Nebraska Law Review

Volume 56 | Issue 3 Article 5

1977

SEC Intervention in Corporate Rehabilitation

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Comment

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I. INTRODUCTION

This comment analyzes the role of the Securities and Exchange Commission in corporate rehabilitation under the present Bankruptcy Act[1] and the proposed New Bankruptcy Act.[2] Section II examines why the SEC prefers a Chapter X bankruptcy proceeding[3] over a Chapter XI bankruptcy proceeding[4] and how that preference is effectuated. Section III gives an historical review of the major cases in which the SEC forced companies to use Chapter X, and attempts to derive a standard which courts will apply when faced with a debtor that wants to use Chapter XI, and an SEC recommendation for Chapter X. Finally, a critical analysis of the effect of Chapter VII of the proposed New Bankruptcy Act and the elimination of the SEC in corporate rehabilitation proceedings as examined in Section IV. First, a general understanding of the distinction between Chapter X and XI is necessary.

At some time, a financially distressed business debtor may seek or be compelled to seek relief under the Bankruptcy Act. In most cases, relief is sought under Chapters I-VII of the Bankruptcy Act, and involves liquidation of assets, distribution to creditors and complete discharge of debts.[5] Often, financial rehabilitation is

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1. 11 U.S.C. §§ 1-1255 (1970).
2. H.R. 10792, 93d Cong., 1st Sess. (1973); S. 2565, 93d Cong., 1st Sess. (1973).
   Pub. L. No. 91-354, 84 Stat. 468 (1970), established the Bankruptcy Commission which two years later submitted a report consisting of two parts. Part I contains an analysis of the present Bankruptcy law with recommendations for changes and Part II contains the proposed statute and notes. H.R. Doc. No. 93-137, 93d Cong., 1st Sess. (1973). This proposed legislation will hereinafter be referred to as the Proposed New Bankruptcy Act.
3. Bankruptcy Act §§ 101-276 (11 U.S.C. §§ 501-676 (1970)) (corporate reorganization).
4. Bankruptcy Act §§ 301-399 (11 U.S.C. §§ 701-799 (1970)) (arrangements).
5. The overwhelming number of business bankruptcies are straight liquidation proceedings under Chapters I-VII of the Bankruptcy Act. In-

more desirable, and a Chapter X reorganization or a Chapter XI arrangement may be invoked. Chapters X and XI are designed to permit the financially troubled business to continue operation on the theory that all the interested parties will benefit if the business can be salvaged and preserved as a going concern. The procedures employed by these two chapters, however, do not afford alternate routes to rehabilitation, but "are legally, mutually exclusive paths to . . . financial rehabilitation."[6]

The basic theory behind the application of Chapters X and XI is that the going concern value of a debtor's assets is greater than their liquidation value. Only when a debtor is hopelessly insolvent, and has little value as a going concern, should straight bankruptcy be employed. Once it has been determined that rehabilitation is more advantageous than straight bankruptcy, there must be a choice between Chapter X or Chapter XI. This determination is based on the needs and preferences of the debtor as determined by the debtor in conjunction with its creditors and possibly a trustee. Ultimately, this determination is subject to review by the courts.

In general, Chapter X reorganizations are more appropriate for large, publicly held corporations[7] with complicated debt structures and where the interests of secured creditors and stockholders[8] will be affected. Chapter XI arrangements are used in cases of smaller corporate debtors, individuals or partnerships,[9] where a mere composition and extension of the claims of unsecured creditors is necessary. Normally, a Chapter XI proceeding is preferable to a Chapter X proceeding because it is less expensive, time consuming, and does not require rigid administration by a court. Several more specific distinctions are noteworthy.

There is an initial distinction as to who may file a petition under each Chapter. A Chapter XI proceeding may be initiated

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dicative of this is the fact that of the total number of 189,513 bankruptcy proceedings (business and nonfiscal year ending on June 30, 1974), 157,967 were straight bankruptcies. There were only 163 corporate reorganization proceedings under Chapter X of the Bankruptcy Act, and 2,171 filings under Chapter XI of the Bankruptcy Act. ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS, TABLES OF BANKRUPTCY STATISTICS (table F2, for fiscal year ending June 30, 1974).

6. SEC v. American Trailer Rentals Co., 379 U.S. 594, 607 (1965).
7. The provisions of Chapter XI are equally applicable to an individual or to a partnership. Although Chapter X is only available to "corporations," the Bankruptcy Act defines this to include certain unincorporated companies and associations and any business conducted by trustees. Bankruptcy Act § 1(8) (11 U.S.C. § 1(8) (1970)).
8. Bankruptcy Act § 216 (11 U.S.C. § 616 (1970)).
9. *Id.* §§ 306(3), 321 (11 U.S.C. §§ 706(3), 721 (1970)).

only by the voluntary act of the debtor, whereas a Chapter X proceeding may be initiated either by the debtor or its creditors. Another distinction involves the modification of creditors' rights. An arrangement under Chapter XI can modify only the rights of unsecured creditors,[10] with no alteration of the rights of secured creditors.[11] A reorganization under Chapter X, however, can modify the rights of both secured and unsecured creditors. The distinction with which the SEC is most concerned, when faced with a chapter selection, is the appointment of an independent trustee. Under Chapter XI the management of a debtor corporation prepares the arrangement and remains in control throughout the proceeding. In sharp contrast, the preparation of a plan under Chapter X is closely controlled by the court. Where the liabilities of the debtor exceed $250,000, the appointment of an independent trustee is mandatory.[12] A trustee may be appointed at the discre-

10. *Id.* §§ 307(2), 356 (11 U.S.C. §§ 707(2), 756 (1970)).
11. This statement is not always true but depends upon the particular arrangement. A "creditor" includes "anyone who owns a debt, demand or claim provable in bankruptcy, and may include his duly authorized agent, attorney or proxy." Bankruptcy Act § 1(11) (11 U.S.C. § 1(11) (1970)). Bankruptcy Act § 307(1) (11 U.S.C. § 707(1) (1970)), however, gives creditor a broader definition when it states " 'creditors' shall include the holders of all unsecured debts, demands, or claims whatever character against a debtor, whether or not provable as debts under section 63 of this Act and whether liquidated or unliquidated, fixed or contingent." Bankruptcy Act § 308 (11 U.S.C. § 708 (1970)), involves the determination of what creditors are affected by an arrangement.

> The meaning of the word "creditor," as used in §308 [11 U.S.C. § 708], depends on whether or not the arrangement provides for an extension of time for payment of debts in full. If the arrangement does not propose such extension, either to creditors generally or to some class of them, then "creditor" as used in §308 [11 U.S.C. § 708] has the meaning given to it by the definition of that word in §1(11) [11 U.S.C. § 1(11)]. If the arrangement proposes an extension of time for payment in full of all unsecured debts, then "creditor" as used in §308 [11 U.S.C. § 708] has the meaning given to it by the definition of that word in §307(1) [11 U.S.C. § 707(1)]. If the arrangement divides creditors into classes, and provides for an extension of time payment in full of debts in one class, but does not provide similarly for debts in the other class or classes, then "creditor" as used in §308 [11 U.S.C. § 708] has two meanings. When applied to creditors in the class whose debts are to be extended, then "creditor" as used in §308 [11 U.S.C. § 708] has the meaning given to it by the definition in §307(1) [11 U.S.C. § 707(1)]; when applied to creditors in any other class, it has the meaning given to it by the definition in § 1(11) [11 U.S.C. § 1(11)].

8 COLLIER ON BANKRUPTCY ¶ 2.41 (14th ed. Moore 1974) (footnotes omitted).

12. Bankruptcy Act § 156 (11 U.S.C. § 556 (1970)).

tion of the court at any time.[13] The trustee has complete control over the preparation of the plan of reorganization and has the power to displace the management of the debtor corporation if necessary.

These alternate routes of rehabilitation available under Chapters X and XI clearly afford the debtor and its creditors distinct advantages and disadvantages. The mutual exclusivity of these alternate means of rehabilitation is best expressed by an article published shortly after the enactment of the Chandler Act.

> Chapter X is reorganization in the grand manner. It represents the response of its draftsmen to the great reorganization cases and to the atmosphere of melodrama and importance which colors all discussion of them. . . . Chapter XI, on the other hand, has about it the grubbiness of bankruptcy. It provides a cheap and practical method of settlement . . . for poor debtors whose estates cannot afford the expense of an elaborate public ceremonial.[14]

II. THE ROLE OF THE SEC IN CORPORATE REHABILITATION

A. Function of the SEC in Chapter X Reorganization

Having briefly examined the distinction between Chapter X and Chapter XI, the initial question is why the SEC prefers a Chapter X proceeding. This can be answered only after the role of the SEC with respect to corporate rehabilitation is understood. The SEC has virtually no function in Chapter XI proceedings.[15] In contrast, the SEC performs a very integral role in all Chapter X proceedings.[16]

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13. *Id.*
14. Rostow & Cutler, *Competing Systems of Corporate Reorganization: Chapters X and XI of the Bankruptcy Act*, 48 YALE L. J. 1334, 1334 (1939).
15. The Court in SEC v. American Trailer Rentals Co., 379 U.S. 594 (1965), held that even though no expressed statutory rights and responsibilities were given to the SEC under Chapter XI, as was the case with Chapter X, the SEC is still entitled to intervene and be heard in a Chapter XI proceeding. The Court, however, failed to discuss whether these SEC rights of intervention for Chapter XI were the same or different as their rights under Chapter X. In fact, the Court never really defined what rights of intervention the SEC had.

    Also, if shareholders are solicited to accept some alteration of their stock interest in a Chapter XI proceeding there is probably an anti-fraud Federal Securities problem and the solicitation would probably be subject to the SEC's proxy rules. These functions are not provided for in the Bankruptcy Act, but are governed by the Federal Securities Laws.
16. It is interesting to note that the SEC was very instrumental in obtain-

Many of the underlying purposes of the Securities Act, the Securities Exchange Act, and the Bankruptcy Act are the same. Apparently, Congress intended that courts and the SEC assist each other in bankruptcy proceedings. As one court noted:

> Both the Securities Exchange Act of 1934, 15 U.S.C.A. § 78a et seq., and the Bankruptcy Act, 11 U.S.C.A. § 1 et seq., are statutory enactments grounded primarily upon protection of the public interest in two different but overlapping areas of our economic existence. To the extent that the fields mingle, it is apparent to the Court that Congress has determined that there will be an embracing cooperation.[17]

The participation of an administrative agency in judicial proceedings, is somewhat unique to bankruptcy.[18] As Roscoe Pound noted:

> It is another presupposition of administrative absolutism that a reasonable adjustment of relations and regulation of conduct may be attained by putting the guiding and regulating agency in the position of a party to controversial situations, like the man who intervenes in a brawl, not to stop the fight, but to go in and take part in it on the side of one of the combatants. Many examples might be cited. But one familiar to you is the Securities and Exchange Commission becoming a party to all important reorganizations, as provided in the Lea Bill.[19]

The close relationship between the recommendations of the SEC and subsequent decisions by the courts demonstrates the courts' reliance on the expertise of the SEC in the performance of their statutory duties.

The SEC is entrusted with the function of "watchdog" for the holders of public debt. This role is based on the assumption that "the investing public dissociated from control or active participation in the management, needs impartial and expert administrative assistance in the ascertainment of facts, in the detection of fraud, and in the understanding of complex financial problems."[20] In other words, where public debt is present there is a need for an investigation by an independent trustee, which is not provided for

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ing congressional approval of Chapter X, while the National Association of Credit Men, whose alignment of interests is with small trade creditors, was the primary impetus behind the passage of Chapter XI.

17. In re Otis & Co., 104 F. Supp. 201, 203 (N.D. Ohio 1952).
18. *See* Frank, *Epithetical Jurisprudence and the Work of the Securities and Exchange Commission in the Administration of Chapter X of the Bankruptcy Act*, 18 N.Y.U. Q. L. REV. 317 (1941).
19. Pound, *Trend of the New Laws*, 9 INVESTMENT BANKING 24, 26 (1938). Pound meant the Chandler Bill, which had just been enacted, not the Lea Bill.
20. SEC v. United States Realty & Improvement Co., 310 U.S. 434, 448-49 n.6 (1940).

under Chapter XI. This is especially true when there is evidence of fraud or incompetence on the part of management. In addition, Chapter X subjects the debtor to a strict "fair and equitable"[21] standard not available under Chapter XI. Finally, Chapter X requires a larger percentage of the creditors to approve the plan than is required under Chapter XI, and the stockholders may be required to approve a plan under Chapter X if the debtor is solvent.

Thus, Chapter X provides the means by which the SEC is able to effectuate its role as a public watchdog. Most of the SEC's authority under Chapter X is derived from section 208.[22] Under this provision, the SEC serves as an advisor to the federal district courts as a party to reorganization proceedings either at the request or with the approval of the courts. The SEC is able to render independent, expert advice and assistance to the courts, which otherwise would be unavailable. Representatives of the SEC work closely with the court-appointed trustees and their counsel and with other interested parties in the resolution of problems and the formulation of plans of reorganization. The SEC also makes recommendations on the independence of trustees and their counsel, fee allowances to various parties, including the trustees and their counsel, sales of properties and other assets, interim distributions to security holders, and other financial and legal matters. It should be emphasized that the SEC's power is strictly advisory and it has no power to enforce its findings or to make them binding on the courts. The cases discussed in section III will demonstrate, however, that the courts do rely heavily on the views expressed by the SEC.

The authority given to the SEC to actively participate in the early formulation of the plan for reorganization can be understood in light of section 208 which also provides, "the Commission may not appeal or file any petition for appeal in any such proceeding."[23] If the SEC were not given extensive input early in the reorganization proceeding, its effectiveness would be drastically impaired. Conversely, the denial of a right to appeal forces the SEC to participate early in the proceedings, when its expertise can be most beneficial. This restriction, however, does not forbid or prevent the SEC from participating in appeals taken by other parties, which in fact the SEC considers part of its function in reorganization.[24] Whatever the intent, the result has been to

21. Bankruptcy Act § 221(2) (11 U.S.C. § 621(2) (1970)).
22. *Id.* § 208 (11 U.S.C. § 608 (1970)).
23. *Id.*
24. *See, e.g.*, In re Postal Telegraph & Cable, 119 F.2d 861 (2d Cir. 1941);

guarantee the participation of the SEC from the time of the initial filing of the bankruptcy petition.

One of the primary functions of the SEC in the formulation of the plan of reorganization is to provide "fair and equitable" treatment for the various creditors and security holders and to help assure that the plan is "feasible" and will permit the corporation to emerge from the rehabilitation financially sound. To achieve these goals, the SEC may undertake a thorough study and analysis of the debtor's past operations, its financial condition, its past earning power and its competitive position in the particular industry. In a case where the liabilities of the corporate debtor exceed its assets by greater than $3,000,000, Chapter X requires the SEC to prepare and submit a report as to the fairness and flexibility of the plan.[25] This report is filed with the court for its assistance and is distributed among the creditors and security holders to enable them to exercise an informal judgment in considering whether to vote for or against acceptance of the plan.[26] The court will not enter judgment until it has received a report from the SEC or until it has been notified that the SEC will not file a report.[27]

Keeping in mind that the SEC has very limited authority under a Chapter XI proceeding, it is clear that the SEC would prefer to exert its broader powers in a Chapter X proceeding. There it can act to protect larger numbers of public investors. The SEC, however, can not force a debtor into Chapter X unless a petititon was filed previously under Chapter XI. Then, the SEC can file a motion to have the debtor's petition dismissed, or, if the debtor voluntarily amends its petition to comply with the requirements of

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In re Sheridan View Bldg. Corp., 149 F.2d 532 (7th Cir.), *cert. denied*, 326 U.S. 737 (1945).

25. Bankruptcy Act § 172 (11 U.S.C. § 572 (1970)).
26. *Id.* § 175 (11 U.S.C. § 575 (1970)). This so-called "175 package" exempts from the proxy requirements of Rule 14a(2)(E) of the Commission's Proxy Rules and Regulations under the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78hh (1970), all materials forwarded to shareholders pursuant to this provision. Bankruptcy Act § 264 (11 U.S.C. § 664 (1970)), exempts § 5 of the Securities Act of 1933, 15 U.S.C. §§ 77a-77bbbb (1970), which requires the registration of securities, from the application of Chapter X. Similarly, Bankruptcy Act § 393 (11 U.S.C. § 793 (1970)) exempts application of § 5 of the Securities Act of 1933 to Chapter XI proceedings. For a comprehensive discussion of the effect of the SEC registration requirements on the Bankruptcy Act, see Corotto, *Debtor Relief Proceedings under the Bankruptcy Act and the Securities Act of 1933: The Registration Requirement and Its Implications*, 47 AM. BANKR. L.J. 183 (1973).
27. Bankruptcy Act § 173 (11 U.S.C. § 573 (1970)).

Chapter X, the SEC can move to have the proceeding transferred to Chapter X.

B. SEC Intervention in Chapter XI Arrangements

If a corporate debtor files a petition under Chapter XI and the SEC believes the rehabilitation belongs to Chapter X, the SEC can file a motion with the court pursuant to section 328[28] of Chapter XI requesting a dismissal or a transfer to Chapter X. Section 328 provides that the SEC or any party in interest, including creditors, may apply to the court to have the Chapter XI petition dismissed unless, (1) it is amended to comply with Chapter X by a certain date, or (2) an involuntary creditor's petition is filed under Chapter X. It either of these latter events occurs, the Chapter XI petition will not be dismissed and, in order to preserve continuity, the Chapter X petition will be considered to have been filed at the time the Chapter XI petition was filed. In most cases, the corporate debtor will amend its Chapter XI petition voluntarily to comply with Chapter X. The difficulty with this procedure arises when the court must determine the standards to be applied in a section 328 motion by the SEC.

The purpose of section 328 can be understood better after looking at its legislative history.[29] Congress had two primary reasons for adopting section 328 in 1952. The first reason was to codify the *SEC v. United States Realty and Improvement Co.*[30] decision which permitted the SEC to intervene on behalf of public investors. The second reason was to adopt a trasnfer procedure complimentary to section 147[31] of Chapter X, which provides for transfers to Chapter XI. Neither reason manifested any congressional intent to have the SEC serve as a watchdog for the public investors in rehabilitation proceedings.

The assumption until this time has been that a section 328 motion by the SEC should be granted if it would be in the interests of public investors. However, it has been argued that a Chapter X proceeding, as invoked by the SEC, may in fact have the effect of an antirehabilitation statute. This is because the rigidity of a Chapter X proceeding may cause a potentially successful Chapter XI arrangement, that has been transferred to a Chapter X proceeding under section 328, to result in liquidation of the debtor. The debtor generally experiences a loss of management and an unwill-

28. *Id.* § 328 (11 U.S.C. § 728 (1970)).
29. [1952] U.S. CODE CONG. & AD. NEWS 1960.
30. 310 U.S. 434 (1940).
31. Bankruptcy Act § 147 (11 U.S.C. § 547 (1970)).

ingness of new investors to follow an extensive Chapter X proceeding. Although these factors might indicate that a Chapter XI proceeding should be preferred, the existence of public debt may influence courts to transfer the proceeding to Chapter X where an independent trustee can be appointed. It becomes apparent, therefore, that what is in the best interests of the public investors may not necessarily be in the best interests of the debtor or other creditors.

The issue thus becomes whether the presence of public debt should cause the automatic transfer of a proceeding to Chapter X at the expense of the debtor's rehabilitation. It is possible that a forced liquidation would not be in the best interests of the public debt holders as well as other creditors and the debtor. The question is: what standards should the court apply when presented with a section 328 motion?

III. JUDICIAL STANDARDS FOR SEC INTERVENTION

It would appear from this examination of the distinction between the alternate routes of rehabilitation that Chapter XI generally is more suitable for small corporations or individual businesses, whereas Chapter X is geared toward large corporations with complicated debt structures. Traditionally, the size of a corporate debtor was thought to provide a rough estimate of which chapter was appropriate for a bankruptcy proceeding. The Bankruptcy Act, however, provides no formula to determine whether corporate debtors should be rehabilitated under Chapter X or Chapter XI. Due to this lack of guidance, the courts are faced with an especially difficult problem each time a medium-sized corporation seeks rehabilitation under Chapter XI and the SEC moves to dismiss or transfer the petition to Chapter X. As one commentator wrote: "The 'general principles' approach has led most of the writers in this area to conduct a frantic search for *the* criteria of removal from Chapter XI to Chapter X."[32]

There does appear to be one factor which manifests itself in most Chapter selection cases. It is the common knowledge that the heart and soul and success of a business depends upon its management.[33] A common cause of corporate collapse is fraudulent or inept management. Evidence of such mismanagement would favor a Chapter X proceeding which provides much closer

32. 37 COLO. L. REV. 500, 502 (1965).
33. Katskee, *The Calculus of Corporate Reorganization Chapter X v. XI and The Role of the SEC Assessed*, 45 AM. BANKR. L.J. 171 (1971).

judicial scrutiny in the development of a plan to rehabilitate the debtor, and authorizes a trustee to take over the management of the corporate debtor. In contrast, a Chapter XI proceeding permits the debtor's management to remain in control. This is not to say that a mere suspicion of mismanagement is sufficient to transfer a Chapter XI proceeding to Chapter X. Actual evidence of either fraudulent or inept management is required. An historical review of the cases in this area puts the effect of mismanagement on chapter selection into a better perspective.

A. *United States Realty*: The Fair and Equitable Standard

The landmark case in the area of SEC intervention in corporate rehabilitation is *SEC v. United States Realty & Improvement Co.*[34] This case established the precedent for future intervention by the SEC in a corporate rehabilitation proceeding. Mismanagement was not at issue in this case but the court did express its distaste for the corporation's "frequent adoption of plans which favored management at the expense of other interests."[35] The Supreme Court faced two issues: (1) whether adequate relief was available under Chapter XI and (2) whether the SEC, absent statutory authority, was permitted to intervene on behalf of the public debt holders. The Court resolved the first issue by holding that a corporation with public debt holders could file a petition under Chapter XI, provided the plan had no effect on the interests of the public debt holders. The Court concluded, however, that the complicated debt structure of the debtor prevented consummation of a feasible plan of rehabilitation under Chapter XI without readjustment of the public debt holders' interest. The Court also concluded that the SEC could intervene in a Chapter XI proceeding even though there was no direct statutory authority under the Bankruptcy Act. As the Court stated,

> [W]e think it plain that the Commission has a sufficient interest in the maintenance of its statutory authority and the performance of its public duties to entitle it through intervention to prevent reorganizations, which should rightly be subjected to its scrutiny, from proceeding without it.[36]

With the exception of Justice Roberts's dissent in *United States Realty*, the authority of the SEC to intervene in Chapter XI proceedings never was challenged seriously. Eventually, in 1952, Congress added section 328[37] to the Bankruptcy Act which author-

34. 310 U.S. 434 (1940).
35. *Id.* at 448.
36. *Id.* at 460.
37. Bankruptcy Act § 328 (11 U.S.C. § 728 (1970)).

ized intervention by the SEC in Chapter XI proceedings. It is noteworthy that section 366 was amended simultaneously,[38] and the Chapter XI requirement of "fair and equitable" was changed to "the best interests of the creditor." Congress had recognized that the "fair and equitable" standard was incongruous with the purpose of a Chapter XI proceeding.[39] *United States Realty* was decided when section 366 of Chapter XI still contained the "fair and equitable" standard requiring readjustment of stock holdings, which could not be effectuated under the Chapter XI plan. The question arose whether *United States Realty* should be limited to its own facts and no longer adhered to, since the "fair and equitable" standard had been eliminated from Chapter XI. As later cases demonstrated, the spirit of *United States Realty* lived on, without concern over the statutory amendment to section 366.

It was sixteen years before the Supreme Court faced the issue of chapter selection again. The circuit courts, however, decided two relatively minor cases in the interim. The first case, *Mecca Temple v. Darrock*,[40] was the only other case decided prior to the 1952 revisions to the Bankruptcy Act. The debtor, a fraternal society, filed a petition under Chapter XI proposing to pay each bondholder ten per cent over a period of years. The referee dismissed the petition, holding that it should be transferred to Chapter X. The Second Circuit affirmed, citing *United States Realty* as authority, and holding that the "fair and equitable" doctrine prevented Chapter XI from providing adequate relief for the public debt holders. Although mismanagement was not a factor in *Mecca Temple*, it was important in the later case of *In re Transvision, Inc.*[41] This case involved 385,000 shares of out-

38. *Id.* § 366 (11 U.S.C. § 766 (1970)).

39. The courts have interpreted "fair and equitable" to require a division of creditors and stockholders into classes where the claim of each class, from the senior to junior classification, must be fully satisfied before another class may receive payment on their obligations. In essence, this strict or absolute priority rule requires that parties affected by the reorganization be allowed to retain the advantage of their respective priorities. Clearly this is incongruous with a Chapter XI proceeding which does not attempt to adjust the interests of public debt holders. *See* Case v. Los Angeles Lumber Prod. Co., 308 U.S. 106 (1939). *See also* Note, *The Role of the SEC in Corporate Reorganizations Under the Bankruptcy Act*, 1958 U. ILL. L.F. 631.

The new standard for Chapter XI proceedings, subsequent to the 1952 revision, is the "best interests of the creditors" which means only that under Chapter XI the creditors must receive a value greater than they would receive under a forced liquidation. 9 COLLIER ON BANKRUPTCY ¶ 9.17 (14th ed. Moore 1975). *See also* In re Peoples Loan & Inv. Co., 410 F.2d 851, 857 n.6 (8th Cir. 1969).

40. 142 F.2d 869 (2d Cir.), *cert. denied*, 323 U.S. 784 (1945).

41. 217 F.2d 243 (2d Cir. 1954), *cert. denied*, 348 U.S. 952 (1955).

standing common stock, of which the management owned 250,000 shares. The balance was owned by 425 public investors. The debtor initiated a plan under Chapter XI which provided for the liquidation of all unsecured debts over $50 at a rate of 2 per cent each month for fifty months, leaving unaffected the rights of stockholders and secured creditors. The court denied the SEC's petition to transfer the proceeding to Chapter X because it believed that the desired financial condition could be achieved under Chapter XI.

> The SEC has adduced no information which would tend to indicate that the plan is likely to fail, but has, at most, indicated that there may be some basis for suspecting possible improprieties in past management. Certainly, so ephemeral a suspicion is not an adequate basis upon which to overturn a plan . . . .[42]

Thus the court expressed its willingness to consider management as a factor in chapter selection, but the evidence must consist of more than a mere suspicion. One year later, the Supreme Court again was confronted with the issue of chapter selection.

B. *General Stores Corp.*: The "Needs" Test

In *General Stores Corp. v. Shlensky*,[43] the debtor initiated a Chapter XI arrangement under which he proposed a 40 per cent settlement with each of his unsecured creditors. One stockholder out of 7,000, holding only 3,000 of 2,322,422 outstanding shares, together with the SEC, moved to dismiss the proceeding unless it was amended to comply with Chapter X. The Court, relying on its previous decision in *United States Realty*, affirmed the decision to transfer the proceeding to Chapter X. Justice Douglas developed what he called a "needs test" for determining which chapter was appropriate for a corporate rehabilitation.

> The character of the debtor is not the controlling consideration in a choice between c. X and c. XI. Nor is the nature of the capital structure. It may well be that in most cases where the debtor's securities are publicly held c. X will afford the more appropriate remedy. But that is not necessarily so. A large company with publicly held securities may have as much need for a simple composition of unsecured debts as a smaller company. And there is no reason we can see why c. XI may not serve that end. The essential difference is not between the small company and the large company but between the needs to be served.[44]

Justice Douglas proceeded to explain that these "needs to be served" included such factors as (1) the need to readjust the

42. *Id.* at 247.
43. 350 U.S. 462 (1956).
44. *Id.* at 466.

corporate debts which, without any sacrifice by stockholders, may violate the fair and equitable plan, (2) the need for management to account for its misdeeds, and (3) the need for new management to avoid a later collapse of the corporation. Clearly these needs, which would require a transfer to Chapter X, incorporate management as the primary determinative factor. In the case at bar, Justice Douglas found that the debtor had experienced a rocky history and "either an improvident overextension or a business that has been out of step with modern trends."[45] Enlightened by the opinion of Justice Douglas, the circuit courts began to give more serious consideration to the management factor in chapter selection cases.

In *SEC v. Wilcox-Gay Corp.*,[46] the Sixth Circuit unanimously affirmed the denial of an SEC application to transfer a Chapter XI proceeding to Chapter X. The court held that the standards set forth by the Supreme Court in *General Stores* had been applied properly by the district judge. The court emphasized its failure to apply the fair and equitable rule, the recommendation of the creditor's committee that present management be retained, and the adherence to the *Transvision* and *General Stores* cases as the factors on which it relied. The court held that the instant case did not require a pervasive reorganization as was necessary in the *General Stores* case. It began to appear that with the foundation of *Transvision* and *Wilcox-Gay*, the courts were beginning to give greater consideration to the retention of the management of a corporate debtor when no demonstration of management misconduct had been shown.

In the following year, in *SEC v. Liberty Baking Corp.*,[47] the Second Circuit applied the doctrine evoked by *General Stores* to grant an SEC application for dismissal or voluntary transfer from Chapter XI to Chapter X. This particular debtor already had been through two proceedings under the Bankruptcy Act and was seeking a modification of the claims of the public debenture holders. The court held that there was more than a mere suspicion of mismanagement because a sufficient record of discretionary mismanagement had been demonstrated. It was on these grounds that the court initially distinguished this case from *Transvision* and *Wilcox-Gay*.[48] The court noted that a full investigation of the situation which was available only under Chapter X, was imperative because the "facts now of record suggest the possibility that an

45. *Id.* at 467.
46. 231 F.2d 859 (6th Cir. 1956).
47. 240 F.2d 511 (2d Cir.), *cert. denied*, 353 U.S. 930 (1957).
48. *Id.* at 516 n.10.

independent trustee's investigation might also reveal a need for 'an accounting from the management for misdeeds' which caused the present necessity of a further reorganization."[49] Thus the courts appeared to be evolving a standard which required all rehabilitation cases containing sufficient evidence of mismanagement be filed under Chapter X. In the absence of such a showing, the courts left the proceeding in Chapter XI.

Six years later, the Second Circuit permitted another corporate debtor to remain under Chapter XI. In *Grayson-Robinson Stores, Inc. v. SEC*,[50] there was no publicly held debt to be adjusted, and a strong creditor's committee, which was receptive to the contributions of stockholder interests, had been formed. The debtor was a nationwide chain of retail apparel stores which had expanded without increasing its equity base and long term financing. The court held that the interests of the debtor were best served by Chapter XI: "[T]he possibility that new management is sorely needed is suggested from the fact that until November, 1960, when the present management gained control of Grayson, the debtor had enjoyed many consecutive years of profitable operation."[51] This case should not be considered as an exception to the *Liberty Baking Corp.* approach to the factor of management, but is at most an anomaly.

In two other cases, before the Supreme Court was again faced with the issue, appellate courts affirmed motions by the SEC to transfer Chapter XI proceedings to Chapter X. In *SEC v. Crumpton Builders, Inc.*,[52] the debtor, a shell house builder, suffered severe losses when the shell house market sharply declined shortly after the corporation went public. The court held the motion to dismiss or transfer the proceeding to Chapter X was dismissed improperly by the district court because the plan of arrangement was inequitable to the creditors. The court decided that various criteria had emerged from the previous cases which required that "there should be no particular need for recapitalization or replacement of management. There should be no indication of unfair or treacherous dealings by management or any other group standing to gain by the arrangement."[53] Also in 1964, the case of *SEC v. Canandaigua Enterprises Corp.*[54] was decided in the Second Circuit. This case involved a bankrupt race track in which the

49. *Id.* at 515.
50. 320 F.2d 940 (2d Cir. 1963).
51. *Id.* at 951.
52. 337 F.2d 907 (5th Cir. 1964).
53. *Id.* at 912.
54. 339 F.2d 14 (2d Cir. 1964).

petition to transfer the petition from Chapter XI to Chapter X was granted over the objection of the stockholders and creditors who felt the proposed arrangement would not meet the "fair and equitable" standard of Chapter X. The Court in *General Stores* regretted that it had to order a proceeding not favored by creditors or stockholders, but concluded that it was forced to follow the "needs test" which the court found

> emphasized the need to determine on the facts of the case whether the formulation of a plan under the control of the debtor, as provided by c. XI, or the formulation of a plan under the auspices of disinterested trustees, as assured by c. X and the other protective provisions of that chapter, would better serve "the public and private interests concerned including those of the debtor."[55]

In applying the "needs test," as first articulated in *General Stores*, the court relied on the presumption in favor of Chapter X where there is a need for readjustment of the public debt, and avoided the issue of management misconduct.

C. *Trailer Rentals*

Finally, we arrive at what has been the last exposé by the Supreme Court on the issue of chapter selection. In *SEC v. American Trailer Rentals Co.*,[56] the debtor was engaged in the business of trailer rentals. The company was financed through the sale of trailers to investors, and by the lease-back of the trailers for a 2 per cent return on investment each month for ten years. In 1961, the SEC stepped in to halt these sale and leaseback arrangements on the theory that securities were involved that could not be sold to the public until the necessary registration statement was filed by the debtor. An attempt to meet this requirement failed due to SEC's suspicion of false and misleading statements in the offered material. The company then filed a Chapter XI petition. At that time, its liabilities exceeded its assets by $682,282. The recommendation by the referee for a Chapter XI arrangement was adopted by both the district and circuit courts, although both courts recognized that the debtor's officers would have effective control over the corporation after the arrangement, and preferential treatment was being given to the banks. The Supreme Court, in what amounted to a treatise of all the law to date, unanimously reversed the lower courts' opinions. Justice Goldberg, writing the opinion, reaffirmed the principles of *United States Realty* and *General Stores* by holding that,

55. 350 U.S. 462, 465 (1956) (quoting SEC v. United States Realty Co., 310 U.S. 434, 455 (1940)).
56. 379 U.S. 594 (1965).

> the "needs to be served" included such factors as requirements of fairness to public debt holders, need for a trustee's evaluation of an accounting from management or determination that new management is necessary, and the need to readjust a complicated debt structure requiring more than a simple composition of unsecured debt.[57]

The Supreme Court thus reaffirmed the importance of the management of a corporate debtor by incorporating this factor in the "needs" test.

American Trailer Rentals made it clear that Chapter X and Chapter XI are "legally mutually exclusive paths to . . . financial rehabilitation"[58] and are not alternate routes. The courts, when faced with an SEC motion to intervene, must then determine which proceeding is appropriate. Several appellate court cases were decided since the *American Trailer Rentals* case.

Before 1965 had ended, the First Circuit faced this issue in *SEC v. Burton*.[59] The SEC appealed the denial of its motion under section 328.[60] The court withheld its opinion until the Supreme Court had decided the *American Trailer Rentals* case, and remanded the case to the district court "to review the factual situation as it is now in the light of the criteria for the exercise of discretion as developed by the Court in *SEC v. American Trailer Rentals Co. . . .*"[61] On remand, however, the district court stood by its previous ruling and again denied the SEC's motion to dismiss.[62] The court distinguished this case from *American Trailer Rentals* on four grounds. First, in *Burton* there was only a minor adjustment of public debt. Second, there was no misconduct on the part of past management. Third, new management now operated the business; and finally, a transfer to Chapter X "could well lead to disaster for the subordinated creditors and stockholders of the debtor."[63] The SEC alleged that mismanagement was a contributing factor to the financial difficulties of Burton, but the court held that this had not been adequately demonstrated and new management had since taken over.

Four years later, the appellate courts were again confronted with the issue of chapter selection. In *In re Peoples Loan & Investment Co. of Fort Smith*,[64] the debtor was forced to file a

57. *Id.* at 610.
58. *Id.* at 607.
59. 342 F.2d 783 (1st Cir. 1965).
60. In re American Guar. Corp., 221 F. Supp. 961 (D.R.I. 1963).
61. SEC v. Burton, 342 F.2d 783, 785 (1st Cir. 1965).
62. In re American Guar. Corp., 246 F. Supp. 322 (D.R.I. 1965).
63. *Id.* at 327.
64. 410 F.2d 851 (8th Cir. 1969).

petition under Chapter XI as a result of a run on its deposits caused by a suit brought by the SEC against a similar, though unrelated, loan and thrift company located in the same area. The SEC filed a section 328 motion which the district court denied. The Eighth Circuit reversed, based on its application of the needs test as set forth in *General Stores* and *American Trailer Rentals.* The court held that in most cases where public debt is involved, the needs test will balance in favor of Chapter X, though "there are exceptions to the general rule that where public investor creditors are involved Chapter X is the proper proceeding. But as *Shlensky* and *Trailer Rentals* indicate, the exceptions are held within very narrow limits."[65] In addition the court based its decision on "much evidence of mismanagement and self-dealing, particularly in regard to the mortgage holding on the shell homes."[66]

That same year, the Tenth Circuit addressed a similar chapter selection case in *Norman Finance & Thrift Corp. v. SEC.*[67] The debtor in this case, as in *Peoples*, was a loan and thrift company which found itself with an operating deficit of $400,000. *Norman* filed a petition under Chapter XI and the SEC quickly filed a motion under section 328 to have the proceeding transferred to Chapter X. The district court denied the motion, but on appeal the circuit court reversed, relying upon *United States Realty, General Stores*, and *American Trailer Rentals.* The court reasoned that the problems of mismanagement by officers and the drastic adjustment of the rights of depositor-creditors, which were not present in the *Peoples* case, justified the need for a stricter Chapter X proceeding. In both *Peoples* and *Norman* the majority of the public debt holders voted in favor of the Chapter XI proceeding, but in both cases the courts ruled to transfer the proceedings to Chapter X. But in both cases there was also actual evidence of mismanagement on which the selection of Chapter X could be justified.

The two most recent cases on chapter selection indicate that the SEC may have reevaluated its policy with respect to this issue. In these cases the SEC appeared to step back from its role as *élan vital* to a more passive role.[68] In *Posi-Seal International, Inc., v. Chipperfield,*[69] a stockholder holding 11 percent of the company's stock

65. *Id.* at 858.
66. *Id.*
67. 415 F.2d 1199 (10th Cir. 1969).
68. *See* 36 SEC ANN. REP. 194-200 (1970); 37 SEC ANN. REP. 195-203 (1971); 38 SEC ANN. REP. 126-28 (1972); 40 SEC ANN. REP. 130-32 (1974); 41 SEC ANN. REP. 158-62 (1975).
69. 457 F.2d 237 (2d Cir. 1972).

filed a petition for review of a Chapter XI confirmation order pursuant to section 39(c) of the Bankruptcy Act.[70] His contention was that the arrangement involved the " 'affection' of stockholder rights" and should properly be brought under Chapter X.[71] The district court adopted the conclusions of the referee and upheld the confirmation order. The Second Circuit was concerned with the issue of whether the proceeding was properly brought under Chapter XI and requested an amicus curiae brief from the SEC as to whether the district court had abused its discretion. The brief stated that the SEC found no error in the confirmation of the plan. In affirming the denial by the district court of the petition for review, the court stated: "While we realize that the court below did not have 'open ended' discretion to determine between Chapter X and XI, the guiding principles of rehabilitation of the debtor and the public investors have been served here."[72]

Finally, in *In re KDI Corp.*,[73] the SEC again was not the movant for a dismissal or transfer to Chapter X. The debtor was a large publicly-owned holding company. It reported net sales of $140 million and earnings of $5.3 million in 1969, but it was unable to meet its current obligations in August, 1970. KDI then filed a petition under chapter XI of the Bankruptcy Act and a proposed plan of arrangement. Two investors filed a section 328 motion arguing the "circumstances and capital structure of the debtor were such that the relief afforded by Chapter XI is inadequate"[74] and the proceeding should have been brought under Chapter X. The district court denied the investor's motion and the Sixth Circuit affirmed. The court found that KDI had taken many drastic and effective steps to correct past mistakes by getting rid of bad investments, obtaining a new management team, and renegotiating its agreements with the banks. Because the SEC was familiar with the KDI proceedings, and yet it had not seen fit to join in the motion to dismiss or transfer the proceeding to Chapter X, the court concluded there was no threat to the interests of the public investors, and therefore, no need to transfer the proceeding out of Chapter XI. In addition to the SEC taking a more passive role the failure to produce any convincing proof of mismanagement was again a major consideration.

> In addition to supplying new management, a trustee is frequently needed to investigate past mismanagement, fraud or breach of

70. Bankruptcy Act § 39(c) (11 U.S.C. § 67(c) (1970)).
71. 457 F.2d at 238.
72. *Id.* at 240.
73. 477 F.2d 726 (6th Cir. 1973).
74. *Id.* at 730.

trust by officers or directors. While KDI has suffered from bad management in the sense of poor business judgment and insufficient financial controls and accounting practices, the appellants failed to produce convincing proof of any fraud or bad faith.[75]

D. Summary

Looking at these cases in retrospect, each court of last resort upheld the section 328 motion when evidence of mismanagement was sufficiently demonstrated. *United States Realty* layed the foundation for SEC intervention in chapter selection. Fifteen years later, beginning with *Transvision* and running through *KDI*, the integrity and competence of the management of a corporate debtor appeared to be the only common thread bringing any semblence of order to this area of apparent chaos. Every case in which the court of last resort denied a section 328 motion, no substantial evidence of mismanagement was demonstrated to the court. It is important to keep in mind that most of the evidence presented in chapter selection cases is provided by the SEC. The courts, therefore, must rely heavily on SEC recommendations. Considering the judicial reliance on SEC recommendations, the less active role taken by the SEC in recent chapter selection cases has resulted in fewer section 328 transfer cases. As noted, the two most recent cases, *Posi Seal* and *KDI*, were both initiated by investors instead of by the SEC, and in both cases the section 328 motion was denied. Whether the more passive role of the SEC is the result of an enlightened attitude toward the ability of a debtor and its creditors to make satisfactory arrangements, or from a lack of manpower to review all the cases, there is no indication that this trend will not continue. However, should Congress vote to adopt the proposed Bankruptcy Act of 1973, this entire area of case law would be no more than history.

IV. CHAPTER VII OF THE PROPOSED BANKRUPTCY ACT AND THE SEC'S ROLE IN CORPORATE REHABILITATION

As mentioned at the outset, the basic theory behind the application of Chapters X and XI is that the going concern value of a debtor's assets is greater than their liquidation value. Chapter VII of the proposed New Bankruptcy Act consolidates Chapters X, XI and XII and eliminates any opportunity for chapter selection.[76]

The proposed New Bankruptcy Act, if adopted, would supplant the present Bankruptcy Act of 1898. The Commission on

75. *Id.* at 734.

76. The discussion of Chapter VII of the Proposed New Bankruptcy Act, *supra* note 2, will be limited to the role of the bankruptcy administrator and the elimination of the SEC from rehabilitation proceedings.

Bankruptcy Laws of the United States was formed by congressional resolution in response to the urgent need to update the bankruptcy system to conform to the realities of our present economy. Under the Act, independent courts of bankruptcy would be established separate from the United States district courts and would have jurisdiction over all controversies arising under the Act, with the exception of criminal cases.[77] In addition, the Commission has recommended the creation of a new, independent agency to be known as the "United States Bankruptcy Administration" which would be headed by a bankruptcy administrator appointed by the President for a term of seven years subject to confirmation by the Senate. The administrator would be authorized to appoint a deputy, regional administrators and such other officers as he would find necessary in a system of organization that is responsible "for efficient, effective, and economical conduct of the business and affairs of the Administration."[78] The Commission has proposed two principal reasons for creating the office of bankruptcy administrator: (1) it hopes to eliminate conflict between the judicial and the administrative responsibilities of the bankruptcy judge and (2) it hopes to increase uniformity in bankruptcy proceedings.[79]

A. Judicial or Administrative Duties?

The separation of the judicial and administrative functions of the bankruptcy judge was a major concern of the Commission. Under the present system, the bankruptcy judge, in the exercise of his administrative duties, must work very closely with the trustee and the lawyer of the debtor in supervising the debtor's estate. At the same time, the judge is required to exercise nonpartial judicial discretion. Over a period of time the judge can not avoid becoming friendly with the attorneys who regularly appear before him representing debtors. Even if impropriety does not exist, the present system is far from conducive to the customary adversary proceeding which is so basic to our judicial system. The summary proceeding under the present system has been strongly criticized.[80] The mere potential for unfairness should be a sufficient basis to

77. Proposed New Bankruptcy Act, *supra* note 2, §§ 2-101, 2-201, 2-202. The proposed bankruptcy courts would be patterned largely after the United States Tax Court. *Compare id.* §§ 2-102, 2-103, 2-104 (pertaining to Bankruptcy judges) *with* 26 U.S.C. §§ 7443, 7447, 7448 (1970) (pertaining to tax court judges).

78. Proposed New Bankruptcy Act, *supra* note 2, § 3-102(b).

79. *See* H.R. Doc. No. 93-137, 93d Cong., 1st Sess. (1973) (Part I contains the Commission's report) [hereinafter cited as the Report].

80. *See* Treister, *Summary Judgment Bankruptcy Jurisdiction: Is it too Summary?*, 39 U.S. CAL. L. REV. 78 (1966).

dictate the need for a separation of the functions of the bankruptcy judge. As the Commission itself stated:

> [T]he Commission believes that making an individual responsible for conduct of both administrative and judicial aspects of a bankruptcy case is incompatible with the proper performance of the judicial function. Even if a paragon of integrity were sitting on a bench and could keep his mind and feelings insultated from influences which arise from his previous official connections with the case before him and with one of the parties to it, he probably could not dispel the appearance of a relationship which might compromise his judicial objectivity.[81]

The opponents of the proposed New Bankruptcy Act agree that there is a need to eliminate the conflict between the judicial and administrative responsibilities of a bankruptcy judge; however, they argue that the Commission's proposal of a Bankruptcy Administrator would merely shift the conflict to the Bankruptcy Administrator, thus defeating the underlying purpose of the separation of the judicial and administrative responsibilities. As Conrad Cyr noted: "The paradox presented therefore is that the 'United States Bankruptcy Administration,' created principally to eliminate real and apparent conflicts on the part of the bankruptcy court, would become an executive compendium of conflicting interests, powers and responsibilities.[82] Cyr proposed a segregation of the clerical staffs of the local bankruptcy courts from the bankruptcy judges by placing these clerical staffs in the administrative office of the United States courts.[83]

The proponents of the proposed New Bankruptcy Act assert that Cyr's proposal is not a viable solution to the need for separation of judicial and administrative responsibilities. They argue that the clerical staffs would be exercising mere ministerial duties. The duties performed by an administrator under the proposed New Bankruptcy Act, on the other hand, would not be ministerial. The administrator would have the authority to exercise independent discretion in the day to day problems of the bankruptcy proceeding.

Though both the opponents and proponents of the proposed New Bankruptcy Act concur in the need for the separation of the duties of the bankruptcy judge, there is little agreement as to how this best can be accomplished. The opponents of the Act argue that the enormous amount of discretion given the bankruptcy administrator in effect merely shifts the conflict from the judge to the administrator. The proponents, on the other hand, argue that

81. Report, *supra* note 79, at 93-94.
82. Cyr, *The Bankruptcy Act of 1973: Back to the Drafting Board*, 48 AM. BANKR. L. J. 45, 63-64 (1974).
83. *Id.* at 59.

any alternative solution creates only ministerial duties in the administrators and the real discretion still remains with the judge. The arguments on both sides are strong, and ultimate resolution of the issue should come from Congress.

B. Uniformity in Bankruptcy Proceedings

The other major improvement the Commission hoped to achieve by placing the administrative duties in the hands of a bankruptcy administrator was to bring uniformity to the actual practice and procedure of bankruptcy throughout the United States. Under the present system, each bankruptcy judge has his own procedure for administering the estate of a debtor. The lack of uniformity under the present system allows debtors to be treated differently, depending upon the jurisdiction in which the action is brought. Through the establishment of an independent agency which would be responsible for the administration of all bankruptcy proceedings, the hope is that debtors all over the country will be treated uniformly.

This recommendation for a national office of a bankruptcy administrator has met with strong objection in the legal community and is considered the most controversial provision of the proposed New Bankruptcy Act. The argument against an independent bankruptcy agency headquartered in Washington, D.C., is that it can not possibly be responsive to the difficult and pressing problems of corporate debtors across the country. The fear is that the agency would become merely part of the federal bureaucracy, incapable of handling the urgencies of corporate rehabilitation. The bankruptcy administrator would have the power to appoint a trustee virtually at will.[84] Once a trustee has been appointed his duties would encompass the formulation of a plan of reorganization.[85] The bankruptcy administrator, however, retains the authority to decide whether the debtor may continue the operation of his business.[86] This tremendous concentration of discretionary authority, it is argued, is totally inimical to the self-help theories which serve as a basis for Chapter X reorganizations and Chapter XI arrangements. The objections to the bankruptcy administrator are summarized in an article by Weintraub and Levin:

> The heart and pulse of bankruptcy is contained in the chapter proceedings. Our economy is dependent upon flexible bankruptcy laws which can give insolvent debtors an opportunity to survive with going-concern values with the aid of debtor support. It is

84. Proposed New Bankruptcy Act, *supra* note 2, § 7-102.
85. *Id.* § 7-103(b).
86. *Id.* § 7-104. *See also id.* § 7-112 (authorizing dismissal if a plan is not filed within the time affixed by the bankruptcy administrator).

> therefore difficult to see what activity would be left to the bankruptcy judges when the Administrator is virtually taking over the entire administration of the chapter proceedings.[87]

C. Elimination of the SEC

The creation of the office of bankruptcy administrator will eliminate the SEC from corporate rehabilitation proceedings. As stated in the Commission's report:

> The administrator will, nevertheless, perform the functions now delegated to the Securities and Exchange Commission in Chapter X cases of the present Act, including the preparation of an advisory report on proposed plans and the recommendation of compensation to be allowed trustees, attorneys, and accountants.[88]

Questions have been raised whether the bankruptcy administrator can effectively replace the SEC in reorganization proceedings. Even though the SEC has thirty-five years of experience in corporate rehabilitation, its less active role in recent cases demonstrates that the SEC may no longer be necessary for rehabilitation proceedings. If this trend is due to a change in attitude by the SEC of its role as a public watchdog to that of greater concern for the needs of the corporate debtor and the competence and honesty of the management, then Chapter VII of the Act is a substantial improvement over the present system. If this trend towards less involvement in bankruptcy rehabilitation, on the other hand, is merely due to an understaffing of the SEC in its bankruptcy division[89] then the justification for a bankruptcy administration is even greater. The bankruptcy administrator, being a disinterested party, would be able to look out for the interests of the public investor.

The removal of administrative duties from the bankruptcy judge is a necessary reform, but it is unclear at this time whether another bureaucratic agency in Washington will solve the problem. In light of the diminishing role of the SEC in corporate rehabilitation and the discretionary authority given the bankruptcy administrator, passage of the proposed New Bankruptcy Act should not endanger the rights of public investors by the elimination of the SEC from bankruptcy proceedings.

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87. Weintraub & Levin, *Chapter VII (Reorganizations) As Proposed By the Bankruptcy Commission: The Widening Gap Between Theory and Reality*, 47 AM. BANKR. L.J. 323, 340 (1973).
88. Report, *supra* note 79, at 125.
89. *See* King, *The Business Reorganization Chapter of the Proposed Bankruptcy Code—Or Whatever Happened to Chapters X, XI, XII*, 78 COM. L.J. 429, 430 n. 3 (1973).

APPENDIX

1 Case & Year	2 Transferred to Chapter X	3 Number of Public Investors	4 Court of Last Resort	5 Effect on Lower Court(s) Rulings	6 Evidence of Mismanagement
United States Realty (1940)	Yes	7,000	Supreme Court	Reversed	Yes (a)
Mecca Temple (1945)	Yes	1,834 Bondholders	2d Circuit	Reversed	—
Transvision (1955)	No	425	2d Circuit	Affirmed	No
General Stores (1956)	Yes	7,000	Supreme Court	Affirmed	Yes
Wilcox-Gay (1956)	No	3,000	6th Circuit	Affirmed	No *
Liberty Baking (1957)	Yes	385	2d Circuit	Reversed	Yes
Grayson-Robinson (1963)	No	3,470	2d Circuit	Affirmed	No (b)
Crumpton Builders (1964)	Yes	2,630	5th Circuit	Reversed	Yes
Canandaigua (1964)	Yes	6,130	2d Circuit	Reversed	Yes
American Trailer Rentals (1965)	Yes	5,866	Supreme Court	Reversed	Yes
Burton (1965)	No	3,910	1st Circuit	Remand	No
Peoples Loan (1969)	Yes	3,000+	8th Circuit	Reversed	Yes
Norman (1969)	Yes	600	10th Circuit	Reversed	Yes
Posi-Seal (1972)	No	1,700	2d Circuit	Affirmed	No
KDI (1973)	No	—	6th Circuit	Affirmed	No *

(a) Though no actual evidence of mismanagement, the case does have supporting language. 310 U.S. at 454.

(b) Though not in the majority opinion, mismanagement is suggested in Judge Clark's dissent.

* Not only is there no evidence of mismanagement, but actual evidence of highly competent management.