveyances" are concerned the rules are essentially the same as for individuals, 8 THOMPSON, CORPS. (3rd ed. 1927) §6235.

[11]McDonald v Williams, 174 U. S. 397, 19 Sup Ct. 743 (1899); Sweet v Lang, 14 F. (2d) 762 (C. C. A. 8th, 1926); Fear v Bartlett, 81 Md. 435, 32 Atl. 322, (1895) 33 L. R. A. 721. In this connection insolvency means merely the inability to pay debts in the ordinary course of the business, Joseph v Raff, 82 App. Div. 47, 81 N. Y. Supp. 546 (1st Dept. 1903), *aff'd* 176 N. Y. 611, 68 N. E. 1118 (1903).

and probably is not even applicable to an insolvent corporation which continues as a going concern.[12] The second is excluded because the right may be exercised only after a judgment has been obtained[13] and the property of the corporation exhausted.[14]

Generally, an unsecured creditor has no claim on his debtor's property in the absence of a judgment; the debt itself conferring no title to or equity in his property.[15] This rule is applicable to corporate as well as to individual debtors.[16]

The sweeping dictum that creditors "have no right of control over corporate management and no interest in or to the assets of a solvent corporation"[17] is only partially true. It is true to the extent that creditors ordinarily have no voting rights[18] and hence have no right to participate in the election of directors or to contest the validity of corporate elections.[19] Nor may creditors attack an *ultra vires* transaction "unless it also resulted in depleting the assets of the corporation in fraud of creditors".[20]

---

[12]8 THOMPSON, CORPS. (3d ed. 1927) §§6130, 6131, 6139. Under certain circumstances the doctrine is applied when the corporation has ceased to do business by reason of a sale of all its assets even though not insolvent. See Hurd v. N. Y. & C. Steam Laundry Co., 167 N. Y. 89, 60 N. E. 327 (1901).

[13]Fourth Natl. Bank v. Franklyn, 120 U. S. 747, 7 Sup. Ct. 757 (1887); Cutright v. Stanford, 81 Ill. 240 (1876); Handy v. Draper, 89 N. Y. 334 (1882). *Cf.* Wyman v. Wallace, 201 U. S. 230, 12 Sup. Ct. 495 (1906); Walton v. Coe, 110 N. Y. 109, 17 N. E. 676 (1888); Parker v. Adams, 38 Misc. 325, 77 N. Y. Supp. 861 (1902). Performance of this condition precedent may be dispensed with when impossible of performance. See review of authorities in United Glass Co. v. Vary, 152 N. Y. 121, 46 N. E. 312 (1897).

[14]Strelaw v. American Color Co., 162 Mich. 709, 127 N. W. 716 (1910); Wetherbee v. Baker, 35 N. J. Eq. 501 (1882); Appeal of Means, 85 Pa. 75 (1877). Under special circumstances this requirement may be dispensed with, Shellington v. Howland, 53 N. Y. 371 (1873).

[15]GLENN, *supra* note 8 at pp. 2–6.

[16]Graham Button Co. v. Spillmann, 50 N. J. Eq. 120, 24 Atl. 571 (1892).

[17]Sweet v. Lang, *supra* note 11, at p. 766.

[18]Under certain statutes bondholders may not be given voting rights. See Durkee v. People, 155 Ill. 354, 40 N. E. 626 (1895); Pollitz v. Wabash R.R. Co., 167 App. Div. 669, 152 N. Y. Supp. 803 (1st Dept. 1915). See also, Holt v. California Development Co., 161 Fed. 3 (C. C. A. 9th, 1908). *Cf.* State v. McDaniel, 22 Ohio 354 (1872); Ecker v. Kentucky Ref. Co., 144 Ky. 264, 138 S. W. 264 (1911).

[19]2 THOMPSON, CORPS. (3rd ed. 1927) § 1033.

[20]Brent v. Simpson, 238 Fed. 285, 291 (C. C. A. 5th, 1916), *cert. den.* 243 U. S. 639, 37 Sup. Ct. 743 (1917); Force v. Age-Herald Co., 136 Ala. 271, 33 So. 866 (1902). *Cf. In re* Hool Realty Co., 2 F. (2d) 334 (C. C. A. 7th, 1924), *cert. den.* 266 U. S. 633, 45 Sup. Ct. 225 (1924); Washington Mill Co. v. Sprague Lumber Co., 19 Wash. 165, 52 Pac. 1067 (1898). There is a conflict of authority as to whether creditors may question the validity of corporate acts by directors and officers without requisite stockholders' consent. See Royal Indemnity Co. v. American Bond & Mortgage Co., 53 Sup. Ct. 551, (1933); Leffert v. Jackman, 227 N. Y. 310, 125 N. E. 446 (1919).

The foregoing factors together with the fact that "at common law no individual liability was imposed upon the members or stockholders of a corporation"[21] made the growth of safeguards for the protection of corporate creditors inevitable. To have left them completely to the mercy of the stockholders would have been intolerable.

The primary source of creditors' rights are certain statutory provisions now well-nigh universal.[22] In general, these have three major objectives: (1) to require that stock be issued only for adequate consideration;[23] (2) to maintain the stated capital by limiting the declaration of dividends[24] and by prohibiting the reduction of capital to an extent which would render the corporation insolvent;[25] and (3) to make certain financial information available by requiring the filing of periodic reports in a public office.[26]

It is from these statutes that most cases take their "policy".[27] In addition, of course, creditors frequently bargain for and receive cer-

---

[21]Hoffman v. Worden Co., 2 F. Supp. 353, 354 (N. D. Cal. 1933); Warren, *Safeguarding the Creditors of Corporations*, (1923) 36 HARV. L. REV. 509, 518–522.

[22]Limitations of space prevent reference to all the statutes and analysis of their differences. We shall therefore cite only the proposed Uniform Business Corporations Act, approved by the American Bar Association in 1928 (53 A.B.A. Rep. 92). We shall also take the liberty of treating expressions of courts under specific statutes as expressions of general principles. Due to the substantial uniformity in the American statutory schemes no serious error should result. For a study of the Massachusetts statutes, see Warren, *supra* note 21, at pp. 523–544.

[23]UNIF. BUS. CORP. ACT §§ 15, 16, requiring payment "with cash, other property, tangible or intangible, or with necessary services actually rendered". See DODD, STOCK WATERING (1930).

[24]UNIF. BUS. CORP. ACT §§24, 25, prohibiting payment of dividends "except from the surplus of its assets over the aggregate of its liabilities" including its capital.

[25]UNIF. BUS. CORP. ACT §41, requiring that any proposed reduction shall "not reduce the fair value of the assets of the corporation to an amount less than the total amount of its debts and liabilities plus the amount of its capital stock as so reduced". Some jurisdictions expressly prohibit the purchase by a corporation of its own shares except out of surplus. See N. Y. CONS. LAWS c. 40 (PENAL LAW) §664.

[26]UNIF. BUS. CORP. ACT §§18, 36, requiring report upon organization as to consideration received for shares and annual reports "as to its financial condition". The requirement of §18 that a report be filed as to the consideration received for its stock is far from universal, but see [Federal] SECURITIES ACT OF 1933, *Schedule A* (May 27, 1933, c. 38, 48 Stats.).

[27]Beeause they are deemed to express a "public policy", acts in violation of them arc more than mere *ultra vires* acts. See West Penn Chem. & Mfg. Co. v Prentice, 236 Fed. 891, 895 (C. C. A. 3rd, 1916). Prof. Warren is of the opinion that courts should not attempt to establish safeguards for corporate creditors but should leave the matter to legislation, *supra* note 21 at p. 547. "If it be said that in the

tain special rights by contract.[28] These creditor rights, statutory and contractual, are interpreted by the courts in the light of the relationship which they deem exists between the corporation (that is, its stockholders as represented by the management, the directors) and its creditors. The concept of what that relationship should be also gives rise to certain rights and obligations exclusive of statute and contract.

Directors of a solvent corporation are not "trustees"[29] for its creditors;[30] the relation between them "is that of contract and not of trust".[31] On this premise it is held that directors are not liable to creditors for negligence[32] or for mismanagement.[33] The underlying

---

field of business some of the realities of yesterday are the illusions of today; that the troublous times through which we are passing demonstrate the need for greater protection of creditors of corporations, that is a problem of financial and economic policy which is peculiarly within the province of the legislature. The legislative machinery possesses greater flexibility than the judicial process can or should have in such matters", Shientag, J. in Quintal v Adler, 146 Misc. 300, 262 N. Y. Supp. 126 (1933).

[28]This field is as wide as all contract law—we shall advert only to a few typical cases.

[29]The word "trustee" has come to be used in corporate matters not in its strict technical sense but to describe a somewhat ambiguous fiduciary.

[30]Bird v. Magowan, 43 Atl. 278 (N. J. 1898); Landis v. Sea Isle City Hotel Co., 31 Atl. 755 (N. J. 1895); Force v. Age-Herald Co., *supra* note 20; O'Conner M. & M. Co. v. Coosa F. Co., 95 Ala. 614, 10 So. 290 (1891). *Contra:* Delano v. Case, 121 Ill. 247, 12 N. E. 676 (1887); Thomas v. Sweet, 37 Kan. 183, 14 Pac. 545 (1889); Hibernia Bank v. Succession of Caucienne, 140 La. 969, 74 So. 267, L.R.A. 1917D 402; Pender v. Speight, 159 N. C. 612, 75 S. E. 851 (1912). In Sawyer v. Hoag, 17 Wall. 610 (U. S. 1873), Mr. Justice Miller said, at 623: ". . . when the interest of the public, or of strangers dealing with this corporation is to be affected by any transaction between the stockholders who own the corporation and the corporation itself, such transaction should be subject to a rigid scrutiny, and if foimd to be infected with anything unfair to such third person, ealculated to injure him or designed intentionally and inequitably to screen the stockholder from loss at the expense of the general creditor, it should be disregarded or annulled so far as it may inequitably affect him".

[31]Briggs v. Spanlding, 141 U. S. 132, 147, 11 Sup. Ct. 924 (1891). Directors do become "trustees" for the creditors on insolvency or liquidation. See Giles D. M. Co. v. Klaudcr-Weldon D. M. Co., 233 N. Y. 470, 476, 135 N. E. 854 (1922); Olney v. Conanicut Land Co., 16 R. I. 597, 18 Atl. 181, (1889) 5 L.R.A. 361; Darcy v. Bklyn & N. Y. Ferry Co., 196 N. Y. 99, 89 N. E. 461 (1909).

[32]Deaderick v. Bank, 100 Tenn. 457, 45 S. W. 786 (1897); Allen v. Cochran, 160 La. 425, 107 So. 292 (1926); U. S. Fidelity & Guaranty Co. v. Savings Bank, 154 Iowa 588, 134 N. W. 857, (1912) 45 L. R. A. (N. S.) 421. *Cf.* Ellett v. Newland, 171 La. 1019, 132 So. 761 (1931). A trustee in bankruptcy has the right to sue for negligence and if he refuses creditors may do so, Rural Credit Subscribers' Assn. v. Jett, 205 Ky. 604, 266 S. W. 240 (1924).

[33]Natl. Exchange Bank v. Peters, 44 Fed. 13 (E. D. Va. 1890) appeal dismissed

thought is that creditors have a recognizable grievance only when the directors "fraudulently" divert assets of the corporation with a resulting destruction or lessening of the security behind their debt.[34]

The most frequent methods of diversion of corporate assets away from creditors are:[34a] (1) the payment of unlawful dividends; (2) the improper reduction of capital; and (3) the purchase by the corporation of its own stock out of capital.

Much has already been written on the subject of unlawful dividends[35] and it must suffice here merely to note that it was the obligation not to pay out dividends improperly that gave rise to the notion that the capital of a corporation constituted a "trust fund" for the benefit of its creditors[36] and that the limitations upon dividend payments may not be circumvented by the use of subterfuge.[37]

Small v. Sullivan is interesting.[38] The complaint in an action brought by bondholders against directors, after the mortgage which secured the bonds had been foreclosed and the corporation liqui-

in 144 U. S. 570, 25 Sup. Ct. 767 (1892); Lyman v. Bonney, 118 Mass. 222 (1875); Wilson v. Stevens, 129 Ala. 630, 29 So. 678 (1900); Frost Mfg. Co. v. Foster, 76 Iowa 535 (1889). *Contra:* Anthony v. Jeffress, 172 N. C. 378, 90 S. E. 414 (1916). A trustee in bankruptcy succeeds to the right of the *corporation* to sue for mismanagement, McEwen v. Kelly, 140 Ga. 720, 79 S. E. 777 (1913).

[34]This principle may be quite sufficient if it includes the recognition of the right to preventive relief to prevent such diversion as well as compensatory relief after the event. Although negligence and incompetence do result in endangering the security, it must be remembered that "fraud" is not defined and that the courts could in a "hard" case describe "gross" negligence or mismanagement as "fraud in law". Furthermore, the first victims of loss caused by negligence or mismanagement on the part of the directors (if they are honest) are the stockholders and they are in a position to correct the situation.

[34a]The payment of excessive salaries of course also reacts to the detriment of creditors. In proper cases they may be recovered by legal representatives of the corporation and its creditors in the event of insolvency, see, Ellis v. Ward, 137 Ill. 509, 25 N. E. 530 (1890); McKey v. Swenson, 232 Mich. 505, 205 N. W. 583 (1925). But probably not, if made without fraud at a time when the corporation was solvent, see, Buell v. Lanski, 232 Ill. App. 500 (1924).

[35]Weiner, *Theory of Anglo-American Dividend Law* (1928), 28 Col. L. Rev. 1046, (1929) 29 Col. L. Rev. 461, (1930) 30 Col. L. Rev. 330, 954; Krauss, *Maintenance of a Corporation's Capital* (1931) 9 Tenn. L. Rev. 215; (Note) Statutory Responsibility of Directors for Payment of Dividends out of Capital, (1926) 35 Yale L. J. 870; (Note) Actions against Stockholders to Recover Illegal Dividends, (1933) 33 Col. L. Rev. 481.

[36]Wood v. Dummer, 3 Mason 308, 30 Fed. Cas. No. 17944 (C. C. Me. 1824).

[37]Small v. Sullivan, 245 N. Y. 343, 157 N. E. 261 (1927); Penn. Iron Works Co. v. Mackenzie, 190 Mass. 61, 76 N. E. 228 (1906).

[38]*Supra* note 37. It is to be noted that subsequent statutory changes would have, if then in force, allowed a direct achievement of the result sought to be obtained, see dissenting opinion of Lehman, J., at p. 360.

dated in bankruptcy, to recover for the defendants' fraudulent conversion of assets to their own use, was sustained. The complaint alleged that the defendants consolidated the debtor corporation, having net assets of $52,000,000 but an impaired capital position, with another corporation having assets of only $550 for the sole purpose of recapitalizing on a new basis which would make $2,000,000 available as surplus for distribution as dividends to themselves as stockholders, and that this purpose had been fully carried out. The statutory provisions for consolidation were fully complied with but the court held that this did not constitute a defense.[39]

There is a dearth of cases wherein creditors attack formal capital reductions, and this may indicate either that the statutes drawn for their protection[40] have proven effective,[41] or that capital reductions are not frequently resorted to as a means of injuring creditors. There may be no distribution of "capital" among stockholders except by way of capital reduction[42] and there can be no capital reduction except pursuant to some express statutory authorization therefor.[43] However, a mere purchase by a corporation of its own stock does not constitute a reduction of capital[44] and therefore most of the litigation in this field has involved stock purchases which ordinarily require no formal public action.[45] Stock purchases may be made only out of

[39]The mortgage had stipulated that the bondholders had "no recourse" against the directors but the court held that this afforded no defense to a claim based on their subsequent fraud.

[40]*Supra* note 25.

[41]See Dominquez Land Co. v. Daugherty, 196 Cal. 453, 468, 238 Pac. 697, 703 (1925) sustaining constitutionality of legislation vesting in a Corporations Commissioner the power to permit a distribution to stockholders of a surplus created by a capital reduction. See also State *ex rel.* Radio Corp. v. Benson, 128 Atl. 107 (Del. 1924) for the distinction between a statutory reduction in the number of shares and a reduction of capital.

[42]Stevens v. Olus Mfg. Co., 72 Misc. 508, 130 N. Y. Supp. 22 (1911), *aff'd.* 146 App. Div. 951 (N. Y. 1911) (memo.). A creditor may proceed directly against a stockholder who has improperly received a part of the corporate assets (Trotter v. Lisman, 209 N. Y. 174, 102 N. E. 575 (1913)) for the full amount thereof regardless of existing equities as between the stockholders, Bartlett v. Drew, 57 N. Y. 587 (1874); Clapp v. Peterson, 104 Ill. 26 (1882).

[43]Sutherland v. Olcott, 95 N. Y. 93 (1884); Seignouret v. Home Ins. Co., 24 Fed. 332 (E. D. La. 1885). On the general subject of reductions of capital stock, see (1926) 44 A.L.R. 11.

[44]*In re* Atlantic Printing Co., 60 F. (2d) 553 (D. Mass. 1932). Shares of stock are not retired by mere purchase, 5 THOMPSON, CORPS. (3rd Ed. 1927) §4084.

[45]See Wormser, *The Power of a Corporation to Acquire Its Own Stock* (1915) 24 YALE L. J. 177; Levy, *Purchase by a Corporation of Its Own Stock* (1930) 15 MINN. L. REV. 1.

"surplus"[46] and therefore neither notes nor agreements for purchase, even though made when the corporation did have a sufficient surplus, can be enforced when the necessary surplus no longer exists.[47]

The methods of diversion of assets which we have just touched upon are by and large contrary to express statutory prohibitions, but they obviously do not exhaust the possibilities, nor is a statute essential to impose liability upon those guilty of an improper diversion of assets. Thus, it has been held that directors are liable for the sale to one of their number of property for less than its full value, the court stating that the doctrine which it applied does not depend on statute "but rather on principles inherent in the nature of corporations as artificial persons whose creditors can only enforce their debts by a resort to the property the corporation has acquired".[48]

Short term creditors, or those in a position promptly to mature the obligation and enforce its payment by the usual methods, are less dependent upon equitable relief[48a] than the long term creditor tied to a corporation for many years.[49] He can hardly be satisfied with a

---

[46]Hazard v. Wight, 201 N. Y. 399, 94 N. E. 855 (1911); Topken, Loring & Schwartz, Inc. v. Schwartz, 249 N. Y. 206, 163 N. E. 735 (1928), noted in (1929) 15 CORNELL LAW QUARTERLY 108; Hoover Steel Ball Co. v. Schaefer Ball Bearings Co., 90 N. J. Eq. 164, 106 Atl. 471 (1919); Hamor v. Taylor Rice Eng. Co., 84 Fed. 392 (C. C. Del. 1897); West Penn Chem. & Mfg. Co. v. Prentice, *supra* note 27.

[47]*In re* Atlantic Printing Co., *supra* note 44; Keith v. Kilmer, 261 Fed. 733 (C. C. A. 1st, 1919), cert. den. 252 U. S. 578, 40 Sup. Ct. 344 (1919). *In re* O'Gara & Maguire, Inc., 259 Fed. 935 (D. N. J. 1919); Grasselli Chem. Co. v. Aetna Explosives Co., 258 Fed. 66 (S. D. N. Y. 1918); *In re* Fechheimer Fishel Co., 212 Fed. 357 (C. C. A. 2d, 1914), cert. den. 234 U. S. 760, 34 Sup. Ct. 777 (1914); *In re* Tichenor-Grand Co., 203 Fed. 720 (S. D. N. Y. 1913); Clark v. E. C. Clark Mach. Co., 151 Mich. 416, 115 N. W. 416 (1908). *Cf.* Keith v. Kilmer, 272 Fed. 643 (C. C. A. 1st, 1921); Cross v. Beguelin, 252 N. Y. 262, 169 N. E. 378 (1929); First Trust Co., v. Illinois Central RR. Co., 256 Fed. 830 (C. C. A. 8th, 1919). As to rights of creditors upon subsequent insolvency where the transaction was consummated while solvent, see Kaminsky v. Phinizy, 54 F. (2d) 16 (C. C. A. 5th, 1931); Clapp v. Peterson, 104 Ill. 26 (1882); *In re* Brockway Mfg. Co., 89 Me. 121, 35 Atl. 1612 (1896); Lebens v. Nelson, 148 Minn. 240, 181 N. W. 350 (1921); Wolff v. Heidritter Lumber Co., 112 N. J. Eq. 34, 163 Atl. 140 (1932), noted (1933) 18 CORNELL LAW QUARTERLY 589; Tait v. Pigott, 32 Wash. 344, 73 Pac. 364 (1903); Marvin v. Anderson, 111 Wis. 387, 87 N. W. 226 (1901).

[48]Wilkinson v. Bauerle, 41 N. J. Eq. 635, 644 (1886). See also Darcy v. Bklyn & N. Y. Ferry Co., *supra* note 31. As to rights of a subsequent creditor, see Graham v. LaCrosse & M. R. R. Co., 102 U. S. 148 (1880).

[48a]Assuming that they are in possession of current data as to the affairs of the corporation, otherwise the assertion of their legal rights is generally "too late".

[49]The specific creditor may of course sever the relationship by selling the evidence of indebtedness—if there exists a market therefor. From 1913 to 1932 the total indebtedness of industrial corporations increased 75% but their long-term

position entirely divorced of any power to prevent incompetent or improvident dissipation of the corporate assets. He is obliged to rely upon the intervention of equity or seek to bolster his legal position by private contract.[50] Necessarily, a very few typical illustrations must suffice. A bill by a mortgage bondholder to prevent the impairment of the mortgaged property by the improper sale of the property or of more bonds secured by the same mortgage has been sustained,[51] but it may be that directors who operate mortgaged property in violation of the terms of the mortgage and depreciate its value are accountable only to the corporation and not to the bondholders.[52]

In *Hoyt v. DuPont de Nemours Co.*,[53] the corporation was enjoined, at the suit of a bondholder secured by a "charge" on all its assets, from using certain debentures received for its assets even though such use would have left the bondholder with twice as much security as he had before. Where the mortgage provides for a sinking fund the mortgagee may obtain an accounting in the event of non-compliance,[54] and a controlling stockholder has been held liable for the corporation's failure to maintain a sinking fund as agreed, the stockholder having profited by the use of the funds.[55] Extraordinary circumstances may induce a court to deprive a bondholder of clear contract rights. In *New Jersey National Bank v. Lincoln Mortgage and Title Guaranty Company*,[55a] bonds had been issued under a trust indenture

debt increased, 150% THE INTERNAL DEBTS OF THE UNITED STATES (ed. CLARK, 1933) 175.

[50]Frequently representatives of the security house that floats a bond issue are elected to the board to represent the bondholders. See O'LEARY, *supra* note 1, at pp. 41–44. See Green v. People's Gas Light & Coke Co., 118 Misc. 1, 192 N. Y. Supp. 232 (1922), *aff'd.* 206 App. Div. 647, (4th Dept. 1923) for a case involving conflicting interests between a minority bondholder and a majority bondholder who, as majority stockholder, also controlled the debtor corporation.

[51]Whitmore v. International F. & S. Co., 214 Mass. 525, 102 N. E. 59 (1913). It was alleged that the corporation was insolvent and in default, but the court said "the bill is maintainable whether the principal be due or not, or whether the coupons be paid or unpaid".

[52]Young v. Haviland, 215 Mass. 120, 102 N. E. 338 (1913); Hart v. Hanson, 14 N. D. 570, 105 N. W. 942 (1905). [53]88 N. J. Eq. 196, 102 Atl. 666 (1917).

[54]New York Trust Co. v. Michigan Traction Co., 193 Fed. 175 (W. D. Mich. 1912). The court recognized the right of a mortgagee to invoke the aid of equity to preserve the mortgaged property. We are not treating in this article the rights of secured creditors beyond the limited extent necessary briefly to indicate some types of control which a creditor may achieve by special contract.

[55]Penn. Canal Co. v. Brown, 235 Fed. 669 (C. C. A. 3rd, 1916), cert. den. 242 U. S. 646, 37 Ct. 240 (1916). The court recognized the right of a bondholder to insist that the debtor corporation receive a fair price upon a sale of its property.

[55a]105 N. J. Eq. 557, 148 Atl. 713 (1930).

under which there were pledged real estate mortgages as collateral. The indenture contained express and precise provisions calculated to maintain the collateral at all times at a fixed value and free of defaulted mortgages. Due to the financial depression and the resultant defaults in the mortgages, the debtor corporation was unable to comply, and the court authorized the trustee under the indenture to join in an agreement substantially modifying the indenture.[55b] The decision is not without precedent[55c] but the earlier decisions indicate a greater reluctance on the part of courts to interfere with contract provisions.[55d]

Not being vested with any active affirmative right of control, a creditor may, when completely pessimistic as to the possibilities of the current management, prefer that the corporate affairs be turned over to the control of a court and to that end seek the appointment of a receiver. The corporation may be insolvent and the object liquidation.[56] But with that we are not here concerned.[57]

Operating Receiverships[58]

The general rule is that in the absence of statute, an unsecured, non-judgment creditor may not obtain the appointment of a re-

---

[55b]The petition was opposed by only one small bondholder.

[55c]See Baltimore City v. United Rys. Co., 108 Md. 64, 69 Atl. 436 (1908); Leviness v. Consolidated Gas Co., 114 Md. 559, 80 Atl. 304 (1911); Detroit v. Detroit United Ry., 226 Mich. 354, 197 N. W. 697 (1924); Price v. Long, 87 N. J. Eq. 578, 101 Atl. 195 (1917); New York State Rys. v. Security Trust Co., 135 Misc. 456, 238 N. Y. Supp. 354, *aff'd.* 228 App. Div. 750, 238 N. Y. Supp. 887 (4th Dept. 1930).

[55d]See Duncan v. Mobile & O. R. Co., 2 Woods 542, Fed. Cas. No. 4137 (S. D. Ala. 1876); Fidelity Ins. T. & S. D. Co. v. United N. J. R. R. & C. Co., 36 N. J. Eq. 405 (1883); Clark v. St. Louis, A. & T. H. R. R. Co., 58 How. Pr. 21 (N. Y. 1879); Watt v. Railroad Co., 1 Brewster 418 (Pa. 1867). As to necessary parties, see also, Colorado & So. Ry. Co. v. Blair, 214 N. Y. 497, 108 N. E. 840 (1915).

[56]See 2 Clark, Receivers (2d Ed. 1929) §706.

[57]Our attempt at segregation is largely unrealistic and therefore unsuccessful. Litigation generally arises when the corporation is in financial difficulties. But we adhere in the thought that it may be possible, as it is important, to develop a set of preventive rights and powers. In the two concluding sections (on receiverships and reorganizations) our primary concern is with the not too insolvent corporation, *i. e.*, one with hope but little life.

[58]There are a number of interesting procedural questions involved in federal receivership suits which we shall not treat. Among the more important are: *Venue and the need for ancillary proceedings:* Judicial Code, §56, 36 Stats. 1102 (1911), 28 U. S. C. §117 (1926); Lion Bonding Co. v. Karatz, 262 U. S. 77, 43 Sup. Ct. 480 (1923); Great Western Min. & Mfg. Co. v. Harris, 198 U. S. 561, 25 Sup. Ct., 770 (1905); Primos Chem. Co. v. Fulton Steel Corp. 255 Fed. 427 (S. D. N. Y. 1918), 254 Fed. 454 (N. D. N. Y. 1918); Gatch, Tenant & Co., v. Mobile & O. R. Co., 59 F. (2d) 217 (S. D. Ala. 1932); Laughlin, *The Extraterritorial Power of*

ceiver.[59] There are exceptions to this rule[60] but one—the federal equity consent receivership—has achieved such importance that it has verily become the "rule" and almost preempts the field.[60a]

Much learning has been devoted to finding the precise legal source of this type of receivership in old English Chancery practice,[61] but

Receivers, (1932) 45 HARV. L. REV. 429. The burden of ancillary proceedings led a Special Committee on Equity Receiverships of the Association of the Bar of the City of New York to recommend statutory changes, 1927 YEAR BOOK 299 (see also hearings on H.R. 9999, 10,000, 71st Cong. 2d. Sess. before House Judiciary Committee, April 11, 1930). See GENERAL ORDER IN BANKRUPTCY LI, promulgated May 15, 1933. *Cf.* BANKRUPTCY ACT. §77c (Act of March 3, 1933) as to powers of a "trustee" thereunder. *Conflict with other proceedings:* Gross v. Irving Trust Co., 53 Sup. Ct. 605 (1933); Harkin v. Brundage, 276 U. S. 36, 48 Sup. Ct. 268 (1928); Matter of Paramount Publix Corp., 64 F. (2d) 500 (C. C. A. 2d, 1933); Moore v. Scott, 55 F. (2d) 863 (C. C. A. 9th, 1932); Superior Oil Corp. v. Matlock, 47 F. (2d) 993 (C. C. A. 10th, 1931); (Note) State Statutes and the Federal Equity Courts, (1932) 32 COL. L. REV. 688. *Disaffirmance or adoption of contracts:* Samuels v. E. F. Drew & Co. Inc., 292 Fed. 734 (C. C. A. 2d, 1923); American Brake S. & F. Co. v. N. Y. Rys. Co., 282 Fed. 523 (C. C. A. 2d, 1922), appeal dismissed in 262 U. S. 736, 43 Sup. Ct. 704 (1923); Menke v. Willcox, 275 Fed. 57 (S. D. N. Y. 1921); Clark, *et al*, *Adoption and Rejection of Contracts and Leases by Receivers* (1933) 46 HARV. L. REV. 1111. *Receiver's certificates:* Union Trust Co. v. Illinois Midland Ry. Co., 117 U. S. 434, 6 Sup. Ct. 809 (1886); Von Boston v. United Rys., 8 F. (2d) 826 (C. C. A. 8th, 1925), cert. den. 271 U. S. 665, 46 Sup. Ct. 475 (1926); Mercantile Trust Co. v. Tennessee Cent. R. Co., 291 Fed. 462 (M. D. Tenn. 1921); Westinghouse E. & Mfg. Co. v. Brooklyn Rapid Transit Co. 260 Fed. 550 (C. C. A. 2d, 1919); American Brake Shoe & F. Co. v. Pere Marquette R. Co., 205 Fed. 14 (C. C. A. 6th, 1913), cert. den. 229 U. S. 624, 33 Sup. Ct. 1051 (1913); Thacher, *Some Tendencies of Modern Receiverships*, (1915) 4 CALIF. L. REV. 32; (Note) Labor Problems in the Judicial Operation of Properties, (1933) 33 COL. L. REV. 882.

[59]Pusey & Jones Co. v. Hanssen, 261 U. S. 491, 43 Sup. Ct. 454 (1923); Hollins v. Brierfield Coal & Iron Co., 150 U. S. 371, 14 Sup. Ct. 127 (1893); Trustees Systems Co. v. Payne, 65 F. (2d) 103 (C. C. A. 3d, 1933); Home Mtge. Co. v. Ramsey, 49 F. (2d) 738 (C. C. A. 4th, 1931); Lee v. Riefler & Sons, 43 F. (2d) 364 (M. D. Pa. 1930); Pond v. Framingham & Lowell RR., 130 Mass. 194 (1881); Adee v. Bigler, 81 N. Y. 349 (1880). This is true even when the corporation is insolvent. Solvency is not necessarily a sufficient reason for the denial of a receivership even by a state court. See Adams v. Farmers Natl. Bank, 167 Ky. 506, 180 S. W. 807 (1915): "gross" mismanagement. A secured creditor may obtain a receivership only if the very property mortgaged is jeopardized, Hutson v. Long Bell Lumber Co., 1 Fed. Supp. 468 (W. D. Mo. 1932).

[60]The readiness with which courts have come to appoint receivers has recently called forth a rebuke by a state appellate court, Tachna v. Pressed Steel Car Co., 112 N. J. Eq. 411, 164 Atl. 413 (1933).

[60a]The act of March 3, 1933 amending the Bankruptcy Law does not apply to corporations other than railroads. *Supra* note 1.

[61]See Kroeger, *Jurisdiction of Courts of Equity to Administer Insolvents' Estates*, (1924) 9 ST. LOUIS L. REV. 87; Glenn, *The Basis of the Federal Receivership*, (1925)

whatever the source it exists today, in many respects *sui generis.* Its development was made necessary by the fact that the bankruptcy courts, prior to the amendment of March 3, 1933, were not available to railroads[62] and it was made possible by the diversity clause of the federal constitution.[63]

In 1888, the Supreme Court held[64] that an equity court might, as a matter of discretion in a proper case, on a bill by a judgment-creditor, appoint a receiver to operate a quasi-public corporation and that the creditor's failure to have issued execution was immaterial in the absence of an objection by the corporation. Two years later it extended the rule by holding that the corporation's objection that the plaintiff had an adequate remedy at law which he had not exhausted must be made seasonably.[65]

25 COL. L. REV. 434; Dodd, *Equity Receiverships as Proceedings in Rem,* (1928) 23 ILL. L. REV. 105; (Note) The Propriety of Friendly Receiverships in the Federal Courts, (1930) 43 HARV. L. REV. 1298; Jacobs, *Problems in Federal "Receivership" Jurisdiction,* (1932) 1 MERCER BEASLEY L. REV. 29; (Note) Consent Receiverships Instituted by Non-Judgment Creditor, (1932) 41 YALE L. J. 1086. The Federal courts do not appoint receivers of individuals under the same circumstances as justify them in appointing receivers of corporations. See Zechial v Firemen's Fund Ins. Co., 61 F. (2d) 27 (C. C. A. 4th, 1916); Davis v. Hayden, 238 Fed. 734 (C. C. A. 4th, 1916), cert. den. 243 U. S. 636, 37 Sup. Ct. 400, (1917); Maxwell v. McDaniels, 184 Fed. 311 (C. C. A. 4th, 1910); Clark, *Simple Contract Creditor Securing Appointment of Receiver,* (1927) 1 UNIV. OF CINN. L. REV. 388. The Supreme Court has held that the conveyance by an individual of his property to a corporation for the purpose of procuring its administration in equity is "fraudulent in law", Shapiro v. Wilgus, 287 U. S. 348, 53 Sup. Ct. 145, (1932). But a receiver may be appointed of the assets of a proposed corporation which proves abortive, Garland v. Wilson, 289 Pa. 272, 137 Atl. 266 (1927). 1 CLARK, RECEIVERS, (2d Ed. 1929) pp. 228–230 is of the opinion that courts will ultimately appoint receivers for individuals under the same circumstances as they do for corporations.

[62]BANKRUPTCY ACT, 30 Stats. 547, §4 (1898), 11 U.S.C. § 22 (1926). Although it was the financial distress of the railroads that gave the initial impetus to the practice, it is not confined to public utilities, United States v. Butterworth-Judson Corp., 269 U. S. 504, 46 Sup. Ct. 179 (1926); Price v. United States, 269 U. S. 492, 46 Sup. Ct. 180 (1926); First Natl. Bank v. Stewart Fruit Co., 17 F. (2d) 621 (N. D. Cal. 1927); Union Trust Co. v. Jones, 16 F. (2d) 236 (C. C. A. 4th, 1926). Some of the practices which have grown up in receiverships, such as with regard to the priority of "six months claims" have not yet been extended beyond public utilities. 1 CLARK, RECEIVERS, (2d Ed. 1929) §§ 676–677.

[63]UNITED STATES CONSTITUTION, ART. III, §2. See Warren, *Corporations and Diversity of Citizenship,* (1933) 19 VA. L. REV. 66.

[64]Sage v. Memphis and Little Rock RR. Co., 125 U. S. 361, 8 Sup. Ct. 887 (1888).

[65]Brown v. Lake Superior Iron Co., 134 U. S. 530, 10 Sup. Ct. 604 (1890).

Prior thereto a federal court had appointed equity receivers of the Wabash on its own bill[66] and when the proceedings were thereafter indirectly before the Supreme Court, it did not condemn the practice.[67]

The first direct ruling on consent receiverships, as we now know them, was made by the Supreme Court in 1908, when it sustained the equity receivership of the New York City transit lines.[68] It held that the objection that the plaintiff has no judgment may be waived,[69] that a creditor's receivership bill presents a justiciable "controversy" notwithstanding the defendant's admissions of the allegations and consent to the receivership, and that there is no "collusion" in such admission, consent, and the agreement of the parties to resort to the federal court.[70]

Its legality confirmed by this decision,[71] there developed during the

---

[66]See Wabash, St. L. & P. Ry. Co. v. Central Trust Co., 22 Fed. 272 (E. D. Mo. 1884); Atkins v. Wabash, St. L. & P. Ry. Co., 29 Fed. 161 (N. D. Ill. 1886); Central Trust Co. v. Wabash, St. L. & P. Ry. Co., 29 Fed. 618 (E. D. Mo. 1886).

[67]Quincy, M. & P. RR. Co. v. Humphreys, 145 U. S. 82, 12 Sup. Ct. 787 (1892). It is doubtful whether the Supreme Court would tolerate the practice today. See Shapiro v. Wilgus, *supra* note 61, at p. 356. The practice was however severely criticized by other courts, State *ex rel* Merriam v. Ross, 122 Mo. 435, 25 S. W. 947 (1894) app. dis. 156 U. S. 478, 15 Sup. Ct. 443 (1899); McIlhenny v. Union Trust Co., 80 Tex. 1, 13 S. W. 655 (1890), app. dis. 145 U. S. 641, 12 Sup. Ct. 989 (1892). See also Jones v. Bank of Leadville, 10 Colo. 464, 17 Pac. 272 (1887); *In re* Moss Cigar Co., 50 La. Ann. 789, 23 So. 544 (1898); Kimball v. Goodburn, 32 Mich. 10 (1875); Jones v. Schaff Bros. Co., 187 Mo. App. 597, 174 S. W. 177 (1915); Chamberlain, *New-Fashioned Receiverships*, (1896) 10 HARV. L. REV. 139; *Cf.* Collins v. Central Bank, 1 Ga. 435 (1846); Petition of Kittanning Ins. Co., 146 Pa. 102, 23 Atl. 336 (1892).

[68]*Re* Metropolitan Railway Receivership, 208 U. S. 90, 28 Sup. Ct. 219 (1908). The lower court had noted the existence of "a multitude of precedents", Penn. Steel Co. v. N. Y. City Ry. Co., 157 Fed. 440, 443 (S. D. N. Y. 1907).

[69]The waiver need not be express. See Finney v. Continental Baking & Milling Co., 17 F. (2d) 107 (D. C. Ind. 1927) (removal from state court); Walker v. U. S. Light & Heating Co., 220 Fed. 393 (S. D. N. Y. 1915) (consent in another district). Not all state courts follow the federal practice. See National Lumberman's Bank v. Lake Shore Machinery Co., 260 Mich. 440, 245 N. W. 494 (1932) and note thereon in (1933) 31 MICH. L. REV. 100.

[70]This decision, together with that in Atlantic Trust Co. v. Chapman, 208 U. S. 360, 28 Sup. Ct. 406 (1908), decided the same year holding that the liabilities of a receivership are not chargeable against the plaintiff, rendered use of the procedure adopted by the Wabash unnecessary.

[71]It left no doubt as to the *power* of the court, but the propriety of its exercise in any particular case is necessarily an open question. See Kingsport Press, Inc. v. Brief English Systems, Inc. 54 F. (2d) 497 (C. C. A. 2d, 1931) cert. den., 286 U. S. 545, 52 Sup. Ct. 497 (1931).

succeeding twenty years a recognized and customary consent equity receivership practice in the federal courts.[72]

The theoretical justification for equity receivership seems sound enough even for industrial corporations to whom bankruptcy is available. "In bankruptcy nearly every case ends merely in liquidation, * * * the underlying thought, the compelling motive of equity receiverships is to save the business".[73]

The requisite technique for coming within the permissive language of the *Metropolitan* case was rapidly perfected. It involves procuring a willing non-resident creditor[74] with a claim for more than $3,000[75] to act as plaintiff, the preparation of a bill which sufficiently indicates that the corporation is unable to meet its debts as they mature[76] and that there would be insufficient assets to meet the claims of creditors if they were all permitted to obtain judgments and levy executions[77] but that the corporation is "solvent".[78] The "complete administration" which the bill seeks is held sufficient compliance with the rule that a receivership must be incidental to some ultimate relief.[79] The

[72]From January 1, 1917 to December 1, 1923, the United States District Court for the Southern District of New York appointed equity receivers for 233 corporations having nominal assets of over $750,000,000, *Equity Receiverships in United States Courts*, an inquiry by F. L. Hopkins (The N. Y. World, 1924).

[73]Mayer, *Federal Equity Receiverships*, 6 LECTURES ON LEGAL TOPICS 161, 165, (1924). See also Benton v. R. G. Peters Salt & Lumber Co., 190 Fed. 262, 265 (W. D. Mich. 1911); Kroeger, *supra* note 61 at pp. 200–201.

[74]See Harkin v. Brundage, *supra* note 58, at p. 50. A director of the corporation, if a creditor, may act, Hutchinson v. Phila. & G. S. S. Co., 216 Fed. 795 (E. D. Pa. 1914). But the filing of a bill by a subsidiary corporation, 99% of whose capital stock is owned by the defendant, has been condemned and picturesquely described as "incestuous litigation", Municipal Fin. Corp. v. Bankus Corp., 45 F. (2d) 902 (S. D. N. Y. 1930).

[75]Lion Bonding Co. v. Karatz, *supra* note 58.

[76]*i. e.*, "insolvency" in the equity sense.

[77]See Luhring Collieries Co. v. Interstate Coal Dock Co., 281 Fed. 265, *aff'd* 287 Fed. 711 (C. C. A. 2d, 1923).

[78]*i. e.*, in the bankruptcy sense, BANKRUPTCY ACT, 30 Stats. 544 (1898), 11 U. S. C. §1 (15) (1926). See American Can Co. v. Erie Preserving Co., 171 Fed. 540 *aff'd.* 183 Fed. 96 (C. C. A. 2d, 1910). This is important. The appointment of a receiver, except on the ground of "insolvency", even with the consent of the corporation, is not an "act of bankruptcy" which would leave the way open to any creditor to file an involuntary petition in bankruptcy, Nolte v. Hudson Navigation Co., 8 F. (2d) 859 (C. C. A. 2d, 1925); *In re* Edward Ellsworth, 173 Fed. 699 (W. D. N. Y. 1909). *Cf.* United States v. Butterworth Judson Corp., 269 U. S. 504, 46 Sup. Ct. 179 (1926); Price v. United States, 269 U. S. 492, 502, 46 Sup. Ct. 180 (1926). Sections 74 and 77 of the BANKRUPTCY ACT (added by amendment of March 3, 1933), 47 Stats. 1467, 1474 (1898), permit the filing of a petition by a debtor who "is insolvent or unable to meet his debts as they mature".

[79]Kingsport Press, Inc. v. Brief English Systems, Inc., *supra* note 71, at p. 501;

preparatory work is done quickly and secretly[80] and when the bill is ready for filing there is also ready for simultaneous filing an answer admitting the allegations of the bill and consenting to, or joining in, the prayer for a receiver.[81] The receiver is then appointed without notice to any other creditor.[82]

Trustees Systems Co. v. Payne, *supra* note 59. *Cf.* National Lumberman's Bank v. Lake Shore Machinery Co., *supra* note 69.

[80]For a vivid description of the preparations for a receivership and ancillary proceedings thereunder, see May Hosiery Mills, Inc., v. F. & W. Grand 5–10–25 Cent Stores, 59 F. (2d) 218 (D. C. Mont. 1932). See also New York Times, June 30, 1933, p. 34. If there is to be a receivership there is of course a legitimate need for haste and secrecy to prevent one creditor obtaining a preference by judgment or attachment. Unfortunately, it frequently is merely a race to make sure that the receivership will be under "friendly" auspices. For an indication of these "races" see Christian v. R. Hoe & Co., Inc., 63 F. (2d) 221 (C. C. A. 2d, 1933); Matter of Paramount Publix Corp., *supra* note 58. From their apparent eagerness to make sure that the receivers are appointed in "their" action, it would seem that attorneys have taken the remark that "there should be no 'friendly' receiverships" (Harkin v. Brundage, *supra* note 58, at p. 55) as the statement of a hope rather than a fact. It is said that telegrams have been left unopened by judges because they knew they contained information that a receiver had already been appointed by another court and would thus prevent the appointment of another, testimony of Mr. Blanc before House Judiciary Committee, *supra* note 58 at p. 20. Equity Rule 5 of the Southern District of New York requires the diselosure of all pending suits.

[81]At least to this extent the great majority of federal equity receiverships are prearranged. Standing alone it seems not to constitute illicit "collusion", Metropolitan Receivership, *supra* note 68; Kingsport Press, Inc. v. Brief English Systems, Inc., *supra* note 71. In Harkin v. Brundage, *supra* note 58, there also appeared a conspiracy to oust the state court of jurisdiction and that the plaintiff was assured that it would not be involved in any expense. In May Hosiery Mills, Inc. v. F. & W. Grand 5–10–25 Cent Stores, *supra* note 80, the court found that the purpose of the receivership was not to aid the creditors but to aid the corporation to escape some burdensome leases, *infra* note 87.

[82]Equity Rule 8 of the Southern District of New York provides that, except in the case of a public utility, a meeting of creditors should be held during the first 60 days of operations by the receiver. The receivership works no change in ownership and the corporate existence and functions continue, Royal Indemnity Co. v. American Bond & Mortgage Co., *supra* note 20; *cf.* United States v. Whitridge, 231 U. S. 144, 34 Sup. Ct. 24 (1913); Michigan v. Michigan Trust Co., 286 U. S. 334, 52 Sup. Ct. 512 (1932). The practice of appointing as co-receiver one of the officers of the defendant has been condemned, May Hosiery Mills, Inc. v. F. & W. Grand 5–10–25–Cent Stores, *supra* note 80, at p. 220. It must be noted that despite the refusal of the court in the cited case to appoint any ancillary receivers and its condemnation of the appointment of one Green, defendant's executive vice-president, as a co-receiver by the primary court (S. D. N. Y., E66–133, 1932), he was appointed ancillary co-receiver in 21 other jurisdictions (*Receiver's Report, No. 1*, July 1, 1932). The practice is of course defended on the ground that one familiar with the business is necessary for its successful operation. In

Abuses developed[83] and brought forth vigorous condemnation by the Supreme Court calculated to restore equity operating receiverships to the status of the extraordinary instead of the usual.[84] The equity courts themselves are endeavoring to correct some of the abuses. At least one court has adopted the procedure of appointing on an *ex parte* application only a temporary receiver and not making the appointment "permanent" until notice has been given to all parties in interest.[85] And if any objecting party establishes "the solvency of the defendant and its ability to meet its obligations currently accruing" the receivership will be terminated.[86] It has also

deference to this reason, it has been said that even an officer who had been guilty of mismanagement may be appointed receiver, Fowler v. Jarvis, Conklin Mtge. Trust Co., 66 Fed. 14 (S. D. N. Y. 1894). DEWING, *supra* note 6, at p. 952, cites a study by H. H. Swain, which showed that in 138 out of 150 railway receiverships from 1867 to 1897, old officers of the railroad were appointed as receivers or co-receivers. See also American S. S. Co. v. Wickwire Spencer Steel Co., 42 F. (2d) 886, 891, *aff'd* 49 F. (2d) 766 (C. C. A. 2d, 1931).

[83]The most popular outcry has been against the patronage involved and the allegedly exorbitant allowances to receivers and their counsel. See Hopkins, *supra* note 72. A Special Committee on Equity Receiverships of the Association of the Bar of the City of New York found that the costs in equity were higher than in bankruptcy but that the allowances in bankruptcy were too low, 1927 YEAR BOOK 299. It is also significant "that a careful review of the reported cases for the past ten years [1914–1924] discloses three instances only in which any security holder or ereditor has taken exception to the fees or expenses of receivership", ROSENBERG, CORPORATE REORGANIZATION AND THE FEDERAL COURT (1924) XI. The aggregate cost of the large reorganization is very high. Thus the reorganization of the Chicago, Milwaukee & St. Paul cost more than $5,000,000, Chicago, Milwaukee & St. Paul Reorganization, 131 I. C. C. 673, 699 (1928). It is also charged that receiverships are permitted to carry on much too long. "Indeed, such bills have come to afford a species of locus poenitentiae for the study of possibilities by creditors, shareholders, directors, receivers, and various self-appointed committees sitting under the chancellor's 'umbrella' and watching the weather outside", Hough, C. J., in Manhattan Rubber Mfg. Co. v. Lucey Mfg. Co., 5 F. (2d) 39, 43 (C. C. A. 2d, 1924). See also Kingsport Press Inc. v. Brief English Systems, Inc., *supra* note 71. This criticism somewhat overlooks the idea that equity receiverships were designed to permit reorganization and to prevent liquidation. The "weather" outside may be a most important element in the success of a reorganization. *Cf.* Equity Rule 8 of the Southern District of New York.

[84]Harkin v. Brundage, *supra* note 58, at p. 55; Michigan v. Michigan Trust Co., *supra* note 82, at p. 345; Shapiro v. Wilgus, *supra* note 61, at p. 356; Johnson v. Manhattan Ry. Co., 289 U. S. 479, 53 Sup. Ct. 721 (1933). For a consideration of the effect of these "cautionary admonitions", see *Ex Parte* Relmar Holding Co., 61 F. (2d) 941 (C. C. A. 2d, 1932), cert. den. 53 Sup. Ct. 405 (1933).

[85]Municipal Fin. Corp. v. Bankus Corp., *supra* note 74.

[86]Christian v. R. Hoe & Co. Inc., 63 F. (2d) 218 (C. C. A. 2d, 1933). See also Mitchell v. Lay, 48 F. (2d) 79 (C. C. A. 9th 1930), cert. den. 283 U. S. 864, 51

been suggested that the purpose of the receivership must be to benefit creditors and not the defendant corporation.[87]

Equity receiverships have also been severely criticised because they have not achieved their avowed purpose—reorganization instead of liquidation. One investigator reported that a majority of the cases which he examined resulted in liquidation.[88] Another study disclosed that out of forty equity receiverships only one resulted in actual reorganization.[89] These statistics undoubtedly give an unfair picture because the same weight is given to small unimportant units as to the large and important ones.[90] The undue resort to equity may be because of excessive optimism or because of the lure of higher fees.[90a] Recognizing the unwarranted strain imposed upon the system, determined efforts are being made to induce bankruptcy for those corporations which are palpably beyond rescue.[91]

Whatever the weaknesses or abuses, the equity receivership is a method devised to achieve the socially desirable object of saving corporations only temporarily embarrassed, or of enabling those interested in them to realize their fair going-concern value rather than only junk value. Accordingly, it is correctly regarded as merely a procedural step in reorganization.[92] It is an open question whether it

Sup. Ct. 656 (1930). *Cf.* Union Trust Co. v. Jones, *supra* note 62; American Brake S. & F. Co. v. Pere Marquette R. Co., *supra* note 58. The objection must be made seasonably, American S. S. Co. v. Wickwire-Spencer Steel Co., *supra* note 82, objector stockholder of defendant.

[87]May Hosiery Mills, Inc. v. F. & W. Grand 5–10–25 Cent Stores, *supra* note 80. However, the receivership roundly condemned in the cited case was deemed proper in 29 jurisdictions and it proceeded in regular course until transferred to bankruptcy upon the recommendation of the equity receiver, *supra* note 81. The real objection was that the receivership was directed against a single class of creditors—the lessors. See Douglas and Frank, *Landlord's Claims in Reorganizations* (1933) 42 YALE L. J. 1003. For a number of instances where equity receiverships were had for purposes other than the direct benefit of creditors, see DEWING, *supra* note 6, at p. 945.

[88]Hopkins, *supra* note 72.

[89]DOUGLAS AND WEIR, *supra* note 1.

[90]See CRAVATH, *The Reorganization of Corporations*, in SOME LEGAL PHASES OF CORPORATE FINANCING, REORGANIZATION AND REGULATION (1917) 154, for an indication of some of the successes of equity reorganization.

[90a]*Supra* note 83.

[91]Municipal Fin. Corp. v. Bankus Corp., *supra* note 74; Matter of Bankus Corp., 45 F. (2d) 907 (S. D. N. Y. 1930). The equity court is without power to compel bankruptcy, Manhattan Rubber Mfg. Co. v. Lucey Mfg. Co., *supra* note 83, but it has been sought to correct this by statute, see *Hearings by House Judiciary Committee* held April 11, 1930 on H. R. 9997, 71st Cong. 2d. Sess.

[92]See CRAVATH, *supra* note 90; lecture on *Foreclosure of Railroad Mortgages* by Byrne in same volume, and Cutcheon, *Recent Developments in Federal Railroad*

is the best possible agency to operate embarrassed businesses and supervise their reorganization; it has its staunch defenders;[93] others prefer the bankruptcy court,[94] and still others, new administrative tribunals.[95] The method apparently most recently in favor with Congress is a combination of administrative and judicial action.[96]

Whatever the auspices under which they may be promulgated, the basic problems inherent in reorganization will remain.[97]

Foreclosure Procedure, in SOME LEGAL PHASES OF CORPORATE FINANCING, REORGANIZATION AND REGULATION (1931) 79, 80; ROSENBERG, *supra* note 83, p. 2, DEWING, *supra* note 6, p. 944.

[93]Mayer, *supra* note 73; Taft, *Recent Criticism of the Federal Judiciary*, (1895) 18 A. B. A. Rep. 237; ROSENBERG, *supra* note 83, IX *circa.*

[94]Hough, C. J., in Manhattan Rubber Mfg. Co. v. Lucey Mfg. Co., *supra* note 83, p. 45. For an indication of the difficulties of reorganization in bankruptcy (except, of course, under the Act of March 3, 1933), see Acme Harvester Co. v. Beekman Lumber Co., 222 U. S. 300, 32 Sup. Ct. 96 (1911); *In Re* Wayne Realty Co., 275 Fed. 955 (N. D. Ohio 1921); *In re* Prudential Outfitting Co., 250 Fed. 504 (S. D. N. Y. 1918); *In re* J. B. & J. M. Cornell Co., 186 Fed. 859, (S. D. N. Y. 1911); *In re* Northampton Portland Cement Co., 185 Fed. 542 (E. D. Pa. 1911). But see 7 REMINGTON BANKRUPTCY (3rd ed. 1924) §3074.2.

[95]See Taft, *supra* note 93, p. 264; ROSENBERG, *supra* note 93. This thought may underly the remark by Mr. Justice Peckham, in the Metropolitan Receivership case, *supra* note 68, that "A court is a very unsatisfactory body to administer the affairs of a railroad as a going concern". Administrative action, on the other hand, has not escaped criticism when it has been tried, see dissenting opinions of Commissioner Eastman in Missouri-Kansas-Texas Reorganization, 76 I. C. C. 84, 108 (1922); Denver & Rio Grande Western Reorganization, 90 I. C. C. 141, 156 (1924); Missouri-Kansas-Texas Reorganization, 99 I. C. C. 330, 332 (1925); Chicago, Milwaukee & St. Paul Reorganization, 131 I. C. C. 673, 701 (1928). See also LOCKLIN, REGULATION OF SECURITY ISSUES BY THE INTERSTATE COMMERCE COMMISSION (1925) Chap. X.

[96]BANKRUPTCY ACT, §§75, 77 (added March 3, 1933), *supra* note 78. This is no easy way out, for "the relation between courts and administrative tribunals continues to be one of the most baffling problems", Powell, *The Relation Between the Virginia Court of Appeals and the State Corporation Commission*, (1933) 19 VA. L. REV. 433. See, Rodgers and Groom, *Reorganization of Railroad Corporations Under Section 77 of the Bankruptcy Act* (1933) 33 COL. L. REV. 571, 582 *et seq.;* (Note) Supervision of Railroad Reorganization Expenses by the Interstate Commerce Commission, (1931) 40 YALE L. J. 974, condemning the concurrent jurisdiction of the courts and the Interstate Commerce Commission over railroad reorganizations.

[97]"Lawyers are apt to exaggerate their own importance and the significance of their legal machinery in determining the form and details of reorganization procedure, forgetful that a reorganization is primarily an adjustment of human motives and economic conditions, circumscribed rather than determined by the law", DEWING, *supra* note 6, p. 932.

"Mere shift in the repository of power or change in the mechanics of courts goes for little or nothing", Bourquin, D. J., in May Hosiery Mills, Inc. v. F. & W. Grand 5-10-25 Cent Stores, Inc., *supra* note 80, p. 221.

REORGANIZATION[98]

The usual object of a reorganization necessitated by financial embarrassment is to rearrange the financial structure[99] without breaking up the business unit. To achieve this object, it is manifestly necessary to take away, in whole or part, from some their strict "legal" rights for the benefit of others. Primarily, the problem is economic and not legal. In so far as it is legal, the basic questions involved relate to the relative priorities to which the different classes of "old" securities are entitled in the reorganized corporation, and the respective rights of the minority, or dissenting, holders of a particular class as against the majority thereof who are in favor of a proposed reorganization plan.

The first of these questions centers on compliance with the rule of the *Boyd* case.[100] It, in substance, is that upon reorganization the stockholders may not receive any rights or interests in the reorganized corporation in preference to the creditors,[101] and that when, in pur-

[98]Probably the best available material on the legal aspects is to be found in the books cited *supra* notes 90, 92. See also Frank, *Some Realistic Reflections on Some Aspects of Corporate Reorganizations*, (1933) 19 VA. L. REV. 541; Rodgers and Groom, *supra* note 96. For a non-legal study, by a lawyer, of a large railroad receivership, see LOWENTHAL, THE INVESTOR PAYS (1933).

[99]Generally, so as to reduce fixed charges, raise new capital, and fund past due or early maturities.

[100]Northern Pacific Ry. v. Boyd, 228 U. S. 482, 33 Sup. Ct. 554 (1913). The decision might have been predicted on the basis of Railroad Co. v. Howard, 7 Wall. 392 (U. S. 1868) and Louisville Trust Co. v. Louisville, etc. Ry., 174 U. S. 674, 19 Sup. Ct. 827 (1899), but see the contrary lower federal and state court decisions cited in the Boyd opinion at p. 503. The view that the "sale" is a mere "form" for effecting a transfer to the reorganized corporation was also not new, see Walker v. Whelen, 4 Phila. 389 (Pa. 1861).

[101]The principle may be broader and may mean "that the relative priorities of the old securities, senior to the most junior securities which continue to have any interest in the property, must not be inequitably disturbed", Swaine, *Reorganization of Corporations: Certain Developments of the Last Decade* (1927) in SOME LEGAL PHASES OF CORPORATE FINANCING, REORGANIZATION AND REGULATIONS (1931) 142 and the same author in CORPORATE REORGANIZATION AND THE FEDERAL COURT, *supra* note 83, at p. 104. This would not necessarily be so if the Boyd decision was only an application of the rule against fraudulent conveyances (GLENN, THE LAW OF FRAUDULENT CONVEYANCES (1931) 300), although it has been suggested that the same result could be reached by a court of equity on some broad notion of "fairness", Frank, *supra* note 98. See Guaranty Trust Co. v. Missouri Pac. Ry. Co., 238 Fed. 812 (E. D. Mo. 1916); New York Trust Co. v. Continental & Comm. Trust & S. Bank, 26 F. (2d) 872 (C. C. A. 8th, 1928), cert. den. 278 U. S. 644, 49 Sup. Ct. 80 (1928); *In re* Howell, 215 Fed. 1 (C. C. A. 2d, 1914), cert. den. 235 U. S. 703, 35 Sup. Ct. 205 (1914).

suance of a reorganization plan which provides for the stockholders[102] but not for the creditors, the property is sold to the "new" corporation, a creditor may follow the assets.[103] The Supreme Court, however, qualified the rule as follows:[104]

> "This conclusion does not, as claimed, require the impossible and make it necessary to pay an unsecured creditor in cash as a condition of stockholders retaining an interest in the reorganized company. His interest can be preserved by the issuance, on equitable terms, of income bonds or preferred stock. If he declines a fair offer he is left to protect himself as any other creditor of a judgment debtor, and, having refused to come into a just reorganization, could not thereafter be heard in a court of equity to attack."

Despite the mental distress which the *Boyd* decision caused

---

[102]"There is no moral turpitude, nor is there any illegality in the making and performing of an agreement between the bondholders secured by mortgages, the stockholders, and the unsecured creditors of an insolvent mortgagor, that there should be a foreclosure and sale of the mortgaged property to or for the benefit of a new corporation in which all the members of the three classes shall be permitted at the option of each of them to take the bonds or stock of the new corporation in substantial proportion to the respective ranks and equities of the classes", St. Louis-San Francisco Ry. Co. v. McElvain, 253 Fed. 123, 133 (E. D. Mo. 1918). The right of a stock holder to receive securities in the reorganized corporation arises not out of his status as stockholder but solely under the Plan and he must therefore receive them pursuant thereto if at all, Dow v. Iowa Central Ry. Co., 144 N. Y. 426, 39 N. E. 398 (1895). Where he is not a party to the reorganization agreement (Bondholders') but only a beneficiary thereunder he has no standing to sue for its modification but must accept or reject it *in toto*, Miller v. Dodge, 28 Misc. 640, 59 N. Y. Supp. 1070 (1899). In United Water Works Co. v. Omaha Water Co., 164 N. Y. 41, 58 N. E. 58 (1900) it was held that under the Plan the Bondholders' Committee was not authorized to allot common stock in the "new" corporation to the preferred stockholders of the "old".

[103]The right exists in favor of all who hold "unsatisfied claims", Pierce v. United States, 255 U. S. 398, 41 Sup. Ct. 365 (1921) (fine); Safety Car Heating & Lighting Co. v. U. S. Light & Heating Co., 2 F. (2d) 384 (W. D. N. Y. 1924) (patent infringement claim); Howard v. Maxwell Motor Co., 269 Fed. 292, *aff'd.* 275 Fed. 53 (C. C. A. 2d, 1921) (lease); *cf.* Kansas City Terminal Ry. Co. v. Central Union Trust Co., 28 F. (2d) 177 (C. C. A. 8th, 1928), cert. den. 278 U. S. 655, 49 Sup. Ct. 179 (1928) (executory contract), but see Okmulgee Window Glass Co. v. Frink, 260 Fed. 159 (C. C. A. 8th, 1918), cert. den. 251 U. S. 563, 40 Sup. Ct. 342 (1919). *Cf.* Equitable Trust Co. v. United Box Board & Paper Co., 220 Fed. 714 (D. C. N. J. 1915). The right may be lost by laches, Waller v. Texas & Pac. Ry. Co., 245 U. S. 398, 38 Sup. Ct. 142 (1918); St. Louis & San Francisco RR Co. v. Spiller, 274 U. S. 304, 47 Sup. Ct. 635 (1927). The measure of recovery is considered in Mountain States Power Co. v. A. L. Jordan Lumber Co., 293 Fed. 502 (C. C. A. 9th 1923) cert. den. 264 U. S. 582, 44 Sup. Ct. 217 (1924), but see Mr. Swaine's comments thereon, *supra* note 101, at pp. 174–175.

[104]228 U. S. 482, 508.

reorganization lawyers,[105] it must be accepted as controlling. The problem is to make certain, beyond peradventure, that the reorganization is "just" and that the terms offered the creditors are "fair" and "equitable".

What is "just, fair and equitable" is, of course, so completely dependent upon the details and circumstances of the particular case that nothing beyond the broadest generalities are available for guidance.[106] The following may be ventured:

1) The stockholders may receive securities in the "new" corporation worth more than the amount they are assessed as a condition of participation.[107]

2) The securities offered to the creditors need not be superior in rank or grade to those which the stockholders may obtain; the priorities may be adjusted in the amount of securities given to each or in the amount of the assessment imposed on each.[108]

3) Where the creditor is offered two or more alternatives, it is sufficient if only one is fair.[109]

4) The fairness of the reorganization must be determined by the Chancellor in the "exercise of an informed discretion concerning the practical adjustment of the several rights",[110] and he should "avoid artificial scruples" but look for "substantial justice".[111]

But how to procure the *timely* approval of the chancellor so as to put to rest the specter of the *Boyd* case?[112]

---

[105]See CRAVATH, *supra* note 90, at p. 197; Cutcheon, *An Examination of Devices Employed to Obviate the Embarrassments to Reorganizations created by the Boyd Case* (1927) in SOME LEGAL PHASES OF CORPORATE FINANCE REORGANIZATION AND REGULATION (1931) 35.

[106]See generally, Bonbright and Bergerman, *Two Rival Theories of Priority Rights of Security Holders in a Corporate Reorganization,* (1928) 28 COL. L. REV. 127; Swaine, *supra* note 101, at pp. 148–160; Buscheck, *A Formula For the Judicial Reorganization of Public Service Corporations* (1932) 32 COL. L. REV. 964.

[107]Jameson v. Guaranty Trust Co., 20 F. (2d) 808 (C. C. A. 7th, 1927), cert. den. 275 U. S. 569, 48 Sup. Ct. 141 (1927); P. R. Walsh Tie & Timber Co. v. Missouri Pac. Ry. Co., 280 Fed. 38 (C. C. A. 8th, 1922) cert. den. 260 U. S. 743, 43 Sup. Ct. 164 (1922).

[108]Kansas City Ry. v. Central Union Trust Co., 271 U. S. 445, 455, 46 Sup. Ct. 549 (1926). For the application of the principles in the same case see 28 F. (2d) 177 (C. C. A. 8th, 1928), cert. den. 278 U. S. 655, 49 Sup. Ct. 179 (1928). See also Temmer v. Denver Tramway Co., 18 F. (2d) 226 (C. C. A. 8th, 1927).

[109]Kansas City Terminal Ry. Co. v. Central Union Trust Co., 28 F. (2d) 177, 188 (C. C. A. 8th, 1928), cert. den. 278 U. S. 655, 49 Sup. Ct. 179 (1928).

[110]Kansas City Ry. v. Central Union Trust Co., *supra* note 108.

[111]Kansas City Ry. v. Guardian Trust Co., 240 U. S. 166, 178, 36 Sup. Ct. 334 (1916). It seems that reorganization plans are "uniformly sanctioned" by the courts, see Weiner, *Reorganization Under Section 77: A comment,* (1933) 33 COL. L. REV. 834, 846; TRACY, CORPORATE FORECLOSURES (1929) 350.

[112]Cutcheon, *supra* note 105; Swaine, *supra* note 101, pp. 142–148.

The typical equity receivership of the kind above discussed is ordinarily promptly consolidated with a foreclosure suit brought by the first mortgagee (commonly a corporate-trustee under a trust mortgage securing the mortgage bonds). In due course the mortgagee procures a judgment of foreclosure and sale and is in position to wipe out all junior security holders.[112a] At this stage, economic realities impinge upon legal theory. The first mortgagee does not want to foreclose all junior interests because it is from them that the needed new capital is most readily obtained. Nobody but the bondholders, because of the right to use the bonds in payment, can reasonably bid for the property at a foreclosure sale, and hence the sale, instead of being a means of realizing in cash the fair value of the property sold, becomes an idle ceremony whereby title is transferred to those who represent the majority-bondholders.[112b]

Prior to the *Boyd* case, the courts adopted the practice[113] of inserting in the foreclosure decree an "upset price", that is, the minimum price at which the court would confirm the sale.[114] Its object was, of course, to protect the mortgagor from a sale at an inadequate price. In effect it is a weapon in the hands of the court in a conflict between assenting and dissenting mortgage bondholders because a low upset price means a small cash distribution to the bondholders who stay out of the reorganization and a high upset price means a large cash distribution to them with the resultant burden upon the reorganization.[115]

With the enunciation of the doctrine of the *Boyd* case, "fairness" achieved by such indirection became clearly insufficient. A direct judicial determination of "fairness" became essential.[116] This re-

[112a]For a discussion of some procedural problems in connection with sales in equity under the Federal Judicial Code, see Israels, *Reorganization Sales*, (1932) 32 COL. L. REV. 668.

[112b]The set-up is frequently much more complicated and requires the adjustment of conflicting claims to the mortgaged property and, in railroad receiverships, the problem of divisional liens is no simple one.

[113]It is discretionary, American S. S. Co. v. Wickwire Spencer Steel Co., *supra* note 82.

[114]Spring, *Upset Price in Corporate Reorganizations* (1919) 32 HARV. L. REV. 489.

[115]Weiner, *Conflicting Functions of the Upset Price in a Corporate Reorganization* (1927) 27 COL. L. REV. 132. See also Cohn, *Why Upset Price? An Argument for Reorganization by Decree* (1933) 28 ILL. L. REV. 225.

[116]Where there is a foreclosure sale the determination is ordinarily made in connection with the confirmation of the sale pursuant to provisions inserted in the foreclosure decree, Kansas City Terminal Ry. Co. v. Central Union Trust Co., *supra* note 109, at p. 185; St. Louis-San Francisco Ry. Co. v. McElvain, 253 Fed. 123 (E. D. Mo. 1918). Swaine, *supra* note 101, at p. 146, note 34. Sometimes the determination is made before, see Guaranty Trust Co. v. Missouri Pacific Ry. Co.,

quired a marked change in the attitude theretofore assumed by receivership courts as to their "neutrality" with respect to reorganization plans,[117] and some modification of technique, but the most diffi-

238 Fed. 812 (E. D. Mo. 1916); Guaranty Trust Co. v. Chicago, M & St. P. Ry., 15 F. (2d) 434 (N. D. Ill. 1926); Sullivan v. St. Louis-San Francisco Ry. Co., 147 Misc. 485, 263 N. Y. Supp. 396 (1933). In Industrial & General Trust Ltd. v. Tod, 180 N. Y. 215, 73 N. E. 7 (1908) it was held that under the deposit agreement there considered the committee was impliedly bound to submit a reorganization plan before foreclosure sale so that the depositors might avail of the right to withdraw in time to act. The foreclosure decree is no adjudication of the rights of the parties to a reorganization agreement *inter sese*, Fuller v. Venable, 118 Fed. 543 (C. C. A. 4th, 1902). The sale may, of course, be in equity and without a mortgage foreclosure, Habirshaw Electric Cable Co. v. Habirshaw Electric Cable Co., Inc., 296 Fed. 875 (C. C. A. 2d, 1924), cert. den. 265 U. S. 587, 44 Sup. Ct. 633, (1923). The sale may be "private", Stokes v. Williams, 226 Fed. 148 (C. C. A. 3d, 1915), cert. den. 241 U. S. 681, 36 Sup. Ct. 728 (1915). As to whether a sale is necessary in order to cut off the rights of security holders who do not participate in the reorganization, see Phipps v. Chicago, R. I. & P. Ry. Co., 284 Fed. 945 (C. C. A. 8th, 1922), cert. granted 261 U. S. 611, 43 Sup. Ct. 363 (1922), dismissed by stipulation, 262 U. S. 762, 43 Sup. Ct. 701 (1923); Coriell v. Morris White, Inc., 54 F. (2d) 255 (C. C. A. 2d, 1931), *rev'd. sub. nom.* National Surety Co. v. Coriell, 53 Sup. Ct. 678 (1933); Harding v. American Sumatra Tobacco Co., 14 F. (2d) 168 (N. D. Ga. 1926).

[117]In 1894, Circuit Judge Lacombe required "absolute neutrality" on the part of a "receiver as between conflicting plans of reorganization", Fowler v. Jarvis-Conklin Mtge. Co., 63 Fed. 888, 890 (S. D. N. Y.). In 1918, after the Circuit Court of Appeals had sustained his order in the Aetna Explosives Company receivership (252 Fed. 456 (C. C. A. 2d)), Judge Mayer appointed a reorganization committee and upon its failure to agree personally promulgated a plan of reorganization, ROSENBERG, *supra* note 83, 62–63. More recently Judge Mack directed a trustee in bankruptcy to assist in the organization of a bondholders' committee and to supervise the drafting of the deposit agreement, *In re* G. L. Miller & Co. Inc. (S. D. N. Y. 1926). In practice the tie-up is frequently most close. In the Missouri-Kansas-Texas Reorganization, 99 I. C. C. 330, 336 (1925), it was noted that "the reorganization managers acted substantially as a board of directors for the receivers in all matters affecting the management and operation of the property during the period of the receivership". The notion of judicial "impartiality" persists, see *In re* International Match Corp., 59 F. (2d) 1012 (S. D. N. Y. 1932). The foreclosure of very large real-estate mortgage bond issues has recently presented the state courts with analogous situations and they seem to have gone even further than the federal courts in their direct attack on the fairness of reorganization plans, see Clinton Trust Co. v. 142–144 Joralemon Street Corp., 237 App. Div. 789, 263 N. Y. Supp. 359 (2d Dept. 1933); Bergelt v. Roberts, 144 Misc. 832, 258 N. Y. Supp. 905, *aff'd.* 236 App. Div. 777 (1st Dept. 1932); Bank of Manhattan Trust Co. v. Ellda Corp., 147 Misc. 374, 265 N. Y. Supp. 115 (1933). See also Carey and Brabner-Smith, *Studies in Realty Mortgage Foreclosures: V. Reorganization* (1933) 28 ILL. L. REV. 1. People v. S. W. Straus & Co. Inc., N. Y. L. J. May 2, 1933, p. 2644. It has however been held that a separate plenary suit is necessary in order to procure an injunction against the consummation of a reorganization, Empire Trust Co. v. Bim's Realty Corp.,

cult problem was to assure the binding effect of the decree. The matter is still beclouded with uncertainty.

When the property of the corporation is sold to a new corporation all the old creditors and security holders are effectually barred by the decree confirming the sale, because, in the absence of a violation of the *Boyd* doctrine, they may not follow the assets and the "right" against the old corporation—left without assets—is valueless.[118] Recognizing the empty formality of the sale in a reorganization, courts have attempted to do without it. The outstanding case is *Phipps v. Chicago, R. I. & P. Ry. Co.*[119] The Circuit Court of Appeals for the Eighth Circuit there held that a court of equity having possession of property may authorize its transfer to a reorganized corporation and restrain creditors from pursuing the property except pursuant to the plan of reorganization thus compelling them to accept securities under the reorganization plan if the court deems the terms fair. The decision was defended[120] and criticised.[121] The Supreme Court granted *certiorari*[122] but was unfortunately prevented from passing on its merits.[123] In the cited case the Court held the decree binding on a creditor who filed a claim, but in a related case[124] it also held it binding upon one who did not.

In a little known and uncited case[125] the Supreme Court held that a

N. Y. L. J., Nov. 23, 1932, p. 2323. In Clinton Trust Co. v. 142–144 Joralemon Street Corp., the court suggested that equity has another indirect weapon of control in its power to direct the foreclosing trustee to purchase the property for the benefit of *all* bondholders. See First National Bank v. Neil, 137 Kans. 436, 20 P. (2d) 528 (1933) and the authorities there cited; Leesman, *Corporate Trusteeships and Receiverships* (1933) 28 Ill. L. Rev. 238, 259–261. See also Chapter 729 of the New York Laws of 1933 granting such power by statute; *cf.* the Michigan statute held unconstitutional as to dissenting bondholders in Detroit Trust Co. v. Stormfeltz Loveley Co., 257 Mich. 655, 242 N. W. 227 (1932).

[118]As to the rights of receivership creditors, see Texas & Pacific Ry. Co. v. Bloom, 164 U. S. 636, 17 Sup. Ct. 216 (1897).

[119]284 Fed. 945 (C. C. A. 8th, 1922). See also American Brake Shoe & Foundry Co. v. Pittsburgh Rys. Co., 296 Fed. 204 (W. D. Pa. 1918), where a receivership was terminated without sale and the court enjoined creditors from prosecuting their claims for ten months, the corporation being required to comply with certain conditions in the interim.

[120]Rosenberg, *supra* note 83, at 124; Colin, *supra* note 115.

[121]See Swaine, *supra* note 101, at 167–172; Harding v. American Sumatra Tobacco Co., 14 F. (2d) 168 (N. D. Ga. 1926).

[122]261 U. S. 611, 43 Sup. Ct. 363 (1923).

[123]Dismissed per stipulation, 262 U. S. 762, 43 Sup. Ct. 701 (1923).

[124]Chicago, R. I. & P. Ry. Co. v. Lincoln Horse & Mule Comm. Co., 284 Fed. 955 (C. C. A. 8th, 1922).

[125]International Ins. Co. v. Sherman, 262 U. S. 346, 43 Sup. Ct. 574 (1923). Receivership on stockholders' bill based on mismanagement, court approved of a

receivership court is without jurisdiction to enter such a decree as against persons not parties to the suit.

The latest ruling on the question is by the Circuit Court of Appeals for the Second Circuit[126] which held that creditors may not be required to accept securities for their claims and are entitled to cash—ordinarily their proportionate share of the proceeds of a judicial sale, but that a dissenting creditor is not always entitled to insist upon a sale and in lieu thereof may be required to accept his proportionate share in cash based on an appraisal of the property. The Supreme Court reversed, without passing on these questions, because the lower court approved the reorganization plan on insufficient evidence.[127]

Whether the procedural problems are solved by statute or by judicial legislation the conflict of interest between those who approve and those who disapprove a proposed plan of reorganization will remain.[127a] It is important that any procedure adopted make adequate provision for the presentment of their respective views to the tribunal whose decree will bind them.[128]

There is a very strong feeling that the wishes of the majority should govern,[129] but there is real danger that blind adherence to any such rule may permit the working of injustice. The individual secur-

---

reorganization plan and barred "annuity certificate" holders who did not join in plan within twenty days from asserting any claim. Held, without jurisdiction as to non-parties.

[126]Coriell v. Morris White, Inc., 54 F. (2d) 255 (C. C. A. 2d, 1931).

[127]National Surety Co. v. Coriell, 53 Sup. Ct. 678 (1933). The court also was apparently dissatisfied because the value was fixed one year later. The valuation has also been criticised as being merely liquidating value, see Frank, *supra* note 98, pp. 716–718.

[127a]"The inevitable outcome of it all is compromise. An adjustment is reached partly on the basis of the constructive power of the majority, and partly through the weight of obstructive tactics at the hands of the minority", W. Z. RIPLEY, RAILROADS: FINANCE AND ORGANIZATION (1915) 390.

[128]For a discussion of proceedings before the Interstate Commerce Commission, see HARVEY, RIGHTS OF MINORITY STOCKHOLDERS (2d Ed. 1929).

[129]Jameson v. Guaranty Trust Co., *supra* note 107, at p. 815; Fearon v. Bankers' Trust Co., 238 Fed. 83 (C. C. A. 3rd, 1916); *Corporate Reorganization—an Amendment to the Bankruptcy Act—A Symposium* (1933) 19 VA. L. REV. 317; (Note) (1933) 42 YALE L. J. 387; Seiff, *Corporate Reorganizations: Defects and a Remedy,* (1933) 67 U. S. L. REV. 75; Act amending Federal Bankruptcy Act approved March 3, 1933; DELAWARE GEN. CORP. LAW, LAWS OF DELAWARE 1929, p. 368, Sec. 5 (9); KY. STAT. (Carroll, 1930) §771a; Gates v. Boston & N. Y. Air Line RR. Co., 53 Conn. 333, 5 Atl. 695, app. dis. 122 U. S. 646 (1885); Gilfillan v. Union Canal Co., 109 U. S. 401, 3 Sup. Ct. 304 (1883); Canada So. Ry. Co. v. Gebhard, 109 U. S. 527, 3 Sup. Ct. 363 (1883). *Cf.* Mather v. Cinn. Ry. Tunnel Co., 3 Ohio C. Ct. 284 (1888); Landis v. West Penn Ry. Co., 133 Pa. 579, 19 Atl. 556 (1890); Kcane v. Moffly, 217 Pa. 240, 66 Atl. 319 (1907).

ity holder is not in a position to pass upon the merits of a proposed reorganization or effectively to express any views thereon even if he has any.[130] In practice, therefore, the majority vote is simply that of the "protective" committee, or of the reorganization committee, with whom a majority of the securities of a particular class have been deposited.[131] This might be deemed quite sufficient if deposit bespoke an actual choice and agreement. In truth, the practical and psychological factors are such that the security holder deposits without much

[130]An individual security holder will ordinarily not be permitted to intervene (Penn Steel Co. v. N. Y. City Ry. Co. 160 Fed. 222 (S. D. N. Y. 1908)), but a committee, or even more than one for good reason, will be, Penn Steel Co. v. N. Y. City Ry. Co., 181 Fed. 285 (S. D. N. Y. 1910). "In my opinion, the recognition by the court of any bondholders', stockholders' or creditors' committee in receivership proceedings should be conditioned upon the submission to the court of the terms of the deposit agreement and further modification of or approval by the court, and that such provisions, not merely as to compensation but also as to creditors' rights of withdrawal, ratification of reorganization plans and many other matters as the court may deem proper in the circumstances of the particular case," Circuit Judge Mack, as Arbitrator, in Central Hanover Bank & Trust Co. v. Ulster & Delaware Railroad Co., (S. D. N. Y. E. 61–329, April 8, 1932). Intervention is "discretionary", Guaranty Trust Co. v. Chicago, M. & St. P. Ry., *supra* note 116; *cf.* Central Trust Co. v. Chicago, R. I. & P. Ry. Co., 218 Fed. 336 (C. C. A. 2d, 1914). Stockholders will not be permitted to intervene in a foreclosure merely to assert defenses which the receiver can assert, Conley v. International Pump Co., 237 Fed. 286 (S. D. N. Y. 1915). In a strict foreclosure, that is, one proceeding without the aid or agreement of the stockholders, the stockholders have no standing to attack the reorganization, if the value of the property is less than the liabilities, American S. S. Co. v. Wickwire Spencer Steel Co., *supra* note 82. Ordinarily bondholders will be permitted to intervene only when the trustee acting for them also represents conflicting interests or is guilty of bad faith, Guaranty Trust Co. v. Chicago, M. & St. P. Ry. Co., *supra* note 116; Clinton Trust Co. v. 142–144 Joralemon Street Corp., *supra* note 117. In Guaranty Trust Co. v. Chicago, M. & St. P. Ry. Co., it was held that the mere fact that the trustee was depositary for a committee and one of its officers was secretary of the committee was not sufficient. *Cf.* Central Trust Co. v. Chicago, R. I. & P. Ry. Co., 218 Fed. 336 (C. C. A. 2d, 1914). See also Fidelity Trust Co. v. Washington-Oregon Corp., 217 Fed. 588 (W. D. Wash. 1914). One need not be a party in order to be heard, Investment Registry, Ltd. v. Chicago & M. E. Ry. Co., 212 Fed. 594 (C. C. A. 7th, 1913). Section 77 of the Bankruptcy Act has been criticised for according to dissenters too generously the right to be heard, Rodgers and Groom, *supra* note 96, at pp. 590–592. Dissenters are, however, given "little real protection", ibid. at p. 589, see also, Weiner, *supra* note 111; Frank, *supra* note 98, at pp. 708–711.

[131]See generally, Rodgers, *Rights and Duties of the Committee in Bondholders' Reorganizations*, (1929) 42 HARV. L. REV. 899; (Note) Bondholders' Committees in Reorganization, (1928) 41 HARV. L. REV. 377; Rohrlich, *Protective Committees*, (1932) 80 U. of PA. L. REV. 670.

consideration of the merits.[132] The necessary result is that the court must be "vigilant to see, on the one hand, that a dissenter be not permitted to create a maneuvering value in his bonds by opposing confirmation, and on the other, that the majority does not use its power * * * to oppress a helpless minority."[133]

The right of the minority to be treated equally with the majority[134] is not sufficiently assured by an offer of formal equality. The majority committee may be motivated by private intangible considerations beneficial only to them[135] and the minority must therefore be given an opportunity not only to attack any discrimination against them but also the plan itself. Otherwise the dangers of a *pro forma* approval are too great.

A minority committee is generally at a great disadvantage because it is ordinarily organized to oppose a committee already in the field which was organized under the sponsorship either of the

---

[132]Investment Registry, Ltd. v. Chicago & M. E. Ry. Co., *supra* note 130, at p. 611; Isaacs, *supra* note 3, at pp. 208–9; Commissioner Eastman dissenting in Chicago, Milwaukee & St. Paul Reorganization, 131 I. C. C. 673, 702–703 (1928); Industrial Realty Fin. Corp. v. S. W. Straus & Co. Inc., 144 Misc. 832, 258 N. Y. Supp. 905 (1932). Mr. Frank goes so far as to say that majority approval should have "no probative value whatever", *supra* note 98, at p. 714.

[133]Investment Registry, Ltd. v. Chicago & M. E. Ry. Co., *supra* note 130, at p. 610; to the same effect, Palmer v. Bankers' Trust Co., 12 F. (2d) 747, 754 (C. C. A. 8th, 1926), where the court also stated that in weighing the claims of dissenters it would consider whether they bought the securities "pending the reorganization and for the purpose of speculating thereon".

[134]Southern Pacific Co. v. Bogert, 250 U. S. 483, 39 Sup. Ct. 533 (1919). *Cf.* North Amer. Co. v. St. Louis-San Francisco Ry. Co., 28 F. (2d) 174, 175 (E. D. Mo. 1926) *mod.* and *aff'd sub. nom.* Kansas City Terminal Ry. Co. v. Central Union Trust Co., 28 F. (2d) 177 (C. C. A. 8th, 1928), cert. den. 278 U. S. 655, 49 Sup. Ct. 179 (1928) holding that the fact that the reorganization committee purchased claims from certain creditors thus giving them better terms was no objection, but see Investment Registry, Ltd. v. Chicago, & M. E. Ry. Co., *supra* note 130, where the court refused to confirm a sale because the committee had "chilled" the bidding by purchasing a large block of bonds which might have been used by a competing bidder.

[135]Such as retaining control of the corporation, or the good will of the investment bankers who floated certain of the securities. In National Surety Co. v. Coriell, *supra* note 116, Mr. Justice Brandeis said, at p. 682:

> "The creditors who approved of the plan of reorganization appeared to be actuated in their recommendations and desires by considerations not applicable to the dissenting creditors. For the bauk creditors, unlike the others, were to a large extent secured by the pledge of assets and may moreover, have received preferences which would be held invalid if bankruptcy proceedings were instituted. The assenting merchandise creditors were interested not merely as creditors but as sellers of goods; and it appeared that at least some were far more interested in expected profits from future sales than in possible dividends on their existing claims."

corporation or the investment bankers who sold the securities. The committee is wholly powerless to act if it is in no position to circularize the security holders to solicit their deposits or proxies. It is essential therefore that the committee have their names and addresses. In a few recent cases the aid of the court has been sought to procure such lists.[136]

Relief has been granted and denied. It would seem that the sound rule should be that the minority committee may compel disclosure when the information is in the possession of, or has been procured from, a person owing fiduciary obligations to all the security holders of the class, such as the corporation itself,[137] the trustee under a mortgage indenture, or the investment bankers who floated the issue, but not when the information is only in the possession of the majority committee as the result of its own efforts and expense.

[136]Bergelt v. Roberts, *supra* note 117; *In re* International Match Corp., *supra* note 117; Industrial & Realty Fin. Corp. v. S. W. Straus & Co., Inc., *supra* note 132. See also Hart v. Wiltsee, 19 F. (2d) 903 (C. C. A. 1st, 1927), cert. den. 275 U. S. 559, 48 Sup. Ct. 419 (1927).

[137]By an application of the rule that the relationship between a debtor corporation and its bondholders is not that of trust (*supra*, note 30) such relief has been denied against the debtor corporation (Marx v. Merchants' National Properties, Inc., 148 Misc. 6, 265 N. Y. Supp. 163 (1933). It would seem that a court could, where the corporation is in financial difficulties, find a trust relationship. (See *supra*, note 31).