Chapter 11 of the 1978 Bankruptcy Code or Whatever Happened to Good Old Chapter XI Selected Articles on the Bankruptcy Reform Act of 1978.

Arthur L. Moller

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# CHAPTER 11 OF THE 1978 BANKRUPTCY CODE OR WHATEVER HAPPENED TO GOOD OLD CHAPTER XI?

ARTHUR L. MOLLER*

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As is expected when important new legislation appears, there have been several Law Journal articles on the Bankruptcy Reform Act of 1978 already published, and certainly there are many more to come.

One of the most drastic, and probably the least successful, provisions of the new Bankruptcy Code is the consolidation of Chapters VIII, X, XI, and XII of the Bankruptcy Act into a single chapter, chapter 11 of the Code. As of this writing I have seen only two articles dealing with the new chapter 11. The article by Professor King is full of praise for the new chapter, but rather reserved. That is the nature of the good Professor. The article by Mr. Trost is far less reserved; it is totally ecstatic. That is the nature of Mr. Trost. He writes as if the consolidation were a panacea for everyone involved in these cases, debtors, secured and unsecured creditors, and equity security holders alike.

I find myself at odds with both of these writers in several important respects. Perhaps there is room for a dissonant view of the consolidation effort. There is some good in the new chapter, to be sure; at least some small part of Chapter XI of the Bankruptcy Act has been retained. But some of it is far less good. Rehabilitation of business debtors has been made much more difficult. In all probability only strong businesses can survive the process, much like old Chapter X.

This is not intended even to suggest that the entire Bankruptcy Reform Act of 1978 is flawed. Far from it. There is a tremendous amount of good to be found in the Reform Act, improvement that long has been needed. At the head of the list is the improvement in stature of the new Bankruptcy Court, of which Professor Frank Kennedy has written elsewhere in this issue of the Journal. Next in line for praise is the granting to the bankruptcy court of pervasive

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1. The Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, consists of four titles: Title I is the enactment of the new title 11 of the United States Code, which is referred to hereafter as the Bankruptcy Code or simply, Code; Title II contains amendments to title 28 of the United States Code and to the Federal Rules of Evidence; Title III contains amendments to other acts; Title IV contains the repeal of the Bankruptcy Act and the transition provisions. Generally speaking, the provisions of the Reform Act become effective October 1, 1979.


CHAPTER 11

and exclusive civil jurisdiction over all matters related to a bankruptcy case. This jurisdiction includes removal to the bankruptcy court of cases which were pending in other courts at the time of the filing of the petition in bankruptcy court. The legislative history makes it entirely clear that Congress meant by the expanded jurisdiction to eliminate the old dichotomy between plenary and summary jurisdiction in bankruptcy, and to vest in the bankruptcy court complete jurisdiction over the bankruptcy case and all matters related to it. All other good things in the Bankruptcy Reform Act of 1978 pale in comparison with these two major accomplishments.

I. WHY CONSOLIDATION?

The idea of consolidation of Chapters X, XI, and XII of the Bankruptcy Act originated with the Commission on the Bankruptcy Laws of the United States. This Commission was created pursuant to Senate Joint Resolution No. 88 in the 91st Congress in 1970. Its report pointed out the inability of the Supreme Court and the Commission to articulate clear and positive guidelines to differentiate between debtors which should be reorganized in Chapter X and those which might be reorganized in Chapter XI. It seemed distressed that Chapter XI was being used by corporations with total indebtedness of as much as $80 million, which the Commission obviously considered too much for the relatively forthright and direct procedure of Chapter XI. Although the evidence on which the conclusion is based is not recounted, the Commission did conclude that Chapter XI had the same potential for abuse as the equity receivership which had been supplanted by section 77B of the Bank-

4. Id. § 1471. As the result of a compromise between the House and the Senate, exclusive jurisdiction of all cases under title 11 is vested in the United States district courts. Id. § 1471(a). In turn, the bankruptcy courts are vested with all the jurisdiction vested in the district courts. Id. § 1471(c). In addition, the bankruptcy court is vested with exclusive jurisdiction of all of the property of the debtor, wherever located, id. § 1471(e), a provision which was included in the rehabilitation chapters of the Bankruptcy Act (§§ 77a, 111, 311, 411, and 611) but was not included in Chapters I through VII, the "straight" bankruptcy provisions. The bankruptcy court may, in the interest of justice, abstain from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11, and its decision to abstain is not reviewable by appeal or otherwise. Id. § 1471(d).

5. Id. § 1478.


Bankruptcy Act in 1934,\(^8\) and therefore should be abolished. The report continued:

It is not feasible to attempt to carve out of Chapter XI certain cases which should be under Chapter X. As pointed out by Mr. Justice Douglas, the facts of each case determine the appropriate relief. The only solution is an elimination of the disparate procedures. The Commission therefore recommends a comprehensive business reorganization chapter. The Commission's recommendations that appointment of an independent trustee be discretionary, the absolute priority rule be made more flexible, a finding be required that the survival of the debtor is reasonably probable, and procedural reforms be made possible by the administrative agency\(^9\) dispel arguments in favor of retaining Chapter XI. Even the desire [of the debtor's management and its attorneys] to retain control is no longer a compelling argument for Chapter XI, since the appointment of an independent trustee is discretionary.\(^10\)

Even in its wildest dreams the Commission never gave a thought to consolidating Chapter VIII of the Bankruptcy Act\(^11\) into the business reorganization chapter of a new act. The drafters of the new Code seem to have gotten carried away; they have thrown railroad reorganizations into chapter 11,\(^12\) and in so doing found it necessary to exclude from railroad reorganization cases an amazingly small number of sections which apply to other entities.\(^13\) If, with these relatively minor adjustments, chapter 11 fits this kind of case, who can contend seriously that any substantial part of Chapter XI of the Bankruptcy Act has been retained?

Another argument advanced in favor of the consolidation of the rehabilitation chapters of the Bankruptcy Act into a single chapter was that this would obviate the often futile, always extremely disruptive and wasteful, motion under section 328 of the Act and Rule 11-15 brought by the Securities and Exchange Commission,\(^14\) occa-

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8. Section 77B had, in turn, been replaced by Chapters X and XI in 1938.
9. The Commission recommended the creation of a United States Bankruptcy Administration with extensive powers in connection with liquidation and reorganization cases. The United States trustee which is created by the Bankruptcy Reform Act of 1978 for 18 pilot districts is but a pale copy of the Commission's Bankruptcy Administration.
11. Chapter VIII of the Bankruptcy Act consists of only one section, section 77, and relates to railroad reorganization.
12. Subchapter IV of chapter 11, consisting of sections 1161-1174.
14. Hereafter "SEC."
sionally by others, to convert the Chapter XI case to one under Chapter X. In numerous cases such a motion was not filed until the case had progressed to a point of near resolution of the debtor's problems. Rule 11-15 attempted to halt the inordinate delay which had become practice under section 328, and required that the motion be filed within 120 days after the date of the first meeting of creditors and stockholders, but lost much of the ground that might have been gained by giving the court authority to extend the time for making such motions.

These and other premises of the reformers will be referred to and discussed in the context of various specific provisions of chapter 11.

II. Chapter 11

Chapter 11 cannot be viewed as an entity; it is not complete in and of itself. But no chapter of the new Bankruptcy Code is. The Code is as much of a ten-finger exercise as is the Uniform Commercial Code. Chapters 1, 3, and 5 of the Bankruptcy Code are applicable to a chapter 11 case. The definitions for chapter 11 cases are found partly in chapter 1 and partly in chapter 11. Rules of construction and specification of entities which may be debtors under chapter 11 are found in chapter 1. Administrative powers, including the automatic stay, use of collateral, the borrowing of money, rejection of executory contracts, and provisions regarding continuation of utility services are contained in chapter 3. The

15. The classic example of late filing is SEC v. Canaigua Enterprises Corp., 339 F.2d 14 (2d Cir. 1964), in which the filing was delayed until after a plan had been proposed and accepted by quite substantial majorities. With the filing of the transfer motion the court was compelled to halt all forward progress in the case to hear the motion. At the conclusion of the hearing the district court denied the SEC request for transfer to Chapter X and the SEC promptly appealed. With considerable reluctance 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. Adjudication followed.

18. Id. § 101.
19. Id. § 1101.
20. Id. § 102.
21. Id. § 109(d).
22. Id. § 362.
23. Id. § 363.
24. Id. § 364.
25. Id. § 365.
26. Id. § 366.
turnover of property to the estate, the avoiding powers of a trustee or debtor, and setoff are found in chapter 5. In eighteen judicial districts there will be a United States trustee who is given important powers and duties in chapter 11 cases by chapter 15 of the Bankruptcy Code, and by provisions added to title 28 of the United States Code.

III. Commencement of the Case

Chapter 11 is available to all businesses, whether operated by individuals, partnerships, or corporations. The case may be commenced by the filing of a voluntary petition by a debtor, a joint petition by debtor and spouse, or by an involuntary petition filed by creditors. The requirements for an involuntary petition under chapter 11 are the same as for a liquidating case under chapter 7 of the Code. Three petitioning creditors, or a single creditor if there are less than 12, holding claims that aggregate at least $5,000 more than the value of any lien on property of the debtor, may file the involuntary petition. The petition need allege only that the debtor generally is not paying his debts as they become due, or that within 120 days before the filing of the petition a custodian was appointed or authorized to take possession of substantially all of the property of the debtor. If the debtor contests the involuntary petition, a jury trial on the issues is a matter within the discretion of the court. The notion of an involuntary petition is a radical departure from Chapter XI of the Bankruptcy Act. Clearly the concept is derived

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27. Id. § 542.
28. Id. §§ 544 et seq. These powers are discussed elsewhere in this issue of the Journal by Vernon Teofan and L.E. Creel, III.
29. Id. § 553.
30. Id. § 1501. These districts are referred to hereafter as "pilot districts."
31. Id. §§ 151102-151105.
32. 28 U.S.C.A. §§ 581 et seq. (West Supp. 1979) (especially section 586(a)(3)).
34. Id. § 302.
35. Id. § 303(a). A petition filed by less than all of the general partners of a partnership is treated as an involuntary petition. See id. § 303(b)(3).
36. Id. § 303(b)(1).
37. Id. § 303(b)(2).
38. "Custodian" is defined in section 101(10).
39. Id. § 303(h).
40. 28 U.S.C.A. § 1480(b) (West Supp. 1979). Jury trial of the issues created by an answer filed in a case under Chapter X was not permitted. See Bankruptcy Act §§ 143, 144 (repealed 1978, previously codified as 11 U.S.C. §§ 543, 544).
Instead from Chapter X.41

If the involuntary petition is not timely controverted42 the court shall enter an order for relief under chapter 11 against the debtor.43

The apparent ease of sustaining an involuntary petition which has resulted from the abolition of acts of bankruptcy and removal of the need to allege and prove insolvency of the debtor made it necessary to build into the Code certain protective devices. If the court dismisses the involuntary petition other than on the consent of all petitioners and the debtor, and if the debtor does not waive the right to judgment, the court may grant judgment in favor of the debtor against the petitioners for costs, a reasonable attorney's fee, and any damages proximately caused by the taking of possession of the debtor's property by a trustee appointed by the court.44 In addition, the court may render judgment against any petitioning creditor that filed the petition in bad faith for any damages proximately caused by such filing, and for punitive damages.45

IV. The Automatic Stay

The filing of a petition under any chapter of the Code operates automatically as a stay, applicable to all entities,46 of (1) the commencement or continuation of a judicial, administrative, or other proceeding against the debtor that was or could have been commenced before the filing of the petition under title 11, or to recover a claim against the debtor that arose before the commencement of the case;47 (2) the enforcement against the debtor or against property of the estate,48 of a judgment obtained before the commencement of the case;49 (3) any act to obtain possession of property of the estate or property from the estate;50 (4) any act to

42. It is probable that Rule 10-112(a)(1) will govern the time to file an answer to an involuntary chapter 11 petition until new rules are promulgated.
44. Id. § 303(i)(1). This subsection states these various elements of damages disjunctively. However, “or” is not exclusive. See id. § 102(5). The court may grant any or all of the damages provided for under this provision.
45. Id. 303(i)(2).
46. Under the definition contained in 11 U.S.C. 101(14), “entity” includes a person, estate, trust, and governmental unit. Section 101(30) defines “person” to include an individual, partnership, and corporation, but does not include a governmental unit. Id. § 101(30).
47. Id. § 362(a)(1).
48. Property of the estate is defined in section 541.
49. Id. § 362(a)(2).
50. Id. § 362(a)(3).
create, perfect, or enforce any lien against property of the estate; 51 (5) any act to create, perfect, or enforce against property of the estate any lien to the extent that such lien secures a claim that arose before the commencement of the case; 52 (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case; 53 (7) the setoff of any debt owing to the debtor that arose before the commencement of the case; 54 and (8) the commencement or continuation of a proceeding before the United States Tax Court concerning the debtor. 55

Certain types of actions specifically are excepted from the operation of the automatic stay. The filing of a petition does not stay the commencement or continuation of criminal proceedings against the debtor; 56 the collection of alimony, maintenance, or support from property that is not property of the estate; 57 any act to perfect an interest in property to the extent that the trustee's rights and powers are subject to such perfection under section 546(b); 58 the commencement or continuation of a proceeding by a governmental unit to enforce a police or regulatory power; 59 the enforcement of a judgment, other than a money judgment, obtained in an action by a governmental unit to enforce its police or regulatory power; 60 the setoff of mutual debts and credits involving commodities or securities; 61 the commencement of actions by the Secretary of Housing and Urban Development to foreclose a mortgage or deed of trust on property consisting of five or more living units, held by the Secretary, which is or was formerly insured under the National Housing Act; 62 or the issuance to the debtor by a governmental unit of a notice of tax deficiency. 63

51. Id. § 362(a)(4).
52. Id. § 362(a)(5).
53. Id. § 362(a)(6).
54. Id. § 362(a)(7). Even though the right of setoff of mutual debts and credits is stayed, the right of setoff is not nullified. See id. § 553.
55. Id. § 362(a)(8).
56. Id. § 362(b)(1).
57. Id. § 362(b)(2).
58. Id. § 362(b)(3). This will permit the perfection of prepetition purchase money security interests and mechanics' liens, the retroactive effect of which is recognized by section 546(b).
59. Id. § 362(b)(4).
60. Id. § 362(b)(5).
61. Id. § 362(b)(6). This provision has no relevance in chapter 11 because those entities may not be debtors in chapter 11 cases. See id. § 109(d).
62. Id. § 362(b)(7). It should be noted that commencement of such suit is not stayed. Prosecution of the suit is.
63. Id. § 362(b)(8).
A. Duration of the Stay

Except as it may be modified, the stay of an act against property of the estate continues until such property is no longer property of the estate; and the stay of any other act continues until the earliest of the closing of the case, the dismissal of the case, and, if the case concerns an individual and is under chapter 7, or is a case under chapter 9, 11, or 13, the time a discharge is granted or denied.64

B. Relief from the Stay

In order to obtain relief from the stay, a party must institute a proceeding in the bankruptcy court. Because the Bankruptcy Rules remain in effect to the extent they are not inconsistent with provisions in the Code65 a complaint must be filed with the court seeking such relief. The stay may be terminated, annulled, modified, or conditioned for cause,66 including lack of adequate protection of the interest of a secured creditor.67 The stay also may be modified if the debtor does not have an equity in the property which secures the claim and such property is not necessary to an effective reorganization.68 The party requesting relief from the stay has the burden of proof on the issue of the debtor's equity in the property;69 the trustee or debtor has the burden of proof on all other issues.70

The Committee on the Judiciary of the House of Representatives expressed some concern over the delay of the courts in resolving requests for relief from the automatic stay71 despite the mandate in the Bankruptcy Rules72 and set about to correct the problem. The method chosen may well put an end to the near-current condition of the bankruptcy court dockets throughout the land. If the court does not hold a preliminary or a final hearing on the complaint for relief from the stay of an act against property of the estate within 30 days after it is filed, the stay is terminated with respect to the

64. Id. § 362(c).
67. Id. 362(d)(1). "Adequate protection" is illustrated but not defined in section 361.
68. Id. § 362(d)(2).
69. Id. § 362(g)(1).
70. Id. § 362(g)(2).
71. "Too often today, court delay in handling requests for relief amounts to a complete denial of relief. The court can thus avoid the issue, and yet rule in the debtor's favor. This bill prevents such action . . . ." See H.R. REP. No., supra note 6, at 175 (1977).
72. Rules 601(c), 8-501(c), 9-4(c), 10-601(c), 11-44(d), 12-43(d), and 13-401(d).
party making such request. If the hearing which is held within such 30-day period is only a preliminary hearing, the court shall order the stay continued if there is a reasonable likelihood that the party opposing relief from the stay will prevail at the final hearing, and the final hearing shall be commenced within 30 days after that preliminary hearing. No time is specified within which the hearing must be concluded, nor, having been concluded, within which the court must announce a ruling. If it be true, as the Committee suggested, that the courts have deliberately ignored the mandate of the Rules for a speedy determination, a complete cure may not have been effected.

The provisions in the Rules for ex parte relief from the stay in order to prevent irreparable damage before a hearing can be held are carried forward.

Other remedies than the automatic stay are available to the bankruptcy court to restrain interference with its cases. Section 2a(15) of the Bankruptcy Act has been included in the Code. In addition, the bankruptcy court is invested with the powers of a court of equity, law, and admiralty, and, having become a “court of the United States,” the bankruptcy court has the power to issue writs under the All Writs Statute.

There is the suggestion in the Senate Report on the Bankruptcy Reform Act of 1978 that the use of the phrase “on request” for relief from the stay made it clear that the only issue at the hearings on relief from the stay will be lack of adequate protection, the debtor’s equity in the property, and the necessity of the property to an effective reorganization of the debtor, and that this hearing is not the appropriate time to consider other issues, such as counterclaims against the creditor. It would seem that “on request” is far too neutral a phrase to require such result.

74. Id. § 362(e)(1), (e)(2).
75. Id. § 362(f).
76. Id. § 105(a).
82. This hearing will not be the appropriate time at which to bring in other issues, such as counterclaims against the debtor, which, although relevant to the question of the amount of the debt, concern largely collateral or unrelated matters. This ap-
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V. OPERATION OF THE DEBTOR'S BUSINESS

In an abrupt about-face from Chapters X, XI, and XII of the Bankruptcy Act, the Code provides that no order of the court is required for the continued operation of his business by the debtor; unless the court orders otherwise the debtor continues to operate the business.83 The court is removed from any obligation to oversee or otherwise be concerned about the operation of that business. That is the function of the creditors’ committee, the United States trustee, and the creditors themselves. The court is in the case to resolve disputes impartially. Until a pleading is filed creating an issue, the court may not inject itself into these cases.84 Until the parties in interest become accustomed to the fact that the bankruptcy judge is no longer permitted sua sponte to curb the debtor’s methods of operating the business, or order its closing, and learn to take the necessary action to bring these matters to issue before the court, it is very likely that assets will be dissipated. In pilot districts the supervision of the debtor in chapter 11 is one of the United States trustee’s duties.85 In other districts the creditors’ committees will have to wing it without outside assistance. So complete is the divorce of the court from such administrative matters that the continued validity of local rules such as those which require the court, without request of a party in interest, to fix the salaries of individual

83. 11 U.S.C. § 1108 provides that unless the court orders otherwise, the trustee may operate the debtor’s business. Section 1107 in turn confers on the debtor in possession, with exceptions not here pertinent, all the rights and powers of a trustee serving in a case under chapter 11. As is noted elsewhere in this article, a trustee may be appointed only on application, and for cause shown.

84. Although until rules like Rules 10-212, 11-25, and 12-24 are replaced by new rules, the court must fix dates for creditor’s meetings, and may order a meeting of equity security holders, see 11 U.S.C. § 341(b), the court may not preside at, and may not attend, any of such meetings. See id. § 341(c).

debtors or officers of a debtor corporation appears to be in serious doubt.

In the operation of the debtor's business, the debtor in possession or the trustee will have full use of and be subject to the perils of the administrative powers provided in subchapter IV of chapter 3, and of the powers in connection with the estate contained in subchapter III of chapter 5. There is no doubt that the administrative powers of chapter 3 sound better on cursory reading than they will prove to be in actual operation.

A. Use of Collateral

"Cash collateral" is defined to mean cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents in which the estate and another entity have an interest. In addition, if noncash collateral is converted into proceeds of the type defined as cash collateral, the proceeds must be treated as cash collateral as long as proceeds are subject to the prepetition security interest. Stated another way, if the debtor sells for cash inventory that is subject to a prepetition security interest, or collects accounts receivable which are subject to a prepetition security interest, these proceeds become cash collateral, and they must be segregated and accounted for.

The debtor or trustee may not use, sell, or lease cash collateral, in the ordinary course of business or otherwise, unless each entity that has an interest in such cash collateral consents, or the court, after notice and a hearing, authorizes such use, sale, or lease. Non-cash collateral which is property of the estate may be used, sold, or leased in the ordinary course of business without notice and a hearing. If such noncash collateral is to be used otherwise than in the ordinary course of business, the court, after notice and a hearing,

86. E.g., Rule XI-3 of the Southern and Eastern Districts of New York.
88. Id. §§ 541-554. The avoiding powers of the trustee or debtor under sections 544 through 551 are discussed in an article by Vernon Teofan and L.E. Creel, III elsewhere in this issue of the Journal and are not treated here.
89. Id. § 363(a).
90. Id. § 552(b). The 1972 version of Article 9 of the Uniform Commercial Code, as adopted in most states, automatically applies the security interest to proceeds.
91. Id. § 363(c)(4).
92. Id. § 363(c)(2).
93. Id. § 363(c)(1).
must authorize it.94

"After notice and a hearing" is a term to which a rule of construction applies.95 It means after notice which is appropriate in the particular circumstances, and appropriate opportunity for a hearing. An actual hearing is not required if notice is given properly and if such a hearing is not timely requested by a party in interest, or if there is insufficient time for a hearing to be commenced before such act must be done, and the court authorizes the act.96 The matter of "appropriate notice" is left to rules which have not yet been promulgated. Until they are, it must be assumed that the debtor or trustee may in writing notify persons asserting an interest in property of the estate which is to be sold or used that in, say, ten days he proposes to sell or otherwise dispose of certain property. Unless a party in interest files a pleading with the court objecting to the disposal of the property in question and asks for a hearing on the issue, the debtor or trustee may proceed, without court order, to go forward with the proposed disposal of the property, and will not be required to segregate the proceeds.

It is not at all clear what the debtor or trustee must do during his operations during the first few days following the filing of the petition in order to be able to use or dispose of cash collateral or of collateral the proceeds of which become cash collateral. In these days of the all-encompassing reach of the security interest of Article 9 of the Uniform Commercial Code, the average business will be destroyed before the debtor will be able to get an order of the court "after notice and a hearing" to authorize the use of cash collateral or of collateral the proceeds of which become cash collateral. In an earlier version of section 363 it was proposed that the debtor or trustee, without court order, could use or sell what was then called "soft collateral" for not more than 5 days after notification of other parties which had an interest in that collateral,97 but this authorization did not make its way into the final draft. It seems relatively certain that in most cases the debtor or trustee, as a matter of survival, will continue business as usual, will reduce inventory and accounts receivable to cash, will use that cash until the secured creditor moves to stop him, and, like Scarlett O'Hara, will worry tomorrow about protecting any interest of a secured party.

94. Id. § 363(b).
95. Id. § 102(1).
96. Id. § 102(1).
B. Adequate Protection

It seems to be the clear intent of the Code that before the debtor may use or dispose of any property in which another entity has an interest, either in the ordinary course of business or otherwise, "adequate protection" of that interest must be furnished. It was thought by the drafters that the nature and amount of such protection could be negotiated by the debtor and the interest holders in most instances, and that the court would not have to become involved. It is extremely doubtful that such optimism will become a reality. More frequently than not lenders harbor perpetual feelings of insecurity, and agreements will not come easily for the debtor.

The authorization contained in section 363(c) for the debtor or trustee to use noncash collateral in the ordinary course of business without an order of the court in practice very likely will place the burden on the secured creditor to invoke the jurisdiction of the court to require the debtor or trustee to provide adequate protection of his interest. This probably is not what was intended by this provision. In theory, the debtor would have taken the initiative and would have reached an agreement with the secured creditor before continuing his postpetition operations. In the midst of the confusion which accompanies the filing of a petition, only a very few debtors will follow this course.

The debtor's right to use collateral may become an issue before the court in another way: the debtor may file a pleading seeking an order of the court authorizing his use of cash collateral, or seeking the use of some incumbered property of the estate other than in the ordinary course of business.

What happens when the debtor's right to use collateral does become an issue before the court? The court is required to prohibit or condition the use, sale, or lease of the collateral "as is necessary to provide adequate protection" of the interest in the property belonging to another entity. In any such hearing, the debtor or trustee has the burden of proof on the issue of adequate protection.

Regarding the timing of the hearing, the Code tells us that if the use of cash collateral is the issue, prompt action should be taken by the court, scheduled in accordance with the needs of the debtor, and that it may be a preliminary hearing or may be consolidated with a

100. Id. § 363(e).
hearing requested by the secured creditor. The hearing requested by the secured creditor very likely will be for modification of the automatic stay to permit foreclosure on the collateral.

What constitutes adequate protection? The Code provides no ready answer. It tells us only that when adequate protection is required, it may be provided by periodic cash payments, by additional or replacement collateral, or by such other relief as will result in the realization by the secured creditor of the "indubitable equivalent" of his interest in the collateral. An administrative priority claim is not the "indubitable equivalent" of the security interest in collateral.

The draftsmen of this provision of the Code have said that the concept of adequate protection is to require such relief as will result in the realization of the value of the secured creditor's interest. However, the Committee report offers pitifully little help in arriving at a measure for "realization of value:"

[All of the suggested means of protecting the secured creditor's interest rely] on the value of the protected entity's interest in the property involved. The section does not specify how value is to be determined, nor does it specify when it is to be determined. These matters are left to case-by-case interpretation and development. It is expected that the courts will apply the concept in light of facts of each case and general equitable principles. It is not intended that the courts will develop a hard and fast rule that will apply in every case. The time and method of valuation is not specified precisely, in order to avoid that result. There are an infinite number of variations possible in dealings between debtors and creditors, the law is continually developing, and new ideas are continually being implemented in this field. The flexibility is important to permit the courts to adapt to varying circumstances and changing modes of financing.

Neither is it expected that the courts will construe the term value to mean, in every case, forced sale liquidation value or full going concern value. There is wide latitude between those two extremes. In any particular case, especially a reorganization case, the determina-

101. Id. § 363(c)(3).
102. Brought under section 362(d).
103. Id. § 361(1). This provision derives from In re Bermec Corp., 445 F.2d 367 (2d Cir. 1971).
105. Id. § 361(3).
106. Id. § 361(3).
107. H.R. REP. No. 595, supra note 6, at 340.
tion of which entity should be entitled to the difference between the going concern value and the liquidation value must be based on equitable considerations based on the facts of the case. It will frequently be based on negotiation between the parties. Only if they cannot agree will the court become involved. 108

Whatever adequate protection may mean, it is intended to compensate the secured creditor to the extent that the debtor’s use or sale of the property “results in a decrease in value of [the secured creditor’s] interest” in such property, 109 and it must result “in the indubitable equivalent of such entity’s interest in such property.” 110 To be sure that it does result in the “indubitable equivalent,” the Code provides: to the extent that the protection afforded may result in less than the full equivalent of the secured creditor’s interest, that creditor is afforded a claim which shall have priority over every other priority claim. 111

C. Postpetition Effect of Security Interest

As was mentioned above, if a prepetition security interest covers proceeds of collateral, those proceeds, received postpetition, become “cash collateral” which the debtor may use only upon order of the court. Otherwise, property acquired by the debtor after commencement of the chapter 11 case is not subject to any lien resulting from any security agreement entered into by the debtor before commencement of the case. 112

In an earlier version of the provision affecting proceeds it was stated that the prepetition security interest extended to such proceeds “except to the extent that the estate acquired the proceeds to the prejudice of other creditors holding unsecured claims.” 113 The exception was intended to cover the situation where the estate expends funds that result in an increase in the value of the collateral. For example, where raw materials were converted into inventory, or inventory into accounts, at some expense to the estate, thus depleting the fund available to general unsecured creditors, the prepetition security interest was not permitted to improve the position of the secured creditor as it existed at the filing of the petition in the

110. Id. § 361(3).
111. Id. § 507(b).
112. Id. § 552(a).
case. The compromise between the House bill and the Senate amendment resulted in altering the earlier language to a provision allowing the court, after notice and a hearing, "and based on the equities of the case," to order otherwise. It is doubtful that this results in any material change in meaning. The court still may make such adjustment to the valuation of the secured creditor's collateral that the adequate protection provided will not recognize any improvement in that creditor's position.

D. Turnover of Property to the Estate

Anyone holding property of the estate on the date of the filing of the petition, or property that the debtor or trustee may use, sell, or lease, may be required to deliver it to the debtor or trustee. If such property is held by a custodian, the turnover proceeding is a contested matter. If it is held by anyone other than a custodian, the turnover is an adversary proceeding. This proceeding arises in, and is directly related to the pending case in the bankruptcy court and may be brought in that court. The jurisdiction of the court is beyond cavil; the bona fide adverse—merely colorable argument is gone for good.

E. Sale Free and Clear

The debtor or trustee may sell property free and clear of any interest in the property of another entity. The sale may be free and clear if applicable nonbankruptcy law permits it, if the other entity consents, if the interest is a lien and the sale price is greater than the amount secured by the lien, or if the other entity could be compelled to accept money satisfaction of the interest in a legal or equitable proceeding. At a sale free and clear of other interests, any holder of such interest will

115. Id. §§ 542, 543. It should be noted that "property that the trustee may use, sell, or lease" is broader than "property of the estate."
116. Id. § 543; Bankruptcy Rules 701(1) and 604. Accordingly, the proceeding will be governed by Bankruptcy Rule 914.
117. 11 U.S.C.A. § 542 (West Supp. 1979); Bankruptcy Rule 701(1).
120. Id. § 363(f)(2).
121. Id. § 363(f)(3).
122. Id. § 363(f)(4).
123. Id. § 363(f)(5).
be permitted to bid. If that holder is the high bidder, he will be permitted to offset the value of his interest against the purchase price of the property, and be liable to the debtor or trustee only for the balance of the sale price, if any. 124

F. Sale of Jointly-owned Property

"Property which the [debtor or] trustee may use" is broader than "property of the estate," and the debtor or trustee may recover from others property in which the debtor has only an undivided ownership interest. He is permitted to sell a co-owner's interest in property in which he had an undivided ownership interest such as a joint tenancy, a tenancy in common, a tenancy by the entirety, or a community property interest. 125 The sale free and clear of such other interest is permissible only if partition is impracticable, 126 if the sale of the estate's interest would realize significantly less for the estate than sale of the property free of the interests of the co-owners, 127 and if the benefits to the estate of such sale outweigh any detriment to the co-owners. 128 The community interest of a non-debtor spouse, or interest of the other co-owner is protected by permitting the co-owner to purchase the property being sold at the price at which the sale is to be consummated. 129

G. Obtaining Credit

Without credit few debtors can survive in a reorganization proceeding. Under both Chapters X and XI of the Bankruptcy Act, the debtor was not permitted to incur any credit, either secured or unsecured, without court approval. Under the Code, unless the court orders otherwise, the debtor or trustee may obtain unsecured credit and incur unsecured debt in the ordinary course of business without a court order, and any debt so incurred automatically is entitled to a first priority as an administrative claim. 130 Any unsecured debt incurred other than in the ordinary course of business will be allowed a first priority only if the court has authorized its incurrence.

124. Id. § 363(k).
125. Id. § 363(h). Community property is the subject of an article by Alan Pedlar in this issue of the Journal.
126. Id. § 363(h)(1).
127. Id. § 363(h)(2).
128. Id. § 363(h)(3).
129. Id. § 363(i).
130. Id. § 364(a).
after notice and a hearing.\textsuperscript{131} In order to avoid a later argument over whether or not the credit was extended in the ordinary course of business, and the risk of losing his priority, the supplier or lender who is willing to extend unsecured credit to the debtor will be wise to require court approval of the transaction.

If the debtor cannot obtain credit on a totally unsecured basis, then, with court approval, credit may be obtained with priority over all other administrative expenses,\textsuperscript{132} secured by a lien on property of the estate that is not otherwise subject to a lien,\textsuperscript{133} or secured by a junior lien on property of the estate that is subject to a lien.\textsuperscript{134} If the debtor still is unable to obtain credit, the court, after notice and a hearing, may authorize the obtaining of new credit which is secured by a senior or equal lien on property of the estate, but only if adequate protection is provided for the lienholder whose lien is to be primed.\textsuperscript{135} The debtor has the burden of proof on the issue of adequate protection.\textsuperscript{136}

\textbf{H. Executory Contracts and Unexpired Leases}

Ipso facto or bankruptcy clauses in leases and other executory contracts are invalidated by the Code. Notwithstanding a provision in an executory contract, or unexpired lease, or in applicable non-bankruptcy law, such contract or lease may not be terminated or modified because of the insolvency or financial condition of the debtor,\textsuperscript{137} the filing of a case under title 11,\textsuperscript{138} or the appointment or taking possession by a trustee in a case under title 11, or of a custodian before the filing of the case under title 11.\textsuperscript{139}

Coupled with the invalidation of ipso facto clauses are provisions permitting the assumption\textsuperscript{140} and subsequent reassignment\textsuperscript{141} of executory contracts and leases. If there has been a default in a contract

\textsuperscript{131.} Id. § 364(b).
\textsuperscript{132.} Id. § 364(c)(1).
\textsuperscript{133.} Id. § 364(c)(2).
\textsuperscript{134.} Id. § 364(c)(3).
\textsuperscript{135.} Id. § 364(d)(1). It would seem that if in this situation the debtor has sufficient property with which to furnish such protection, that same property would be sufficient security for the new borrowing.
\textsuperscript{136.} Id. § 364(d)(2).
\textsuperscript{137.} Id. 365(e)(1)(A). The protection of this subparagraph expires on the closing of the case.
\textsuperscript{138.} Id. § 365(e)(1)(B).
\textsuperscript{139.} Id. § 365(e)(1)(C).
\textsuperscript{140.} Id. § 365(b).
\textsuperscript{141.} Id. § 365(f).
or lease, before the debtor may assume it he must cure, or provide adequate assurance that he will promptly cure, the default,142 compensate, or provide adequate assurance that he will promptly compensate, the other party to such contract for any actual pecuniary loss resulting from the default,143 and provide adequate assurance of future performance under such contract or lease.144 The cure provisions do not apply to ipso facto clauses,145 and there are special limiting provisions applying to assumption and assignment of shopping center leases.146 If there has been a default in a lease, the debtor may not require the lessor to provide services or supplies incidental to the lease unless the lessor is compensated for any services and supplies provided under the lease before assumption.147 A contract to make a loan, or extend other debt financing or financial accommodations, to the debtor or for the benefit of the debtor may not be assumed, and may not be assigned.148

The debtor may assume or reject an executory contract or unexpired lease at any time before the confirmation of a plan, but the court, on request of a party to the contract or lease, may order the debtor to determine within a specified time whether to assume or reject it.149 The effective date of the rejection is stated in section 365(d).

The Bankruptcy Act provision to the effect that the rejection of an unexpired lease by the trustee of the lessor does not deprive the lessee of his estate,150 which no one could understand or apply, has been corrected. The lessee may treat the lease as terminated by such rejection, or he may remain in possession for the balance of the term of the lease, including any renewal or extension of the term that is enforceable under nonbankruptcy law.151 If the lessee opts to remain in possession, he may offset against the rent reserved

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142. Id. § 365(b)(1)(A).
143. Id. § 365(b)(1)(B).
144. Id. § 365(b)(1)(C).
145. Id. § 365(b)(2).
146. Id. § 365(b)(3).
147. Id. § 365(b)(4).
148. Id. § 365(c)(2).
149. Id. § 365(d)(2). The other party to an executory contract with the debtor occupies an equivocal position. Until the contract is rejected he is not a creditor with an allowable claim. The result sought to be achieved by this subsection was available pre-Code without express statutory authority. See In re Greenpoint Metallic Bed Co., Inc., 113 F.2d 881 (2d Cir. 1940).
150. Bankruptcy Act § 70b (repealed 1978, previously codified as 11 U.S.C. § 110(b)).
under the lease any damages occurring after the date of rejection caused by the nonperformance of any obligation of the debtor-lessee after that date, but must forego any other claim against the estate on account of damages arising from such rejection.\footnote{152}{Id. \S 365(h)(2).}

I. Utility Service

The debtor is given some, though it may be short-lived, protection from a cut-off of service by a utility because of the filing of a case under title 11. A utility, be it the telephone company, the gas company, or the electric company, may not alter, refuse, or discontinue service, or discriminate against a debtor solely on the basis that a prepetition bill was not paid.\footnote{153}{Id. \S 366(a).} However, if within 20 days after filing the debtor does not furnish adequate assurance of payment, in the form of a deposit or other security, for service after that date the utility company is free to act as it may see fit.\footnote{154}{Id. \S 366(b).} On request of a party in interest, and after notice and a hearing, the court may order reasonable modification of the amount of deposit or other security necessary to provide adequate assurance of payment.\footnote{155}{Id. \S 366(b).} In this manner the Code seems to have attempted to accomodate the holdings of the Court of Appeals for the Fifth Circuit in both \textit{In re Fontainebleau Hotel Corp.},\footnote{156}{South Cent. Bell Tel. Co. v. Simon, 508 F.2d 1055, 1056 (5th Cir. 1975), holding that a hotel’s telephone numbers are a valuable property which the bankruptcy court could protect by enjoining their being disconnected, and denying the telephone company’s request for a deposit to assure payment of future services.} and \textit{In re Security Investment Properties, Inc.}\footnote{157}{Georgia Power Co. v. Security Inv. Properties, Inc., 559 F.2d 1321 (5th Cir. 1977), in which the court reversed the bankruptcy court and district court orders enjoining the disconnecting of electric service for refusal to post security for future service.}

The 20-day period of the Code does not allow the debtor much time to negotiate the amount of the security demanded by the utility company. Even if the debtor should file a motion with the court to intercede in the matter immediately upon the filing of the chapter 11 petition, the court may not be able to schedule a hearing on it in this short time. Also, the requirements of due process must be met, and a hearing cannot be scheduled immediately. In this circumstance, surely the bankruptcy court must have the power to
enjoin temporarily a cut-off pending a hearing.\textsuperscript{158} If the debtor operates an apartment project and files a chapter 11 petition in mid-July, a cut-off of the electricity needed to operate the air conditioning surely would end all hopes for rehabilitation. It is believed that the reasoning of \textit{Security Investment Properties} is not intended to deprive the court of the power to preserve the status quo by issuing such a restraining order.

\textbf{VI. COMMITTEES OF CREDITORS AND STOCKHOLDERS}

As soon as is practicable after the order for relief, the court shall appoint a committee of unsecured creditors.\textsuperscript{159} In pilot districts the appointment is made automatically by the United States trustees.\textsuperscript{160} These provisions mean that in every case, large or small, there must be at least one committee. Committees to represent equity security holders, or additional creditors' committees, may be appointed only by court order made on request of a party in interest.\textsuperscript{161} In pilot districts these committees also are appointed by the United States trustee.

A creditors' committee ordinarily shall consist of persons willing to serve that hold the seven largest claims against the debtor of the kinds represented on such committee.\textsuperscript{162} This same subsection permits the court or the United States trustee to recognize and appoint a committee organized by creditors before the order for relief if such committee was fairly chosen and is representative of the different kinds of claims to be represented.\textsuperscript{163} The language of section 1102 is precatory only. The court or the United States trustee is not compelled to designate a committee consisting of seven persons, nor is it compelled to select the committee members only from the largest claims or equity security holders in any given class.\textsuperscript{164} Any party in interest who does not consider the committee appointed by either the court or the United States trustee to be representative of the

\textsuperscript{159} Id. 1102(a)(1). The functions of the committee are set forth in section 1103(c).
\textsuperscript{160} Id. § 151102(a).
\textsuperscript{161} Id. §§ 1102(a)(2), 151102(b).
\textsuperscript{162} Id. § 1102(b)(1).
\textsuperscript{163} The purpose in having the committee appointed by the court or the United States trustee rather than permitting them to be elected as was done under Chapter XI of the Bankruptcy Act was to discourage lawyer control of such committees for his own gain. See H.R. REP. No. 595, supra note 6, at 93. There is substantial sentiment that the recognition of prepetition committees will defeat, or at least materially weaken, that purpose.
class for which it was appointed has the right to request the court to change the membership or the size of the committee to balance the representation of the particular classes. 165

Although Chapter X of the Bankruptcy Act contained no recognition of an “official” committee of either creditors or stockholders, multiple committees representing divergent classes and interests in those cases were not uncommon. Because such committees were not “official,” the services for which compensation might be allowed were restricted. 166 Chapter XI recognized only one committee, which usually is referred to as the “official” committee. 167 There is no inhibition against “unofficial” committees in chapter 11 cases, as under Chapter X of the Bankruptcy Act. However, an attorney or other professional person employed by an “unofficial” committee may be compensated out of the estate only for having made a substantial contribution in the chapter 11 case. 168 This is quite similar to the restrictions on compensation in Chapter X of the Bankruptcy Act. The professional persons employed by committees appointed under section 1102 of the Code are not subject to such restriction; they may be compensated from the estate based on time, nature and value of their services, and the cost of comparable services in non-bankruptcy matters. 169 This compares favorably with the kinds of services which were considered compensable under Chapter XI. However, by providing for compensation based on the “cost of comparable services other than in a case under” title 11 it was the intent to overrule In re Beverly Crest Convalescent Hospital, Inc., 171 and similar cases which required fees to be determined based on notions of conservation of the estate and economy of administration, and obvious resentment of the fact that practicing attorneys expect to be compensated at a higher hourly rate than federal district judges. 172

165. Id. § 1102(c).
169. Id. §§ 328, 330.
170. Id. § 330(a)(1).
171. 548 F.2d 817 (9th Cir. 1976, as amended 1977).
172. H.R. Rep. No. 595, supra note 6, at 330 states:
If Beverly Crest were allowed to stand, attorneys that could earn much higher incomes in other fields would leave the bankruptcy arena. Bankruptcy specialists, who enable the system to operate smoothly, efficiently, and expeditiously, would be driven
There are restrictions on the employment of professional persons by an appointed committee. Such persons must be selected at a scheduled meeting of the committee at which a majority of the members are present, and may be employed only if approved by the court.\textsuperscript{173} A person employed to represent such committee may not, while employed by the committee, represent any other person or entity in the case.\textsuperscript{174} If the professional person had been representing a creditor at the commencement of the case, he must give up that representation if he is to serve the committee in the case.

VII. APPOINTMENT OF TRUSTEE OR EXAMINER

In an apparent attempt at appeasement of the champions of old Chapter XI and debtors in possession, the Code presumes that the debtor will remain in possession and continue to operate his business in a chapter 11 case. A trustee may be appointed only on order of the court, made on request of a party in interest and after notice and a hearing, and for cause shown.\textsuperscript{175} The number of holders of the debtor's securities or the amount of assets or liabilities of the debtor specifically are excluded from consideration by the court as cause for the appointment of a trustee.\textsuperscript{176} Cause includes fraud, dishonesty, incompetence, or gross mismanagement of the debtor's affairs by current management, either before or after commencement of the case.\textsuperscript{177} The appointment of a trustee also may be made if such appointment is in the interest of creditors, any equity security holders, and other interests of the estate.\textsuperscript{178}

At this point it should be obvious to everyone, especially those who have had to cope with a motion under section 328 of the Bankruptcy Act or Rule 11-15, that these factors referred to in section elsewhere, and the bankruptcy field would be occupied by those who could not find other work and those who practice bankruptcy law only occasionally almost as a public service. Bankruptcy fees that are lower than fees in other areas of the legal profession may operate properly when the attorneys appearing in bankruptcy cases do so intermittently, because a low fee in a small segment of a practice can be absorbed by other work. Bankruptcy specialists, however, if required to accept fees in all of their cases that are consistently lower than fees they could receive elsewhere, will not remain in the bankruptcy field.

\textsuperscript{174} Id. § 1103(b).
\textsuperscript{175} Id. § 1104.
\textsuperscript{176} Id. § 1104(a)(1), (a)(2).
\textsuperscript{177} Id. § 1104(a)(1).
\textsuperscript{178} Id. § 1104(a)(2).
1104(a)(1) and (a)(2) of the Code are the very ones harped on by the SEC, and by the rare others who file such motions, as the reasons why a case should be transferred from Chapter XI to Chapter X. Truly, then, has the change effected by the Code done anything more than to give a new name to the same motion and the same hearing?

If the court decides that a trustee should be appointed, the person chosen for such appointment does not have to be selected from the panel of private trustees established under 28 U.S.C. section 604(f). In pilot districts, when the court decides that a trustee should be appointed, the appointment is made by the United States trustee; the person selected does not have to be chosen from the panel of private trustees established under 28 U.S.C. section 586(b), but is subject to approval by the court. The United States trustee has standing to request the appointment of a trustee or an examiner in these cases.

The protection afforded by a trustee would be needed in cases where current management of the debtor has been fraudulent or dishonest, or has grossly mismanaged the company affairs. A trustee would be needed also where the debtor's management has abandoned the business. Generally, a trustee would not be needed in any case where the functions to be performed could be provided by an examiner. Where current management is adequate, but there is evidence of some misdeeds by former management, the necessary investigation can be conducted by an examiner, presumably at a lesser cost to the estate than if a trustee were to be appointed.

If the debtor's fixed, liquidated, unsecured debts, other than for goods, services, or taxes, or owing to an insider, exceed $5,000,000 the court must, on application by a party in interest, appoint an examiner if it does not appoint a trustee. This appointment must be made whether or not there is any evidence of fraud or mismanagement by either current or past management. The inconsistency in this provision is obvious. In deciding whether a trustee should be

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179. Id. § 151102(a).
180. Id. § 1104(a).
181. This is a situation which may occur with some frequency after October 1, 1979. It is unlikely that an individual proprietor will stay in place very long after an order for relief is entered against him in an involuntary chapter 11 case.
182. Id. § 101(25) defines an "insider."
183. Id. § 1104(b)(2). The examiner's duties are set out in section 1106(b), and include, in addition to the specific duties, "any other duties of the trustee that the court orders the debtor in possession not to perform."
appointed, the court is forbidden to consider the amount of the
debtor's assets or liabilities. Yet the court is given no discretion
in the matter of appointment of an examiner if the amount of the
debts exceeds the stated minimum.

There is a major oversight regarding the examiner. The Code
contains provisions detailing the employment of professional per-
sons by a trustee, and there are elaborate and detailed provisions
regarding the compensation of the persons so employed. Conspic-
uously absent are any provisions for the employment of professional
persons by an examiner, and any provisions regarding the compen-
sation of any such persons. There is no doubt that in conducting an
investigation the examiner must have the assistance of accountants,
attorneys, and possibly others. This matter seems to have escaped
the attention of the committees of both Houses of Congress in earlier
competing drafts of the proposed Bankruptcy Reform Act, as well
as in the final draft which was passed amid great confusion of last-
minute amendments and compromises, in October, 1978.

Is it safe to assume that the court has inherent power to authorize
an examiner to employ such professional persons, and likewise to
allow them compensation? Perhaps. More likely, probably not. The
accepted tenets of statutory construction force the conclusion that
Congress, having provided for the employment and compensation of
professional persons by trustees, debtors, and committees, but not
by examiners, intended that an examiner should not employ such
persons, and that no compensation should be permitted in the event
any might be so employed.

It would seem that corrective legislation is required if the provi-
sions in the Code concerning the appointment of an examiner are
not to become totally meaningless.

VIII. MEETINGS OF CREDITORS AND STOCKHOLDERS

The Code contemplates that within a reasonable time after the
order for relief in a case under title 11, including a chapter 11 case,
there shall be a meeting of creditors. In addition, in a case involv-

184. Id. § 1104(a)(1), (a)(2).
185. Id. § 327.
186. Id. §§ 328, 330, 331.
188. Cf. United Merchants & Manufacturers, Inc. v. J. Henry Schroder Bank & Trust
Co. (In re United Merchants & Manufacturers, Inc.), 597 F.2d 348 (2d. Cir. 1979).
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ing a corporation, the court may order a meeting of any equity
security holders. Until new rules may be promulgated, it is not at
all certain whether Rule 10-212 or Rule 11-25 will apply to govern
the time of such meeting. In any event, the court may not preside
at, and may not attend, any such meeting. This, of course, creates
a problem regarding the conduct of such meeting. There is no guid-
ance in existing rules or in the Code. It would appear that in pilot
districts the meeting might be presided over by the United States
trustee. In those or any other districts it also makes sense to have
the chairman of the creditors’ committee or the attorney for the
creditors’ committee to preside. Or, if a trustee or an examiner has
been appointed by the time of the initial meeting, he might preside.
Until new rules may be promulgated to offer some guidance, this is
another matter that will have to be governed by a local rule or order
of the bankruptcy court. Whoever may preside at such meeting, the
debtor is required to appear and submit to examination under oath,
and he may be examined by creditors, any indenture trustee, or by
the trustee or examiner.

IX. FILING AND ALLOWANCE OF CLAIMS

The concept of provability of claims contained in section 63 of the
Bankruptcy Act has been scrapped by the Code. In its place we now
have a concept of allowability of claims and interests. The purpose
of the change is to make all claims allowable and to avoid traps for
the unwary such as the provision in the Bankruptcy Act which
denied provability to a claim of damages for negligence unless a suit
had been instituted prior to the filing of the petition in bankruptcy
and was still pending at the time of such filing. In addition, the
Code requires the estimation of contingent or unliquidated claims
which frequently were denied allowability in a bankruptcy proceed-
ning because liquidation or estimation of such claim would unduly
delay administration of the proceeding under the Bankruptcy Act.
Whether the claim was denied provability or allowability, the end

190. Id. § 341(b).
191. Id. § 341(c).
192. Id. § 342.
193. Id. §§ 501, 502.
103(a)(7)).
196. Bankruptcy Act § 57d (repealed 1978, previously codified as 11 U.S.C. § 93(d)).
result was another nondischargeable debt for the bankrupt or
debtor.

In the context of a chapter 11 case, there are special rules regard-
ing the proof of claims and interests. These are contained in section
1111. If a claim or interest is scheduled by the debtor or trustee \(^{197}\) as not disputed, not contingent, and not unliquidated, it is deemed
filed under section 501. \(^{198}\) In turn, a claim filed under section 501 is
deemed allowed unless a party in interest objects to it. \(^{199}\) Thus,
creditors and interest holders who are scheduled in this manner by
the debtor or trustee do not have to bother with filing claims in the
case in order to vote and to participate in distribution under any
plan which may be confirmed in the case. However, if the claim or
interest is scheduled by the debtor or trustee as disputed, contin-
gent, or unliquidated, the holder of that claim or interest is required
to file a proof of claim or interest in the case if he is to participate
in distribution under the plan. \(^{200}\) The holder of the claim or interest
must determine for himself how his claim or interest is scheduled.
These Code provisions are parallel to the existing Chapter X Rules \(^{201}\) rather than the Chapter XI Rules. \(^{202}\)

A proof of claim as filed constitutes prima facie evidence of the
validity and amount of the claim, \(^{203}\) as was the case under the Bank-
ruptcy Act and Rules. The Code does not specify the time within
which the required proofs must be filed. Accordingly, until new rules
are promulgated a bar order fixing such time must be entered by
the court.

X. THE PLAN

In the debate on consolidation of the business reorganization
chapters, the argument was made that Chapter XI, in permitting a
plan to be filed only by the debtor, allowed the debtor too much
power. Mr. Trost refers to it as “the almost arrogant power of the
chapter XI debtor to force liquidation if creditors do not agree to his
business rescue plan.” \(^{204}\) This view seems not to recognize the power
over the plan wielded by a strong creditors’ committee. In the pro-

\(^{197}\) Under section 521(1) or section 1106(a)(2).
\(^{199}\) Id. § 502(a).
\(^{200}\) Id. § 1111(a).
\(^{201}\) Rule 10-401.
\(^{202}\) Rule 11-33.
\(^{204}\) Note 2, supra.
cess of negotiating a plan the debtor has always been fully aware that the demands of the creditors' committee must be met or an adjudication could follow. For management of a corporate debtor the prospect of adjudication might not be all that important. If the creditors thought they could get more if the business were kept alive there was nothing to prevent their filing an involuntary Chapter X petition in the pending Chapter XI case, letting a trustee displace old management, and try to resurrect a viable business from the ruins. If the debtor was an individual and he preferred liquidation to some plan other than his own, nothing could prevent his choosing liquidation. He could ask for adjudication and walk away with his exempt property.

The situation under the Code has not really changed all that much. In a voluntary chapter 11 case, as long as he remains in possession the debtor still has the option at any time to convert to a case under chapter 7, the Bankruptcy Code equivalent of adjudication and liquidation under the Act, and his conversion filed in the chapter 11 case constitutes an order for relief under chapter 7, whether the creditors like it or not. True, if the creditors wish they may seek to re-convert to chapter 11, but if the debtor chooses, as he probably will, they will have to get along without him, and they may not use any of his exempt property to promote a plan which they may later file in the case. Has chapter 11 really advanced the cause of the creditors all that much, then, when the debtor is an individual?

A. Who May File a Plan

Whether the case originated with a voluntary or an involuntary petition, if the debtor has been retained in possession he has the exclusive right to file a plan for 120 days after the date of the order for relief. If the debtor does file a plan within this period, he has an additional 60 days in which to obtain the necessary acceptances, and no one else may file a plan during such additional time. The court, for cause shown, may reduce or extend the 120-day period or the 180-day period.

206. Id. § 706(b).
207. Id. § 1123(c).
208. Id. § 1121(b).
209. Id. § 1121(c)(3).
210. Id. § 1121(d).
When a trustee is appointed, the debtor loses the exclusive right to file a plan; any party in interest may file a plan at any time after such appointment. In this context the debtor is a party in interest, and is entitled to file a plan if he chooses. The appointment of an examiner in the case does not affect the debtor's exclusive right to file a plan during the stated period.

B. Classification of Claims or Interests

Integral to the formulation of a plan is the classification of claims and interests. The plan may classify claims or interests as long as each class is composed of substantially similar claims or interests. However, small unsecured claims, whether or not substantially similar, may be designated as a separate class, subject to court approval as an administrative convenience. Pre-Code this treatment of small claims was accomplished without express authority. Under Chapter XI of the Bankruptcy Act and the rules the need for this treatment was greater because a filed but nonvoting claim was counted as a negative vote, whereas plan provisions for payment of these claims in full meant that they were not "materially and adversely affected," rendering it unnecessary for such class to vote. There is less need for such a provision under the Code because the majorities required for acceptance of a plan are based only on those that actually vote; a nonvote does not count as a rejection.

C. Contents of a Plan

The mandatory and permissive provisions of a plan are lifted almost verbatim from Chapter X of the Bankruptcy Act. Some of these provisions fit a corporation or a railroad far better than they do an individual debtor. One mandatory provision of a plan appears in the confirmation section of the Code rather than in section 1123 where one might expect it; a plan is required to accommodate
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priority claims. Administrative expenses and claims arising in the ordinary course of business after commencement of an involuntary case and before appointment of a trustee or entry of the order for relief must be provided for in cash. Priority wage claims, contributions to employee benefit plans, and consumer deposits may be classified and provided for on a deferred basis, but payment in cash will be required for any such class which fails to accept the plan. Priority tax claims may be paid over a period of time not exceeding six years after the date of assessment of the tax, and consent to such treatment by the tax gatherer is not required. These changes in prior law are designed to reduce the cash requirements for confirmation.

One substantial change from Chapter XI is that a plan may provide for a partial or total liquidation of the debtor's assets, thus overruling cases like In re Pure Penn Petroleum Co., Inc., which would not permit such a plan.

D. Disclosure Statement

In cases under chapter 11, both large and small, before there may be any postpetition solicitation of acceptances, the proponent of a plan must submit and the court must approve, a disclosure statement. This requirement is new. Nothing comparable to it appeared in the Bankruptcy Act. Despite the specific provision in the Code that the adequacy of the disclosure statement is not governed by any otherwise applicable nonbankruptcy law, rule, or regul-

220. Id. § 1129(a)(9).
221. Id. § 507(a)(1).
222. Id. § 507(a)(2).
223. Id. § 1129(a)(9)(A).
224. Id. § 507(a)(3).
225. Id. § 507(a)(4).
226. Id. § 507(a)(5).
227. Id. § 1129(a)(9)(B).
228. Id. § 507(a)(6).
229. Id. § 1129(a)(9)(C).
230. Id. § 1123(b)(4).
231. 188 F.2d 851 (2d Cir. 1951). The case has been criticized, and occasionally, at least outside the Second Circuit, not followed.
232. 11 U.S.C.A. § 1125(b) (West Supp. 1979). The disclosure statement is the subject of an article by Robin Phelan and Bruce Cheatham elsewhere in this issue of the Journal.
233. In the sense only that some court action was required before postpetition solicitation of acceptances of a plan could begin, Bankruptcy Act § 174 and Rule 10-303 required court approval of a plan as a predicate to solicitation.
It is probable that the SEC, which has the right to raise an issue in a chapter 11 case and to appear and be heard on it, will attempt to convince the bankruptcy courts that these disclosure statements should comply with SEC regulations.

E. Acceptance of the Plan

The percentage of votes required by the Code for acceptance of a plan differs from all three rehabilitation chapters of the Bankruptcy Act. So also does the method of computing the vote.

Under the Code, a class of creditors has accepted a plan when a majority in number and two-thirds in amount of creditors in the class vote to accept it. A class of equity security holders has accepted the plan when two-thirds in amount of interests in the class vote to accept it. In both instances, the vote is computed on only creditors and interest holders who actually vote. The negative vote imputed to a creditor or interest holder who had filed a proof of claim or interest but did not vote on the plan is gone. Even so, it seems difficult to rationalize the increase over the percentages required by Chapter XI of the Bankruptcy Act.

There are two classes or types of creditors and interest holders whose vote is not required: (1) A class that is not impaired under a plan is deemed to have accepted the plan. Therefore, the solicitation of acceptances from holders of claims or interests in such class is not required. (2) A class that is to receive nothing under the plan is deemed to have rejected the plan. In this second situation, if any class is excluded, before the court may confirm such a plan, it must find that the plan is fair and equitable as to such class and to any class below it. In other words, the presence of such a rejecting class will require a valuation of the debtor and a determination that the reorganization values do not reach this class or any below it before confirmation is possible.

235. Id. § 1109(a). However, the SEC may not appeal from any judgment, order, or decree entered in the case. There is nothing to prevent its joining in an appeal taken by a true party in interest.
236. Rule 10-305(e), Rule 12-37(d). Bankruptcy Act § 362(1) (repealed 1978, previously codified as 11 U.S.C. § 762(i)).
238. Id. § 1126(f).
239. Id. § 1126(g).
F. Impairment of Claims or Interests

The Bankruptcy Act concept of “materially and adversely affected” classes\(^{240}\) has been replaced by the concept of “impairment” of claims or interests.\(^{241}\) A class of claims or interests is impaired under a plan unless the plan “leaves unaltered the legal, equitable, and contractual rights” of the class of claims or interests,\(^{242}\) cures any default that occurred before commencement of the case,\(^{243}\) or the holders are paid in cash.\(^{244}\) If by these standards a class is impaired, its acceptance is required;\(^ {245}\) if such impaired class does not accept, the cram down must be invoked, and the plan must be “fair and equitable” as to such class and any below it.\(^ {246}\)

As has been mentioned, a curing of default does not result in the impairment of a claim. This authority to cure a prepetition default without requiring the consent of that creditor or class of creditors is new.\(^ {247}\) Since such creditor is deemed to be unimpaired, his acceptance of the plan is not needed. If the claim was based on an installment-type loan that, because of the debtor’s default, had been accelerated before the commencement of the chapter 11 case, the debtor may reverse the acceleration and reinstate the loan by providing in the plan for payment of the missed installments, for the compensation of the holder of such claim for any damages incurred as a reasonable result of reliance by such holder on such contractual provision, and for reinstatement of the maturity of such claim as it existed before the default.\(^ {248}\) If the prepetition default was because of an ipso facto or bankruptcy clause no cure is required.\(^ {249}\) The maturity as provided in the original note or other obligation must be reinstated exactly as written. If the debtor should seek to extend the maturity date, the creditor’s acceptance will be required.

XI. Confirmation of the Plan

The first six requirements for confirmation of a plan\(^ {250}\) are lifted

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242. Id. § 1124(1).
243. Id. § 1124(2).
244. Id. § 1124(3).
245. Id. § 1129(a)(8).
246. See id. § 1129(b).
247. Id. § 1124(2).
248. Id. § 1124(2).
249. See id. § 365(b)(2).
250. Id. § 1129(a)(1)-(a)(6).
almost verbatim out of Chapter X of the Bankruptcy Act. There are no surprises here. The vital requirements for confirmation are found in subparagraphs (7) and (8) of section 1129(a) of the Code. It has been reported that the design of the Code draftsmen was to adopt the interest of creditors test of Chapter XI of the Bankruptcy Act and to avoid the fair and equitable test of Chapter X whenever a chapter 11 plan has been accepted by all impaired classes of claims and interests. The question is whether or not they have achieved such an aspiration.

Even though each impaired class has accepted the plan by the requisite majorities, the court still must find, with respect to each class, that each holder of a claim or interest within that class who voted against the plan will receive or retain under the plan property of a value that is not less than the amount that he would receive or retain if the debtor were liquidated under chapter 7 on the effective date of the plan. If any holder of a claim or interest who voted "no" will receive or retain less, the plan cannot be confirmed.

Determining the hypothetical distribution in a liquidation under chapter 7 is no simple matter. The court will have to consider the various subordination provisions which apply in chapter 7 as well as the tax-claim postponement provisions. In addition, in partnership cases the rules governing partnership distributions, and where community property is involved, rules regarding distributions of community property, must be fully accommodated.

It is apparent that the financial standards of confirmation have been made exceedingly complex by the provisions of the Code. They are difficult to comprehend; their application is well-nigh impossible. Should the court, in that attempted application, go wrong regarding a single creditor or interest holder, reversal of the order of confirmation may well result. Inevitably, then, appeals from confirmation orders may be expected to increase, as will reversals on appeal. During the delay caused by such appeals, the debtor will be in limbo, and regardless of the outcome may, as a result, simply expire.

253. Id. § 1129(a)(7).
254. Id. §§ 510, 726(a)(3), 726(a)(4).
255. Id. § 724.
256. Id. § 723.
257. Id. § 726(c).
A. Cram Down

What happens when one or more classes of creditors and interests do not accept a plan? It then becomes necessary to resort to the cram down provisions of the Code. At this writing, only one writer has represented that he understands those provisions, and even he describes an understanding of the Code cram down as requiring "a torturous journey through the statute and legislative history that is fraught with complex concepts, terms of art, and innuendo." Accordingly, this article defers to the only one who purports to understand them all discussion of those provisions.

XII. The Discharge

The discharge which results from confirmation of a plan is, except for an individual debtor, a discharge of all obligations of the debtor to creditors whether dealt with under the plan or whether or not those creditors participate in the reorganization. This is the same discharge which was provided for in Chapter X of the Bankruptcy Act. The debtor who is an individual still must face debts excepted from discharge under section 523 of the Code. This seems ironic and totally inconsistent with the philosophy expressed in chapter 7 of the Code, which permits a discharge to only an individual debtor.

XIII. Conclusion

The attempt to cure some real and some imaginary flaws that existed in the two track system of Chapters X and XI of the Bankruptcy Act has resulted in a clear case of overkill. The controls and the procedures adopted in chapter 11 are carried over from Chapter X. They are quite appropriate for the multi-million dollar corporations and railroads, of which there are few, but are totally inappropriate for the middle-sized businesses, of which there are many. The
tortuously complex procedures, the imposition of an acceptance percentage which is more demanding than even Chapter X of the Bankruptcy Act, and the stringent financial standards for confirmation including a cram down that is so difficult to comprehend that even those who drafted it are not completely sure, effectively exclude from relief the proprietorships which are too large to fit chapter 13, as well as corporations which are neither large enough nor strong enough to survive the new provisions. Chapter 11 may well become as unpopular as Chapter X.

Whatever happened to good old Chapter XI?