CASE NOTES

Bankruptcy—Applicability of Chapters X and XI of the Bankruptcy Act.—*In re Herold Radio & Electronics Corp.*[1]—Debtor corporation filed a petition for arrangement proceedings under Chapter XI of the Bankruptcy Act.[2] The outstanding securities of the corporation included convertible subordinated debentures in the amount of $1,472,000, 4,816 shares of $5.00 par convertible preferred stock and 582,199 shares of $0.25 par common stock. The debentures were held by 400 individuals, the preferred stock by 52, and the common stock, which was listed on the American Stock Exchange, by 1600. The company had a prior history of working capital shortage, heavy interest charges due to increased borrowing, and increasing losses despite managerial efforts to consolidate operations and increase efficiency. The Securities and Exchange Commission moved that the proceedings be dismissed or, amended so as to comply with Chapter X of the Bankruptcy Act.[3] HELD: The petition must be dismissed or amended so as to comply with Chapter X.

Under Chapter X, if the debtor corporation's liabilities exceed $250,000 a disinterested trustee will be appointed[4] to operate the business of the corporation.[5] If the court so directs, the trustee must make a thorough investigation of the corporation's financial condition and/or management, and report the results of these inquiries to the court and to interested parties.[6] Chapter X also allows creditors and stockholders to submit suggestions with respect to a plan of reorganization;[7] secured and unsecured debts, as well as rights of stockholders, may be affected.[8] A petition under Chapter X must state why adequate relief cannot be obtained under Chapter XI.[9]

The procedural safeguards found in Chapter X are sacrificed for the sake of speed and economy when Chapter XI proceedings are utilized.[10] The debtor may stay in possession of, and operate the business subject to court approval,[11] and may himself propose the arrangement.[12] Arrangements

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1 191 F. Supp. 781 (S.D.N.Y. 1961).

2 52 Stat. 905 (1938), 11 U.S.C. §§ 701-799 (1958).

3 52 Stat. 883 (1938), 11 U.S.C. §§ 501-676 (1958).

4 52 Stat. 888 (1938), 11 U.S.C. § 556 (1958).

5 52 Stat. 892 (1938), 11 U.S.C. § 589 (1958).

6 52 Stat. 890 (1938), 11 U.S.C. § 567(1), (2), (5) (1958).

7 Id. at subsection (6).

8 52 Stat. 895 (1938), 11 U.S.C. § 616 (1958).

9 52 Stat. 886 (1938), 11 U.S.C. § 530(7) (1958). See also SEC v. Liberty Baking Corp., 240 F.2d 511 (2d Cir.), cert. denied, 353 U.S. 930 (1957), applying the same test, in effect, to a proceeding under Chapter XI:

> Conceivably under Chapter XI proceedings a plan of arrangement might be presented which would satisfy the requirements of Chapter X and would be as favorable to the creditors as what they could obtain under Chapter X. In such exceptional circumstances we might not disturb the arrangement merely because it had been reached under Chapter XI proceedings.

240 F.2d at 516. See also 6 Collier, Bankruptcy ¶ 0.09 (1940).

10 SEC v. U.S. Realty & Improvement Co., 310 U.S. 434 (1939).

11 52 Stat. 909 (1938), 11 U.S.C. § 742 (1958).

12 52 Stat. 906 (1938), 11 U.S.C. § 706 (1958).

under Chapter XI may only affect the rights of unsecured creditors.[13] While there is no precise formula which would enable one to say that a particular situation falls exclusively within the scope of one chapter or the other, it is important to note that Chapter X was designed to afford procedures adapted to the reorganization of corporations with complicated debt structures and many stockholders while Chapter XI is adapted to a reorganization of the debts of small businesses and corporations.[14]

In *SEC v. U.S. Realty & Improvement Co.*,[15] the Supreme Court indicated that Chapter XI was not available to a debtor corporation with publicly held securities.[16] However, in *General Stores Corp. v. Shlensky*[17] the Court allowed that a large publicly held corporation may avail itself of proceedings under Chapter XI; but if the debtor has a complicated capital structure and there is an indication that an accounting and/or a new management is needed, then Chapter X proceedings are essential.[18] Where the debtor proposes more than a simple composition of unsecured debts,[19] or where a scaling down of creditor's claims is planned without any sacrifice on the part of stockholders,[20] Chapter X is applicable.[21]

Chapter XI is to be preferred to Chapter X whenever the remedy under the former adequately protects both the public and private interests involved.[22] Where there is a reasonable likelihood that a proposed arrangement will succeed and there appears to be no prejudice to interests involved, it is not an abuse of discretion to allow proceedings to continue under Chapter XI although the corporation has publicly held securities outstanding.[23] Thus there is a distinction between public ownership and public interest, Chapter X being required when the public interest

[13] 52 Stat. 910 (1938), 11 U.S.C. § 756 (1958).

[14] 9 Remington, Bankruptcy § 3570.5 (1955), *U.S. Realty* case, supra note 10.

[15] Supra note 10.

[16] Chapters X and XI embody strikingly different schemes of reorganization. Chapter X provides detailed safeguards designed to protect the interests of public investors, Chapter XI provides merely a rudimentary system of creditor control designed for the corporation which has only trade and commercial creditors. The contrast between the procedures described makes it plain that Congress intended that all public security holders should have the protection afforded by Chapter X and that Chapter XI should be confined to corporations with only trade and commercial creditors.

310 U.S. at 437.

[17] 350 U.S. 462 (1956).

[18] Ibid. Mr. Justice Frankfurter, in his dissent, thought that a wider scope should be given to Chapter XI since in 1952 Congress amended Chapter XI thereby eliminating a provision that all arrangements under that Chapter had to be "fair and equitable." Id. at 471-72.

[19] SEC v. Liberty Baking Corp., supra note 9.

[20] *General Stores* case, supra note 17. In this regard it must be noted that unsecured creditors have an absolute priority over stockholders. Northern Pacific R.R. v. Boyd, 228 U.S. 482 (1913); *U.S. Realty* case, supra note 10.

[21] See cases cited supra note 19 & 20.

[22] In re Transvision Inc., 217 F.2d 243 (2d Cir. 1954), cert. denied, 348 U.S. 952 (1955).

[23] SEC v. Wilcox-Gay Corp., 231 F.2d 859 (6th Cir. 1956). A bankruptcy court being a court of equity, on appeal the standard of review is whether there has been an abuse of discretion. *U.S. Realty* case, supra note 10; *General Stores* case, supra note 17; *Liberty Baking* case, supra note 9.

so dictates.[24] Furthermore, mere suspicions of improper actions, without more, are not enough to require the imposition of Chapter X.[25]

In the principal case, the court held that proceedings under Chapter XI are not available to a debtor corporation with publicly held securities when there is a need for a thorough reorganization of the corporation's capital structure.[26] Here, a composition of creditors, without more, would have presented a substantial question of fairness to the debenture holders and, at the same time, the financial history and condition of the debtor indicated that the interests of the investing public, and those of the SEC, could not be adequately represented under the Chapter XI proceedings.

It would appear then, that Chapter XI is available to large publicly held corporations only when the debtor's plan proposes no more than a simple composition of unsecured debts, when there is no reason to believe that management has acted in bad faith or that it is incompetent, and when priority rights of creditors are not jeopardized.

MICHAEL B. SPITZ

Conflict of Laws—Secured Transactions—UCC.—*Casterline v. General Motors Acceptance Corp.*[1]—On October 14, 1957, a New York dealer sold by conditional sale an automobile to Simon and the same day assigned the contract to appellant General Motors Acceptance Corporation. Within two days the automobile passed through a succession of purchasers and lastly was sold to a Pennsylvania purchaser for value in Wilkes-Barre.[2] The original vendor filed his conditional sales contract in the registry of Bronx County, New York, on October 21. No payments on the contract having been made by December, the appellant repossessed the vehicle. From an adverse decision in his action of replevin, the plaintiff appealed to the Superior Court of Pennsylvania. HELD: The vendor's interest is prior to that of the purchaser.

The problem is the interplay of the provisions of the Uniform Conditional Sales Act with those of the Uniform Commercial Code as applied by Pennsylvania. New York law, which governs the original sale, provides that the seller's rights reserved by conditional sale are void as to any bona fide purchaser for value without notice unless the contract or copy is filed in the appropriate filing district within ten days after the sale.[3] New York does not have a title certificate law. In contrast, the Pennsylvania conditional vendor must note his encumbrance on the certificate of title to "perfect" his interest under the Code Section 9-302(3)(b) in conjunction with the Pennsylvania Motor Vehicle Code.[4]

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[24] SEC v. Wilcox-Gay Corp., supra note 23.

[25] 6 Collier, Bankruptcy ¶ 0.11 (1940), In re Transvision, supra note 22.

[26] Supra note 1, at 791.

[1] 171 A.2d 813 (Pa. Super. Ct. 1961).

[2] The ultimate purchaser was refunded the purchase price by his seller, the plaintiff Casterline, and was not involved in the litigation. The court attached no significance to the fact that Casterline was a dealer.

[3] N.Y. Pers. Prop. Law § 65.

[4] Pa. Stat. Ann. tit. 12A § 9-302(3)(bb), and tit. 75 §§ 31-42.