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Article

Business Reorganization Under the New Bankruptcy Code

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One of the most significant changes brought about by the new Bankruptcy Reform Act of 1978, which became effective October 1, 1979, is the revision and consolidation of the former Chapters X, XI, and XII of the Bankruptcy Act of 1938 (concerning corporate reorganizations and arrangements) into a single Chapter 11. The purpose of this article is to analyze the reorganization provisions with respect to some entirely new concepts. When applicable, the roots in former practice are noted, and, alternatively, variations from former practice are discussed.


2. Ch. 575, 52 Stat. 840.
3. 11 U.S.C. §§1101-1174 (Supp. III 1979). The Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, is referred to in the text as the new Code. Bankruptcy law as it existed prior to October 1, 1979, now repealed, is referred to in the text as the Bankruptcy Act or the old Act. Chapter 11, as used herein, refers to Chapter 11 of Title 11 of the United States Code. Chapter X and Chapter XI, as used herein, refer to Chapter X and XI of the now repealed Bankruptcy Act.
An effective reorganization process must contain a reorganization procedure, provide for the survival of the business during the process, and be designed to cause the emergence of a viable business entity.

In light of these requirements, this article focuses first on the commencement of the case and the administrative procedures followed from commencement through the meeting of creditors' committees and the considerations of whether a trustee should be appointed or a debtor should remain in possession. Next, this article focuses on the automatic stay, the obtaining of credit, and the use of collateral, as these are designed to insure the survival of the business during the reorganization process. Lastly, the article treats the plan which is designed to transform the failing business into a viable economic entity. The goal of this article is to contribute to an understanding of what can be characterized as an extensive revision of the reorganization provisions of the Bankruptcy Act.

**REORGANIZATION: BACKGROUND**

Bankruptcy proceedings may be either liquidation proceedings under Chapter 7, or debtor rehabilitation proceedings, known as reorganization proceedings, under Chapter 11. A reorganization under Chapter 11 is an alternative to liquidation under Chapter 7. Subject to minor exceptions, in liquidation the debtor gives up all of his assets in return for a discharge of his debts. The creditors receive all that the debtor had and the business no longer exists. Reorganization, on the other hand, provides for a scaling down of debts. By consent, or under protective provisions, creditors accept less than the full amount of their debts and the debtor is discharged from the balance of the debt. In reorganization, the business, in a modified form, continues and the creditors look to future earnings of the debtor rather than to the debtor's present assets to satisfy their claims. Reorganization, as opposed to liquidation, is appropriate when creditors will fare as well or better than they would in liquidation and when the business with a restructured debt can remain as a viable business enterprise.

In short, the purpose of business reorganization is a restructuring of a debtor's finances, so that instead of liquidating, a failing business may continue to operate, but as a viable company. This will enable creditors to receive as much or more than they would under liquidation and provide continued employment, as well as produce returns for shareholders and generally be a positive force in the economy. From the

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5. See notes 197-215 and accompanying text infra.
standpoint of the debtor and of society, the debtor’s assets are generally more valuable as part of a going concern than they would be after liq-

Under the old Act, difficulties were encountered at the outset in de-
ciding under which chapter to proceed. Chapter X of the old Act was confined to reorganization of a corporation and could affect secured as well as unsecured debt. Chapter XI could be availed of by individuals or corporations, but it could only affect unsecured debt. Debtors frequently preferred Chapter XI because current management was usually left in control of the company. Creditors and the Securities Exchange Commission frequently preferred Chapter X because of greater protection for publicly held debt. Prior to the consolidation, this conflict produced much costly and unproductive litigation which revolved around the question of whether Chapter X or XI was the proper chapter under which a case should be brought.

The quality of a reorganization was more pervasive under Chapter X, since a Chapter X petition could not be filed unless adequate relief was not obtainable under Chapter XI. A Chapter XI petition had to be transferred to Chapter X if the proceeding should have been brought under Chapter X. Furthermore, the courts were less than clear about which chapter was appropriate in particular cases. The applicability of the two chapters was considered by the Supreme Court in SEC v. American Trailer Rentals Co. The substance of the Supreme Court decision in this case was that although Chapter X need not be used in all cases where the debtor is publicly owned or publicly held, it must be used when the plan results in more than a minor adjustment of a large amount of publicly held debt. In American Trailer, the Supreme Court indicated that when public investors were few, or only a minor adjustment of publicly held debt was involved, the following factors should be considered by courts in determining whether Chapter X or XI was the appropriate chapter: (1) the number of public investors; (2) evidence of mismanagement; (3) need for new management; (4) need for a study of the debtor’s financial problems; and (5) the need for pervasive reorganization.

14. The Court defined “minor adjustment” as a short extension of time for payment. Id. at 614.
15. See id. at 610-15.
This problem could be compounded by a late filing of the motion to convert to a Chapter X case. For example, in *SEC v. Canadaigua Enterprises Corp.*,\textsuperscript{16} the filing of the motion to convert was delayed until after a plan had been proposed and accepted. The debtor's problems appeared to be nearly resolved. All progress in the case ceased in order for the court to hear the motion. The district court denied the request for conversion to Chapter X and the SEC appealed. The Court of Appeals for the Second Circuit reversed and sent the case back for the appointment of a trustee and conduct of the case under Chapter X.\textsuperscript{17} As a result of the delay, reorganization failed and adjudication in bankruptcy followed. The consolidation under the new Code, which provides for one proceeding under Chapter 11 for all reorganizations, will eliminate the often time-consuming motion under Section 328 of the old Act\textsuperscript{18} and Bankruptcy Rule 11-15\textsuperscript{19} to convert a Chapter XI case into a Chapter X case.

Chapter 11 of the new Code is not self-contained. The new Code incorporates the provisions of Chapters 1 (General Provisions), 3 (Case Administration), and 5 (Creditors, the Debtor, and the Estate).\textsuperscript{20} Definitions are contained in Chapter 1.\textsuperscript{21} Chapter 3 contains provisions regarding the automatic stay,\textsuperscript{22} use of collateral,\textsuperscript{23} borrowing money,\textsuperscript{24} executory contracts,\textsuperscript{25} and continuation of utility service.\textsuperscript{26} Chapter 5 contains sections on what constitutes property of the estate,\textsuperscript{27} and the trustee's avoiding powers.\textsuperscript{28} The Securities and Exchange Commission is involved in that it may raise, and appear and be heard on, any issue in a case. It may not, however, appeal from any judgment order or decree that is entered.\textsuperscript{29}

Chapter 11 is available to individuals, partnerships, and private and public corporations. The statute conferring jurisdiction first provides that the United States district courts have original and exclusive jurisdiction of all cases under the new Code.\textsuperscript{30} The statute then provides that the bankruptcy court for the district in which a case under the new

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\textsuperscript{16} 339 F.2d 14 (2d Cir. 1964).
\textsuperscript{17} Id. at 15.
\textsuperscript{18} Bankruptcy Act, ch. 575, §328, 66 Stat. 432 (former 11 U.S.C. §728 (1976)).
\textsuperscript{21} Id. §101.
\textsuperscript{22} Id. §362.
\textsuperscript{23} Id. §363.
\textsuperscript{24} Id. §364.
\textsuperscript{25} Id. §365.
\textsuperscript{26} Id. §366.
\textsuperscript{27} Id. §542.
\textsuperscript{28} Id. §§544-554.
\textsuperscript{29} Id. §1109(a).
A reorganization case may be commenced by the filing of a voluntary petition by the debtor or by the filing of an involuntary petition by creditors. The new Code, unlike the old Act, does not require proof of acts of bankruptcy. Although the old Act required proof of acts of bankruptcy as a prerequisite to the filing of an involuntary petition, it was almost impossible for an entity not generally able to pay its debts as they became due to avoid the commission of one of the enumerated acts of bankruptcy. For example, the third act of bankruptcy consisted of a person permitting "while insolvent, any creditor to obtain a lien upon any of his property . . . and not having . . . discharged such lien within thirty days. . . ." The second act of bankruptcy consisted of making a preferential transfer. At some point a creditor will obtain a lien against a person generally not paying his debts.
debts as they become due. Once this occurred, the debtor under the old Act was on the horns of a dilemma. If he did not discharge the lien within 30 days, he had committed the third act of bankruptcy. If he did discharge the lien, he had committed the second act of bankruptcy.

The new Code does not require proof of acts of bankruptcy, and instead the involuntary petition must merely allege that the debtor is generally not paying its debts as they become due. The petition may also allege that a nonbankruptcy custodian was appointed for or took possession of substantially all of the debtor's property within the preceding 120 days. The new Code treats the appointment of such nonbankruptcy custodian (voluntarily appointed by the debtor or involuntarily appointed by a nonbankruptcy court) as an irrebuttable presumption that the debtor is unable to pay its debts as they mature. Once a proceeding to liquidate assets, through the appointment of such nonbankruptcy custodian, has been commenced, the debtor's creditors have an absolute right to have the liquidation or reorganization proceed in the bankruptcy court under all of the protection of the bankruptcy laws.

Upon the filing of a voluntary petition the order for relief is automatic. An order for relief will be entered in an involuntary case when the creditors prove the allegations of the petition. Once the order for relief in an involuntary case is entered, the case will proceed as in a voluntary case. From this point on, the substance of reorganization and the procedure to be followed is the same, whether the case was originally commenced as a voluntary or involuntary one.

When an involuntary petition is dismissed, other than by consent of all petitioners and the debtor, and the debtor does not waive its rights, judgment may be entered against the petitioners for costs and attorney's fees. If an involuntary petition is contested, a jury trial may be held in the discretion of the court. Note that a trustee may be appointed by the bankruptcy court for cause and a major duty of the trustee will be to take possession of the debtor's property. In the case of an involuntary petition, if a trustee was appointed and took possession of the debtor's property, judgment may be awarded for any dam-

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42. Id. §303(h)(2).
43. See S. Rep. No. 95-989, supra note 4, at 5787, 5818.
44. The “order for relief” was previously the adjudication in bankruptcy. See S. Rep. No. 95-989, supra note 4, at 5717.
46. Id. §303(i)(1)(A).
47. Id. §303(i)(1)(B).
50. Id. §§704(1), 1106(a)(1).
ages proximately caused thereby. Whether or not a trustee was appointed, both compensatory and punitive damages may be assessed against a petitioner who is found to have filed in bad faith.

Within a time fixed by the court, the debtor must file a schedule of assets and liabilities, a statement of financial affairs, and a list of creditors. From this list, notice of the initiation of the proceedings will be given to creditors. A proof of claim or interest is deemed filed under Section 501, which deals with filing proofs of claims, for any claim or interest that appears in the filed schedules except for claims that are scheduled as disputed, contingent, or unliquidated. Thus, the new Code dispenses with the requirement under the old Act that every creditor and equity security holder file a proof of claim or interest in a reorganization case.

A Chapter 11 reorganization case may be converted into a liquidation case under Chapter 7. This may be accomplished without cause by the debtor if the petition was a voluntary one or if no trustee has been appointed. The court may for cause convert a Chapter 11 case into a Chapter 7 case or may dismiss the case on request of a party in interest after hearing. Cause in this situation includes, among other things, continuing loss to the estate and absence of a reasonable likelihood of rehabilitation, inability to effectuate a plan, and material default by the debtor with respect to a confirmed plan.

Committees Under the New Code

Many of the actions that must be taken in order to effect a reorganization are accomplished by committees. It is a function of a creditors' committee to examine the debtor under oath. The purpose of the examination is to determine if assets have been improperly disposed of or

51. Id. §303(i)(1)(C).
52. Id. §303(i)(2).
53. Id. §521(1). The present Rules of Bankruptcy Procedure, to the extent that they are not inconsistent with the new Bankruptcy Code, remain effective until they are repealed or superseded. See Bankruptcy Rule 10-108, Appendix, 11 U.S.C. 1434 (1976). The Advisory Committee on Bankruptcy Rules of the Judicial Conference of the United States has distributed guidelines in the form of interim rules and forms to guide bankruptcy courts. These are designed to assist the bench and bar in processing cases and will be binding only to the extent that they are adopted as local bankruptcy rules. With respect to a schedule of assets and liabilities, a statement of financial affairs, and a list of creditors, see Suggested Interim Form Nos. 6, 7, suggested Interim Rule 1007, 11 U.S.C. Interim Bankruptcy Rules 57, 69 (1979) (West Publishing Co.).
55. Id. §1111(a).
56. S. REP. No. 95-989, supra note 4, at 5903.
57. 11 U.S.C. §1112 supra note 4, at 5903.
58. Id. §1112(a).
59. Id. §1112(b).
60. Id.
61. Id. §343.
concealed. The committee may and probably will "investigate the acts, conduct, assets, liabilities and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan." The committee may participate in the formulation of a plan and with the court's approval may select and authorize the employment by the committee of attorneys, accountants, or other agents to represent or perform services for the committee. Under the new Code, a committee of unsecured creditors will be appointed by the court at the earliest practicable time. This change was made because, under former practice, attorneys would too often seek employment by creditors in order to influence the election, and then be retained as counsel for the committee. The change was also made in order "to insure that the committees are fairly representative and not solely controlled by attorneys seeking the counsel position." Under the new Code, when no prepetition committee is formed, the creditors' committee will consist of the seven largest creditors who are willing to serve. In the event that unsecured creditors form a committee prior to the filing of the petition, that committee instead will be the official committee if it is chosen fairly and is representative.

Other nonappointed committees (that is, committees created by creditors themselves without appointment by the court) can function and their employees, attorneys, and accountants, can be compensated from the estate if the committee makes a substantial contribution to the case. However, without proof that the committee will play such a role, only persons employed by the official committee appointed by the court are entitled to compensation based on time devoted to the case and the nature and value of their services.

In order to function properly, the committee must organize. In a substantial change from practice under the old Act, the new Code pro-

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64. See S. Rep. No. 95-989, supra note 4, at 5829.
66. Id. §1103(c)(3).
67. Id. §1103(a).
68. Id. §1102(a)(1).
71. Id.
72. Id. §503(b)(3)(D), (4).
73. Id. §§328, 330(a).
vides that the court may not preside at or even attend the first meeting of creditors. The effect of this change is that the committee, and not the court, will oversee much of the reorganization process. Under the new Code, the court will not be involved in the day-to-day affairs of the debtor. Instead the court's role under the new Code will largely be the judicial role of resolving disputes.

**TRUSTEE OR DEBTOR IN POSSESSION**

During the reorganization process the business must be managed. A choice must be made whether or not to allow old management to continue. If the old management is allowed to remain, it does so as a "debtor in possession" of the property. The other alternative is to select a new entity to manage the company. This is accomplished by the appointment of a trustee. The resolution of this problem is addressed by the new Code in its criteria for the appointment of a trustee.

The new Code establishes standards for the appointment of a trustee. The appointment of a trustee was automatic under Chapter X of the old Act if the debtor's liabilities exceeded $250,000. Under Chapter XI, the debtor usually continued in possession unless, for cause shown, the court appointed a receiver. The new Code leaves the debtor in possession of his property unless a request is made by a party in interest for the appointment of a trustee. The committee of creditors may request the appointment of either a trustee or an examiner. Regardless of the request by the committee, the business will continue to be operated by the debtor in possession unless the court orders otherwise. With certain exceptions the debtor in possession will have all of the rights, functions, and duties of a trustee. The exceptions are the right to receive the compensation that a trustee would receive for his services under Section 330 of the Code, and the investigative duties and powers of a trustee.

A trustee must be appointed if, on application of a party in interest, the court finds that there is cause for appointment. Cause includes fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor. Under former practice, as noted in the discussion of *American Trailer*, the greater the number of holders of securities, the

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74. *Id.* §341(c).
75. *Id.* §1104(a).
78. *Id.* §1103(c)(4).
79. See *id.* §1107(a).
82. See notes 13-15 and accompanying text *supra*.
more likely that old Chapter X would be deemed the appropriate chapter. Therefore, under former practice, the combination of many public investors and great liabilities would result in the appointment of a trustee. In a departure from the old Chapter X procedure, the new Code definition of cause, leading to the appointment of a trustee, specifically excludes consideration of the number of holders of securities of the debtor or the amount of assets or liabilities.

If a trustee is not appointed, upon application of a party in interest, the court will, after notice and hearing, order the appointment of an examiner in either of two situations. The first situation is when such appointment is in the interest of creditors, equity security holders, and those holding other interests in the estate. The second situation in which an examiner will be appointed is when the debtor's fixed, liquidated, unsecured debts, other than debts for goods, services or taxes, or debts owed to an insider, exceed $5,000,000. Once an examiner is appointed, he is to conduct an appropriate investigation, including an investigation of fraud, dishonesty, or incompetence. It should be noted that the appointment of an examiner does not affect the debtor's status as a debtor in possession.

Upon the appointment of a trustee, the debtor does not remain as a debtor in possession. In a change from former practice, unless the court orders otherwise, the trustee may operate the debtor's business. The appointment of a trustee also deprives the debtor of the exclusive right to file a plan of reorganization. After the appointment of a trustee any party in interest may file a plan.

THE AUTOMATIC STAY

After the decision is made as to whether the business will be operated during reorganization by a trustee or by the debtor, the practical problem of how to operate the business effectively must be addressed. Unless the business can perform successfully in the market place while reorganization is in progress, the entire reorganization procedure will likely be futile, since the business will cease to exist as a viable or po-

83. See note 76 and accompanying text supra.
85. Id. §1104(b)(1).
86. Id. §1104(b)(2).
87. Chapters X and XI of the old Act, through Bankruptcy Act, ch. 575, §§189, 343, 52 Stat. 892, 909 (former 11 U.S.C. §§589, 743 (1976)) respectively, permitted continued operation of the business by the trustee or debtor in possession only upon authorization by the court.
88. 11 U.S.C. §1108 (Supp. III 1979). "Thus in a reorganization case operation of the business will be the rule, and it will not be necessary to go to the court to obtain an order authorizing operation." S. Rep. No. 95-989, supra note 4, at 5902.
tentially viable entity. Crucial to the ability of the business to function during reorganization is the automatic stay.

In most cases the debtor will be in default on loans and other obligations at the time of the filing of a petition. Secured creditors will be attempting to take possession of their collateral, and other creditors will be seeking to obtain liens or to improve their positions. The filing of a petition operates as an automatic stay of almost all actions against the debtor.90 This is designed to give the debtor a breathing spell from his creditors. It stops all collection efforts, harrassment, and foreclosure actions.91 It gives the debtor time to formulate and attempt a reorganization plan.92 The plan is the vehicle through which the reorganized company is formed. It provides for the alteration of rights and liabilities and establishes the structure of the reorganized company.93

The stay is applicable, inter alia, to the commencement or continuation of judicial or administrative proceedings, or the enforcement of judgments. The stay also precludes any act to obtain possession of property of the estate, or to create, perfect, or enforce liens.94 Certain actions are excepted from the operation of the stay. These include criminal actions against the debtor, actions for alimony, government action to enforce police or regulatory power, and the issuance to the debtor of notice of tax deficiency.95

Except when terminated or modified, the stay of an act against property continues until the property is no longer property of the estate. The stay of any other act continues until the case is closed or dismissed or until a discharge is granted or denied.96

A party in interest may institute proceedings in the bankruptcy court to obtain relief from the stay. Such relief includes terminating, annulling, modifying, or conditioning the stay. Relief may be granted for cause, including the lack of adequate protection of an interest in property. It may also be granted if the debtor does not have an equity interest in the property, and if such property is not necessary for an effective reorganization.97

Action to vacate a stay will normally be taken after notice and hearing.98 However, the court may grant relief without a hearing when nec-
necessary to prevent irreparable damage that would occur before there is
an opportunity for notice and hearing. A preliminary hearing on the
request for relief from the stay must be commenced within 30 days
after such request or the stay will be automatically terminated. At
the hearing, the court must order the stay continued if there is a reason-
able likelihood that the party opposing the relief will prevail at the final
hearing. The final hearing must be commenced within 30 days after
the preliminary hearing. The automatic stay, as to a party who re-
quests relief from the stay, will cease unless the final hearing is com-
menced on the matter within 60 days from the date of the request for
relief. The court need not, however, conclude the hearing or make its
ruling within any time period set forth in the statute.

In a related matter, it should be noted that the new Code voids so-
called bankruptcy clauses in executory contracts and leases. Notwith-
standing such a provision, contracts or leases may not be terminated or
modified after the commencement of the case because of the insolvency
or financial condition of the debtor, or because of the commencement
of the case.

**OBTAINING CREDIT AND USE OF COLLATERAL**

The breathing spell provided by the automatic stay will not alone
suffice to allow the debtor to survive in the market place during the
reorganization process. In the usual case the debtor will be short of
cash. Creating the ability to obtain that cash is the next subject ad-
dressed by the new Code.

In almost all cases a debtor must be able to obtain credit in order to
secure cash and to continue to operate the business during the reorgani-
ization proceedings. Under former Chapters X and XI, the debtor
could not obtain secured or unsecured credit without court approval.
Under the new Code, the debtor or trustee may obtain unsecured credit
*in the ordinary course of business* without a court order. The debt is
automatically entitled to a first priority as an administrative expense.

If the debt is incurred *other than in the ordinary course of business* it
may receive such first priority if the court so authorizes after notice and
hearing. Court interpretation may be necessary to refine a definition
of which debts are and are not incurred in the ordinary course of busi-

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99. *Id.* §362(f).
100. *See id.* §362(e).
101. *Id.* §362(e)(1).
102. *See id.* §362(e)(2).
103. *See id.* §365(e)(1).
104. *Id.* §364(a). *See id.* §§503(b)(1), 507(a)(1).
105. *Id.* §364(b).
ness. The old Act does not provide insight to future court interpretation of this provision since this distinction did not exist previously. Certain observations can be made, however. If the business is not being operated at this stage of the reorganization proceeding, any credit received probably would not be in the ordinary course of business, and court authorization would be necessary to give that creditor a first priority administrative claim. In this circumstance, the practicing attorney who represents a supplier or lender willing to extend unsecured credit would be well advised to secure court authorization of the transaction. This will avoid a later argument over whether the credit was extended in the ordinary course of business and insure the priority status of the claim.

Frequently the debtor will not be able to obtain credit on an unsecured basis. If this is the case, the court may, after a noticed hearing, authorize the obtaining of credit with priority as an administrative expense, secured by a lien on property of the estate that is not otherwise subject to a lien,106 or secured by a junior lien on property of the estate that is already subject to a lien.107 If credit cannot be obtained on the above basis, the court may authorize credit secured by a senior or equal lien provided there is adequate protection afforded the holder of the lien being affected.108

Unless the court orders otherwise the trustee or debtor in possession may operate the debtor's business,109 and may use collateral. The trustee or debtor in possession may also enter into transactions, including the sale or lease of property, in the ordinary course of business.110 However, the trustee or debtor may not use, sell, or lease cash collateral unless each entity that has an interest in the cash collateral consents, or unless the court so authorizes after notice and hearing.111 Cash collateral is defined as cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents in which the estate and an entity other than the estate have an interest.112 It should also be pointed out that once noncash collateral is converted into cash collateral (for example by a sale of inventory for cash), the proceeds are treated as cash collateral if the security interest applies, as it normally would, to proceeds.113

This right of the debtor or trustee to use collateral is crucial to the

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106. Id. §364(c)(1), (2).
107. Id. §364(c)(3).
108. Id. §364(d)(1).
109. Id. §§1107, 1108.
110. Id. §363(c)(1).
111. Id. §363(c)(2).
112. Id. §363(a).
113. See id. §552(b); U.C.C. art. 9 (9th ed. 1978).
continued operation of the business. Without this type of protection, repossession would frequently effectively end chances for reorganization. In the usual case, most of the debtor's assets will be subject to security interests and the obligations will be in default. Under Uniform Commercial Code Section 9-503, which grants a secured party the right to possession of the collateral after default when possession can be obtained without a breach of the peace, the secured creditor could normally repossess the business assets. However, the right of the trustee or debtor in possession to use the collateral prevents the secured creditors from stopping the operation of the business by taking possession of the collateral.

The advantages of continued effective operation of the business must be balanced against the secured creditor's rights by affording the secured creditor the opportunity to seek relief from the automatic stay. As noted above, such relief shall be granted if the debtor does not have an equity in the property and the property is not necessary to an effective reorganization. Otherwise the court shall only grant relief for cause. "Cause" specifically includes the lack of adequate protection of an interest in property. Thus, if "adequate protection" exists or can be arranged the debtor or trustee can continue to use the collateral. If such does not exist, or cannot be arranged, the secured party may obtain the collateral.

The words "adequate protection" are not defined by the new Code. The Code does state that such protection may be provided by requiring the trustee to make cash payments to the secured creditor, or by providing an additional or replacement lien. The necessary protection may also result from providing relief which will result in the realization by the creditor of "the indubitable equivalent" of his interests. If the attempt to provide "adequate protection" fails to provide such an equivalent, that creditor is granted a priority claim.

The Plan

The provisions discussed above concerning the automatic stay, ob-

115. Id. §362(d).
116. Id. §362(d)(2).
117. Id. §362(d)(1).
118. Id. §361(1).
119. Id. §361(2).
120. Id. §361(3).
121. Id. §507(b). For an informative treatment of the use of property based upon a hypothetical factual situation, see Levi, Use and Disposition of Property Under Chapter 11 of the Bankruptcy Code: Some Practical Concerns, 53 AM. BANKR. L.J. 275 (1979).
taining credit, and use of collateral are designed to enable the debtor to survive during the reorganization process. The provisions relating to the plan are designed to enable the debtor to emerge from the reorganization process as a viable economic entity. They are also an effort to place creditors in no worse a position than they would be in as a result of liquidation.

A. Who May File

With respect to who may file a plan, new Chapter 11 finds a middle ground between old Chapter XI, where only the debtor could propose a plan, and old Chapter X, where any party in interest including creditors could propose a plan.

If a trustee has not been appointed, the debtor in possession has the exclusive right to file a plan for 120 days after the date of the order for relief, regardless of whether the petition for liquidation was voluntary or involuntary. However, the court, for cause shown, may extend or reduce the 120 day period, but only after notice and a hearing. In addition, the debtor may file a plan with the petition. Under the Code, once the exclusive period for filing has passed, any party in interest may file a plan, including creditors or shareholders. Also, any party in interest may file a plan once a trustee has been appointed. If, within 180 days after the date of the order for relief (120 days plus an additional period of 60 days to obtain acceptance), the debtor has filed a plan which has been accepted by each class of claims or interests that are impaired under the plan, other parties may not file a plan. Once the plan has been accepted, the hearing on confirmation of the plan will proceed.

Although parties in interest may file a plan as indicated above, when the debtor has been retained in possession in a voluntary case, that plan will no doubt be tempered by the knowledge of the formulators that a debtor has the option to convert to liquidation under Chapter 7. Although the creditors may move to convert back to Chapter 11, as a practical matter they would have to proceed without the debtor's cooperation. Under these circumstances, the debtor himself is in control of the management of the company and therefore the debtor's coopera-

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124. Id. §1121(d).
125. Id. §1121(a).
126. Id. §1121(c).
127. Id. §1121(c)(1).
128. Id. §1121(c)(3).
129. Id. §1112(a).
130. Id. §706(b).
tion is essential to the success of the plan and the business. When the debtor in possession has indicated a preference for liquidation, realistically no plan could succeed unless its terms were made so favorable to the debtor vis-a-vis the creditors as to convince the debtor to cooperate in the implementation of the plan.

B. Classification Under the Plan

The new Code seeks to enhance the ease of the process of reorganization without adversely affecting substantial interests. Claims and interests may be placed into classes by the plan, and may thereafter be treated alike if they are substantially similar. As an exception to the foregoing, small unsecured claims that are not similar may be placed into a class if they are less than an amount approved by the court as reasonable and necessary for administrative convenience.

C. Contents of the Plan

The Code requires the plan to deal with certain items, and permits the plan to deal with others. The discussion which follows indicates how the matters affecting the reorganization must be divided.

The plan may deal with any or all secured and unsecured debts and with equity interests. Under former practice, secured debts could be dealt with in Chapter X, but not in Chapter XI. The new Code, in this respect, follows old Chapter X and permits a plan to impair any class of claims, secured or unsecured. The provisions of the plan, both mandatory and permissive, follow in large part the requirements of Chapter X of the old Act. In a departure from former Chapter XI practice, generally followed since 1951, the plan may provide for liquidation of the estate. Additional changes from the old Act result in reducing the amount of available cash required for confirmation. Priority claims, such as wages, contributions to employee benefit plans, and consumer deposits, may be provided for on a de-

131. Id. §1122(a).
132. Id. §1122(b).
133. Id. §1123(a).
134. Id. §1123(b).
135. Id. §1123(b)(1).
138. See id. §1123.
140. See In re Pure Penn Petroleum Co. Inc., 188 F.2d 851, 855 (2d Cir. 1951).
ferred basis provided the class accepts the plan. In addition, priority tax claims may be paid over a six-year period.

After dividing the creditors into classes, the plan must specify which classes are not impaired, and how the impaired classes will be treated. Unless a particular creditor agrees otherwise, all creditors in the same class must be treated alike. The plan must provide adequate means for its execution. This may include the retention or transfer of all or part of the debtor's property, merger or consolidation of the debtor with another entity, satisfaction or modification of liens, curing or waiving defaults, and the issuance of securities. It may include any appropriate provisions not inconsistent with the Code.

D. Acceptance of the Plan

Substantial changes have been made with respect to the solicitation of plan acceptance from creditors and equity interest holders. Former Chapter XI permitted solicitation of the acceptance of an unapproved plan prior to the filing of the petition. Under old Chapter X, however, court approval of a plan had to be obtained before acceptances could be solicited. In Chapter X a plan could only be confirmed if it was "fair and equitable." The determination of whether or not a plan was fair and equitable was made under what the courts developed as the "absolute priority" rule. This meant that a dissenting class must be provided for in full before a junior class can receive anything: secured creditors before general creditors, and general creditors before shareholders. In order to apply the "absolute priority" rule, and going concern valuation of the debtor had to be established at a hearing. If the debtor's indebtedness exceeded $3,000,000, the plan had to be submitted to the Securities and Exchange Commission for an advisory report. The hearing and SEC report could consume many months. Only then could the court approve the plan and permit the solicitation of acceptances. The new Code eliminates the time-consuming and expensive process of obtaining court approval before the solicitation of

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142. _Id._ §1129(a)(9)(B). Consumer deposit claims on a priority basis are limited to $900. _Id._ §507(a)(5).
143. _Id._ §1129(a)(9)(C).
144. _Id._ §1123(a)(1).
145. _Id._ §1123(a)(2).
146. _Id._ §1123(a)(3).
147. _Id._ §1123(a)(4).
148. _Id._ §1123(a)(5).
149. _Id._ §1123(b)(5).
150. _Id._ §1123(b)(5).
153. _Id._ §221(2), 52 Stat. 897-98 (former 11 U.S.C. §421(2) (1976)).

acceptances and permits solicitation prior to the filing of the petition.\textsuperscript{155} One entirely new facet of the Code is the requirement that an acceptance of a plan may not be solicited after the commencement of the bankruptcy action unless the court has approved a written disclosure statement which contains "adequate information."\textsuperscript{156} The written disclosure statement containing this "adequate information" must precede or accompany the solicitation of acceptance of a plan made after the filing of the petition. The Code specifically states that the determination of what is "adequate information" is "not governed by...nonbankruptcy law..."\textsuperscript{157} Therefore, the Securities Act of 1933, the Securities Exchange Act of 1934, state securities laws, and SEC regulations do not apply. The Code, however, permits state agencies and the SEC to be heard on the issue of adequate information.\textsuperscript{158} Although these agencies may be heard, they may not appeal from an order approving a disclosure statement.\textsuperscript{159} 

Certain additional relevant factors should be noted with respect to the plan, and the solicitation of its acceptance. It is not necessary for the court to conduct a valuation hearing in order for it to approve the disclosure statement.\textsuperscript{160} Persons who solicit in good faith and in compliance with the Code are not liable for violations of any applicable law, rule, or regulation governing the offer, issuance, sale, or purchase of securities.\textsuperscript{161} Certain offers of securities made as part of a plan are exempted from the securities laws.\textsuperscript{162} A plan may be solicited prior to the filing of the petition, however, the adequacy of disclosure would be governed by nonbankruptcy law, including SEC requirements.

The Code has continued the concept that creditors can, by majority vote, force the nonconsenting minority to accept less than full payment

\textsuperscript{155} 11 U.S.C. §1125(b) (Supp. III 1979). Under this Section, it is only with respect to postpetition solicitation of plan acceptance that the Code requires court approval.

\textsuperscript{156} Id. §1125(b). Adequate information is defined by 11 United States Code Section 1125(a)(1) to mean information of a kind and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records, that would enable a hypothetical reasonable investor of holders of claims or interests of the relevant class to make an informed judgment about the plan.

\textsuperscript{157} Id. §1125(d).

\textsuperscript{158} For an extensive discussion of the effect of the Code investor protection and the participation of the SEC in Chapter 11 proceedings, see, Corotto and Picard, Business Reorganizations Under The Bankruptcy Reform Act of 1978—A New Approach to Investor Protections and the Role of the S.E.C., 28 DePaul L. Rev. 961 (1979). The authors conclude that "the automatic standing given the SEC in reorganization proceedings will provide the Commission with opportunities to function as a constructive force in securing adequate disclosure for the protection of public investors." Id. at 961.


\textsuperscript{160} See id. §1125(b).

\textsuperscript{161} Id. §1125(e).

\textsuperscript{162} Id. §1145. This section is derived from Sections 264, 393, and 518 of the Bankruptcy Act, ch. 575, 52 Stat. 902-03, 914, 928 (former 11 U.S.C. §§664, 793, 918 (1976)).
of their claims. The percentage of votes required to accomplish this, however, has been changed by the Code. Under the Code, a class of creditors accepts a plan when a majority of the individuals and two-thirds in amount of claims of those creditors actually voting approve the plan. A class of equity securities holders accepts the plan when two-thirds in amount of interests actually voting have accepted it. Significantly, the vote is computed only on the basis of entities who actually vote. A nonvote does not count as a rejection and therefore it is easier to obtain acceptance of a plan. This is a change from former Chapter X, in which a nonvote by a claim which was filed and allowed counted as a rejection in computing two-thirds of the outstanding claims. Chapter XI of the old Act required a majority of the creditors and the amount of the unsecured claims filed and allowed, regardless of whether a vote was cast. Nonvotes therefore counted as rejections.

The new Code provisions, which mandate that only the number of creditors actually voting be considered in ruling on whether a class has accepted a plan, represent a major change from former practice. Mathematically, the result of this change is that the proponent of a plan, debtor or creditor, is more likely to gain its acceptance. Therefore, the practicing attorney representing a proponent will find his task facilitated. The change from former practice is a positive one since a creditor who does not display sufficient interest in the reorganization to cast a vote should not be permitted by his inaction to prevent the acceptance of a plan.

The concept of impairment is discussed in full in the following section. Since impairment relates to the acceptance of a plan, however, it should be noted that a class that is not impaired under a plan is deemed to have accepted the plan and the vote of that class is not required. A class is not impaired under a plan that does not deal with or affect the rights of that class of equity interests or creditors. A class that is to receive no payment is deemed not to have accepted the plan and their vote is not required. This would occur when, after applying the

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163. 11 U.S.C. §1126(c) (Supp. III 1979). A principal concept of the old Bankruptcy Act is that if a requisite majority of creditors is willing to accept less than 100 percent in full discharge of their claims, the settlement binds nonconsenting creditors as well. The dissenting creditors are protected by the best interests test, or fair and equitable test, discussed at notes 194-96 and accompanying text infra.
165. Id. §1126(d).
169. Id. §1126(g).
order of priorities and a valuation of the debtor, the equity interests or creditors dealt with have no financial interest in the reorganized business. This will require a valuation hearing, and the application of the fair and equitable rule discussed below.\textsuperscript{170}

E. Impairment of Claims

"Impairment" is a new term introduced by the Code.\textsuperscript{171} It replaces the concept of "materially and adversely affected"\textsuperscript{172} under the old Act. Previously, a claim was not "materially and adversely affected" if it was fully paid. It was also not "materially and adversely affected" if completely unpaid, but considering the claimant's position in the order of priorities, a valuation hearing would indicate the claim had no interest in the company. Under the new Code, a class of claims or interests is impaired unless the plan (1) leaves unaltered the legal, equitable, and contractual rights of the class,\textsuperscript{173} (2) cures any default that occurred,\textsuperscript{174} or (3) provides for payment of the claim in cash.\textsuperscript{175} If the class is impaired either its acceptance must be obtained,\textsuperscript{176} or provisions which have become known as "cram down" provisions must be applied.\textsuperscript{177}

An entirely new provision of the Code grants the debtor a limited right to cure prepetition economic defaults without the consent of the creditor to the plan.\textsuperscript{178} After the occurrence of an act which constitutes a default and permits acceleration, when the creditor accelerates, the debtor may, through the plan, render the performance which constitutes the default.\textsuperscript{179} The default is then cured and the acceleration is reversed without the consent of the creditor whose rights are deemed unimpaired. The effect of this provision is to allow the proponent of a plan to place a particular creditor in a position when he cannot vote against the plan. This can be crucial in the process of securing the requisite percentage of affirmative votes. Thus, this is another instance in which the new Code has made it easier to achieve plan acceptance. The holder of this particular claim whose negative vote is eliminated has no justifiable cause to complain, as he is restored to his original position while others will be receiving less.

\textsuperscript{170} See note 193 and accompanying text infra.
\textsuperscript{172} Bankruptcy Act, ch. 575, §§107, 308, 407, 52 Stat. 884, 906, 917 (former 11 U.S.C. §§507, 707, 807 (1976)).
\textsuperscript{174} Id. §1124(2).
\textsuperscript{175} Id. §1124(3).
\textsuperscript{176} Id. §1129(a)(8).
\textsuperscript{177} See id. §1129(b). See notes 197-215 and accompanying text infra.
\textsuperscript{178} 11 U.S.C. §1124(b) (Supp. III 1979).
\textsuperscript{179} See id.
F. Confirmation

Confirmation of a plan by the court is the conclusion of the reorganization process. It is, in essence, the approval of the plan by the court. The act of confirmation of the plan by the court binds the debtor to the provisions of a plan. Confirmation also binds creditors, regardless of whether the claim of the creditor is impaired under the plan or whether the creditor has accepted the plan. As this effect is vital to the success of the plan, the requirement of confirmation is the vehicle by which the court is able to supervise and oversee the reorganization. The Code also sets forth the standards governing confirmation.

In determining whether to confirm a plan, the court will examine various requirements retained from former Chapter X, and an additional requirement imposed by new Chapter 11. Of major importance, however, the court must find that the plan is feasible; that is, confirmation is not likely to be followed by liquidation or the need for further reorganization. The first six requirements which the court will examine are taken generally from old Chapter X. Under these, the court will require the following: (1) the plan must be proposed in good faith and not by any means forbidden by law; (2) payments made or promised by the proponent, the debtor, or certain others, in connection with the case or the plan, must be disclosed to the court and be reasonable; (3) the identity of proposed officers and directors must be disclosed and their services must be consistent with the needs of creditors, equity security holders, and public policy; (4) the identity and compensation of insiders to be employed by the reorganized debtor must be disclosed; (5) any rate change proposed by the plan must be approved by a regulatory commission with jurisdiction over such rates; and (6) administration expenses are to be paid in cash on confirmation unless such cash payment is waived by the holder of the administration expense claim.

Under Chapter 11, an additional requirement is imposed. At least one class of claims must accept the plan, excluding acceptance by insiders. This requirement can be met when there is a class of claims that

180. Id. §1141(a).
181. Id. §1129.
182. Id. §1129(a)(11).
183. Id. §§1129(a)(1), (2), (3).
184. Id. §§1129(a)(4).
185. Id. §§1129(a)(5)(A).
186. Id. §101(25).
187. Id. §§1129(a)(5)(B).
188. Id. §§1129(a)(6).
189. See id. §§1129(a)(9)(A).
190. Id. §§1129(a)(10).
is not impaired. If all creditors and impaired interests accept the plan, confirmation will follow once the general requirements are met. Chapters X and XI of the old Act applied different standards regarding confirmation. Under Chapter XI, a plan was confirmed if it met the test of being in "the best interests of the creditors." Meeting the "best interests" test meant that creditors would receive at least as much as they would in liquidation. Under Chapter X, a plan was confirmed if it met the test of being "fair and equitable." The "absolute priority" rule was the court-developed application of the requirement mandated by old Chapter X that a plan could be confirmed only if it was "fair and equitable." This "absolute priority" rule meant that all creditors must be provided for in full before equity interests could be satisfied and senior creditors must be paid in full before junior creditors could receive anything. Where all classes either accept the plan or are not impaired by the plan, the Code in effect adopts the "best interests" test of Chapter XI of the old Bankruptcy Act.

Under the "best interests" test, a dissenting creditor of an accepting class is protected by the requirement that he receive no less than he would have received upon liquidation under Chapter 7. If such a dissenting creditor will receive or retain less, the plan may not be confirmed. To make this determination the court will have to consider the subordination provision of Chapter 5, and the priority provision of Chapter 7. Under those provisions, in a liquidation case, all creditors are not treated equally. There is an order of priority established by the Code for the payment of claims. Since under the "best interests" test, a creditor must receive no less than he would in liquidation, the court must apply the order of priorities established for liquidation under Chapter 7 to determine how much the particular creditor would receive under that priority system.

Where all classes either accept the plan or are not impaired, the new Code has rejected the "fair and equitable" test and "absolute priority" rule of former Chapter X. The "best interests" test is much simpler to apply than the "fair and equitable" test because the former does not require a valuation of the debtor as a going concern. This valuation and the resulting hearing is an expensive and time-consuming process. The process is still necessary, however, if all impaired classes do not consent to the plan. By using the "best interests" test, the holders of

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192. Id. §221(2), 52 Stat. 890-91 (former 11 U.S.C. §621(2) (1976)).
193. Id.
195. Id. §510.
196. Id. §726.
senior interests will have an incentive to allow junior interests a greater share, thereby encouraging them to consent and avoid the hearing process. The junior interests may also be persuaded to accept the plan because of the threat that a valuation hearing may determine that they have a lesser interest or no interest at all.

G. "Cram Down" Provisions

If a class does not accept the plan, it may still be confirmed if the interests of such class are protected. This is accomplished by the application of the Code's "cram down" provisions. Although the phrase "cram down" is not used by the Code, it is a phrase that has been used by courts and commentators to describe the circumstances under which a class which does not accept a plan is bound by it despite such nonacceptance. The balance of this section describes the "cram down" provisions of the new Code.

If all of the requirements for confirmation discussed above are met, except that each impaired class has not accepted the plan, the court on request of a proponent shall confirm the plan if it does not discriminate unfairly and is fair and equitable with respect to each impaired class that has dissented. In some instances, as noted below, the new Code applies the "absolute priority" rule to dissenting classes and those below it in priority. This will necessitate, in these instances, the expensive and time-consuming valuation hearing of a "fair and equitable" test. The Code does not define or elaborate on the meaning of the phrase "does not discriminate unfairly." As this is a part of the test that must be met in the application of the Code's "cram down" provisions, and did not exist under prior law, it can be expected that the exact meaning of the words will be the subject of judicial interpretation.

The legislative history indicates that the phrase "does not discriminate unfairly" is "included for clarity" and will apply to subordinated debentures. One writer concludes that the requirement is intended to be complementary to the "fair and equitable" test, and to permit the court to evaluate the complex relationship inherent in the relative priority of classes caused by partial subordination. In all likelihood, if

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197. Id. §1129(b).
198. Id. §1129(a)(9). See notes 176 and 177 and accompanying text supra.
200. See note 210 and accompanying text infra.
the plan protects the rights of a dissenting class in a manner consistent with the treatment of other classes whose legal rights are intertwined with those of the dissenting class, then the plan does not discriminate unfairly with respect to the dissenting class.

Although the new Code does not define "discriminate unfairly," it does define "fair and equitable." This definition is different for each of the three separate categories of secured claims, unsecured claims, and equity interests. In order to meet the condition that a plan be "fair and equitable," the Code sets forth separate requirements as to secured claims, unsecured claims, and equity interests.

1. Secured Claims

As to secured claims, the plan must satisfy one of three requirements. The plan may provide for the secured creditors to retain their lien, to the extent of the allowed amount of the claim, whether the collateral is retained by the debtor or transferred to another entity. In addition, each secured creditor must receive deferred cash payments totaling the allowed amount of the claim. Alternatively, the plan may provide for the sale of collateral free and clear of the lien, provided that the lien attaches to the proceeds. Or, the plan may provide for the realization by the secured creditor of the indubitable equivalent of its claim.

These tests for secured claims did not exist under the old Act. Since they are new, litigation may be expected with respect to their specific application, particularly regarding realization of "the indubitable equivalent." The legislative history states that the indubitable equivalent would be realized if the collateral was abandoned to that class of creditors, or if those creditors received a replacement lien on similar collateral. The legislative history states further that receipt of unsecured notes or equity securities does not constitute the indubitable equivalent of secured claims.

2. Unsecured Claims

The tests to be applied to unsecured claims and equity interests are similar to the familiar "absolute priority" rule under the old Bankruptcy Act. Essentially, under that rule, a dissenting class must be

205. Id. §1129(b)(2).
207. Id. §1129(b)(2)(A)(i)(II).
208. Id. §1129(b)(2)(A)(ii).
210. See note 193 and accompanying text supra.
provided for in full before a junior class can receive anything. As to unsecured claims, one of the two following tests must be met. The plan must either provide for each holder of a claim in the class to receive or retain property of a present value equal to the allowed amount of the claim, or the plan must be such that the holder of any claim or interest that is junior will not receive any property. Therefore, as long as junior claims do not receive any property at all, a plan may be confirmed over the objection of a class of unsecured creditors who receive less than the allowed amount of its claim. A plan may propose that senior classes give up value to junior claims, but it may not be confirmed over the objection of a dissenting class of senior or intermediate claims that are not provided for in full.

3. **Equity Interests**

In order to confirm a plan which has been objected to by a class of equity interests, one of two tests must be met. The plan may provide that each holder of such interest receive or retain property of a present value equal to the greater of any fixed liquidation preference or redemption price, and the value of such interest. This would of course require a valuation hearing. If the debtor’s liabilities exceed his or her assets, the plan need not provide any value to common shareholders because they would have no interest; rather the plan may provide that the holders of any junior interests receive nothing.

**Discharge After Confirmation**

Except as noted below, confirmation discharges all former obligations to creditors, regardless of whether those obligations were dealt with under the plan, and regardless of whether all creditors participated in the reorganization. This is the discharge which was previously provided for in Chapter X of the old Act. Exceptions under the new act pertain to an individual debtor who would not be discharged.

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212. Id. §1129(b)(2)(B)(ii).
216. See note 218 and accompanying text infra.
from certain debts in a liquidation case under Chapter 7, and who is not discharged from these same debts under Chapter 11. These nondischargeable debts are for (1) certain taxes, (2) obtaining money or property by false pretenses, (3) certain unscheduled debts unless the creditor had knowledge of the case, (4) fraud incurred while acting in a fiduciary capacity or embezzlement, (5) willful and malicious conversion, (6) alimony or child support, (7) certain tax penalties, (8) student loans until they have been due and owing for five years, and (9) certain debts owed by the debtor from a previous bankruptcy case in which the debtor was denied a discharge.218

Unless the plan or confirming order provides otherwise, confirmation vests all property of the estate in the debtor.219

CONCLUSION

Many familiar terms and principles of practice under Chapters X and XI of the Bankruptcy Act have been retained. The new Code is based in substantial part on concepts that were tested and refined by the courts. But the new Code contains much that is new and changed. It can be characterized as an extensive revision of reorganization procedures of the federal bankruptcy laws. This effort at bankruptcy reform consumed over eight years. Most of the changes made by the new Code sprang from the perceived need to rectify the many problems that existed under former practice. There will, of course, be a great deal of litigation that will result in interpretations of the new Code. Significantly, the new Chapter 11 promises to be a substantially improved business reorganization process that will adequately protect creditors and owners, and at the same time provide for the survival of any truly viable entity.

218. Id. §§523, 1141(d)(2).
219. Id. §1141(b).