

COMMENT ON RECENT DECISIONS

BANKRUPTCY — CORPORATE REORGANIZATION — A FAIR AND EQUITABLE PLAN—[United States].—A holding company, insolvent both in the equity and in the bankruptcy sense, filed a petition for reorganization under 77B of the Bankruptcy Act. Two bondholders, holding a small percentage of the face value of the debtor's bonds, opposed the plan contending that it was not fair and equitable. Their objection was that stockholders of the old company were to be included in the new, despite the absence of a stockholders' equity in the old company.¹ The district court approved the plan; it was affirmed by the circuit court of appeals.² On a writ of *certiorari* the judgment was reversed, the Supreme Court holding that the plan was not fair and equitable within the requirements of 77B.³

Prior to the enactment of 77B, the courts were in the main applying two theories of priority rights in corporate reorganization proceedings. One was the so-called theory of relative priority and the other that of absolute priority.⁴ In the former, the bondholders receive new securities in exchange for their old with an approximate⁵ equal income and principal claim prior to that of the old stockholders.⁶ In the latter, the bondholders are accorded full priority as to both principal and defaulted interest; and the old stockholders cannot be included unless they furnish a *quid pro quo* for such interest as they acquire in the new corporation.⁷ A third view advanced by reorganization managers involves a scaling down of the assets of the debtor.⁸ This group feels that practical considerations make it "not

1. The financial arrangement may briefly be stated as follows: The assets were \$900,000, while the claims of the bondholders for principal and interest were approximately \$3,800,000. If all of the assets were turned over to the bondholders they would realize less than twenty-five per cent on their claims. Yet under the plan they were required to surrender to the stockholders twenty-three per cent of the value of the enterprise in the form of stock in the new company. The objecting bondholders owned only \$18,500 face amount of a large bond issue.

2. *In re Los Angeles Lumber Products Co.* (D. C. S. D. Cal. 1938) 24 F. Supp. 501, *aff'd*, *In re Los Angeles Lumber Products Co.* (C. C. A. 9, 1939) 100 F. (2d) 963.

3. *Case v. Los Angeles Lumber Products Co., Ltd.* (1939) 60 S. Ct. 1.

4. The material in this paragraph is more fully discussed in an article by Bonbright and Bergerman, *Two Rival Theories of Priority Rights* (1928) 28 Col. L. Rev. 127 and cases discussed and cited in the article. See also Finletter, *Principles of Corporate Reorganization* (1937) c. 6, 375; Note (1938) 23 WASHINGTON UNIVERSITY LAW QUARTERLY 543.

5. "Approximately" is used because the specific amount usually depends on the bargain reached between each group by the reorganization managers.

6. *Downtown Investment Co. v. Boston Metropolitan Bldgs., Inc.* (C. C. A. 1, 1936) 81 F. (2d) 314.

7. *Tellier v. Franks Laundry Co.* (C. C. A. 8, 1939) 101 F. (2d) 561; *In re Barclay Park Corp.* (C. C. A. 2, 1937) 90 F. (2d) 595; *Sophian v. Congress Realty Co.* (C. C. A. 8, 1938) 98 F. (2d) 499.

8. Bonbright and Bergerman, *Two Rival Theories of Priority Rights* (1928) 28 Col. L. Rev. 127, 131; Frank, *Some Realistic Reflections on Some Aspects of Corporate Reorganization* (1933) 19 Va. L. Rev. 541-570,

feasible in most reorganizations to give to the mortgage bondholders securities worth the par value of their bonds, since this would almost never leave any securities available as a lure to induce stockholders to pay their assessments."⁹ Equitable reorganizations have involved a combination of two and sometimes all three of these theories.¹⁰ 77B provided that a plan should become effective upon approval by a two-thirds majority of each class of creditors or shareholders, if the judge found that it was fair and equitable, did not discriminate unfairly in favor of any class, and was feasible.¹¹ However, the statute did not specify which of these theories the judge should follow in determining whether the plan was a fair one.¹²

In *Downtown Investment Co. v. Boston Metropolitan Buildings, Inc.*,¹³ the court, in construing section 77B, seemingly approved the relative priority theory which would permit old stockholders of an insolvent company to retain an interest in the new corporation without requiring any pecuniary contribution on their part. Other lower federal courts, however, followed the absolute priority theory holding that, in order to justify a retention of a stock interest by stockholders, it must appear that they have furnished an additional consideration or have an equity in the estate of the debtor after the rights of the creditor are fully provided for in some way.¹⁴

698-718, 716. Frank criticizes the arguments of Mr. Swain, one of the leaders of the corporate reorganization managers. See also Finletter, *Principles of Corporate Reorganization* (1937) c. 6, 390.

9. Bonbright and Bergerman, *Two Rival Theories of Priority Rights* (1928) 28 Col. L. Rev. 127, 131.

10. Supra note 9, at 144. This usually comes up in situations where there are different classes of securities that lead to the acceptance of this or that arrangement between the bondholders' and the stockholders' committees.

11. Bankruptcy Act (1934) 48 Stat. 911, c. 424, sec. f, (1939 Supp.) 11 U. S. C. A. sec. 207. 77B, as amended, is now Chapter X of the new Bankruptcy Act.

12. Levi, *Corporate Reorganization and a Ministry of Justice* (1938) 23 Minn. L. Rev. 3. In the instant case the court also points out the necessity on the part of the bankruptcy judge to investigate the plan thoroughly. It is well settled that the number agreeing does not in itself render the plan a fair one. *Sophian v. Congress Realty Co.* (C. C. A. 8, 1938) 98 F. (2d) 499; *Tellier v. Franks Laundry Co.* (C. C. A. 8, 1939) 101 F. (2d) 561.

13. (C. C. A. 1, 1936) 81 F. (2d) 314. This plan was held invalid on other grounds, but it is submitted in light of the principal case that the Supreme Court would not affirm this view. The language of the court seems to indicate an adoption of the relative priority theory and in part the views advanced by the reorganization managers. The court said:—"We therefore hold that section 77B does not require that every plan approved as fair and equitable shall be of such a character that it would withstand attack by nonassenting creditors asserting their strict legal rights unaffected by any principles of the Bankruptcy Act. * * * To hold that the phrase 'fair and equitable' has the same meaning when applied to a reorganization under 77B as it had in equity receiverships, is to eliminate from it to a certain degree the rights of creditors and shareholders to adjust their respective rights by contract and nullify provisions of the Act which was passed to facilitate corporate reorganization." 81 F. (2d) at 323.

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

The Supreme Court in the instant case adopts this latter view and thus clarifies the ambiguity resulting from the statute. Once again the corporate reorganization lawyers seem to have suffered a setback.¹⁵ After the passage of the Bankruptcy Act, this group felt that the reorganization of an insolvent corporation would be more practical with less attention paid to dissenting minorities;¹⁶ and that consequently the stockholders of a bankrupt concern having no equities could be included in the reorganized company without furnishing additional consideration. The holding in the principal case, however, definitely repudiates such a view.

L. M. B.

CONSTITUTIONAL LAW—COMMERCE POWER—WAGE REGULATION—FAIR LABOR STANDARDS ACT—[Federal].—Plaintiff, pursuant to the Fair Labor Standards Act,¹ procured a *subpoena duces tecum* ordering defendant to produce wage-books covering employees in its mail order branch at Kansas City. Defendant resisted on the ground, *inter alia*, that the Act, in so far as it seeks to apply to production for commerce as such, exceeds the interstate commerce power. *Held*, that the Act is within the commerce power.²

The Act seeks to eliminate from industry labor conditions detrimental to the maintenance of the minimum standard of living necessary for the health, efficiency, and general well-being of the works for several reasons, each presumed to justify invocation of federal power.³ Of these, the court seems to emphasize the first, namely, that these conditions cause commerce and the channels and instrumentalities of commerce to be used to spread and perpetuate such undesirable labor conditions among the workers of the several states.⁴ This seems to appeal to the recognized federal power to exclude from interstate commerce such things as would have a deleterious effect. Thus Congress may remove the immunity from state control of liquor as an article of commerce, since it is deleterious to morals and health.⁵ Congress may prohibit traffic in diseased cattle, for no one is entitled by

15. The first setback was in *Northern Pac. Ry. v. Boyd* (1912) 228 U. S. 482. Frank, *Some Realistic Reflections on Some Aspects of Corporate Reorganization* (1933) 19 Va. L. Rev. 541, 550.

16. *Dodd, Reorganization Through Bankruptcy: A Remedy For What?* (1935) 48 Harv. L. Rev. 1100, 1110; *Foster, Conflicting Ideals For Reorganization* (1935) 44 Yale L. J. 923, 959.

1. Fair Labor Standards Act (1938) 52 Stat. 1060, (1938 Supp.) 29 U. S. C. A. secs. 201-219. The Act regulates the employment of those engaged in interstate commerce or production for such commerce. Employees "employed in a *bona fide* executive, administrative, professional, or local retailing capacity, * * * or any employee * * * the greater part of whose selling or servicing is in intrastate commerce * * *," are exempted from the provisions of the Act. (1938 Supp.) 29 U. S. C. A. sec. 213. The instant case is not brought within this exception.

2. *Andrews v. Montgomery, Ward & Co.* (D. C. N. D. Ill. 1939) 84 C. C. H. Labor Law Serv. par. 18,465.

3. Note (1939) 8 Geo. Wash. L. Rev. 68.

4. (1938 Supp.) 29 U. S. C. A. sec. 202a (1).

5. *In re Rahrer* (1891) 140 U. S. 545.