While any extensions of judicial limitation on misuses of the charter amendment power is more likely to follow the fiduciary duty approach of the *Lebold* decision, charter conversions by savings and loan associations present an opportunity to institute a standard of fairness unhampered by the restraints of stare decisis. Minority investors will then be better safeguarded against discriminatory treatment and deprivation of their security expectations under the guise of managerial "business judgment."[53]

RIGHTS OF INTERIM CREDITORS UNDER CHAPTER XI OF THE BANKRUPTCY ACT

Federal bankruptcy legislation, continuously in effect since 1898, has played an important role in clearing the wreckage left by business failures. Following the havoc wrought by the depression during the early nineteen thirties, the emphasis has shifted from liquidation of insolvent firms to reorganization and rehabilitation. It is thought that greater benefit will inure, in the long run, to the debtor, his creditors, and the economic system if the organization is permitted to continue operation under a readjusted financial structure.[1]

An important segment of the Federal Bankruptcy Act implementing this restorative purpose is Chapter XI.[2] The Chapter provides machinery whereby embarrassed debtors, individual or corporate, may work out an arrangement with creditors.[3] The debtor alone may propose the plan of arrangement,[4] perhaps with the assistance of a creditors' committee.[5] After acceptance by the creditors, the plan must be submitted

53. Following this writing the Supreme Court of Ohio affirmed 4-2, the decision of the Court of Appeals. Opdyke v. Security Savings and Loan Ass'n, 105 N.E.2d 9 (Ohio 1952). The court confined itself largely to constitutional questions and held that the problems raised by the valuation of the shares and the change in voting rights were of fact and there was sufficient evidence for the courts below to find an absence of fraud. *Id.* 25-26. They held that a determination of violation of the contract clause need not be decided since the merger of another association with Security in 1943 constituted the formation of a new corporation subsequent to the statute granting the power to convert to a federal association.

1. See AMERICAN LAW INSTITUTE, BANKRUPTCY AND ARRANGEMENT PROCEEDINGS 1 (1951).

2. 11 U.S.C. §§ 701-799 (1946).

3. See Rickles, *Chapter XI Arrangements,* 55 COM. L.J. 173 (1950).

4. This should be contrasted with a Chapter X proceeding where the plan is generally instituted by the trustee or others such as a creditors' committee. 11 U.S.C. §§ 569, 570 (1946); AMERICAN LAW INSTITUTE, BANKRUPTCY AND ARRANGEMENT PROCEEDINGS 131 (1951).

5. The creditors' committee may act only in an advisory capacity since it is solely the function of the debtor to finally propose a satisfactory plan. The debtor must include a plan as part of his original petition. 11 U.S.C. § 723 (1946).

to a federal bankruptcy court for confirmation.[6] The arrangement, similar to the common law composition with creditors, should equitably scale down existing debts to a point consistent with a sound financial structure and provide a schedule of payment. Confirmation of the plan binds all creditors existing at the time the petition for the arrangement is filed, "whether or not they are affected by the arrangement or have accepted it or have filed their claims, and whether or not their claims have been scheduled or allowed and are allowable."[7]

A considerable period of time may elapse between the petition for an arrangement and confirmation of the plan adopted. During this interim period the debtor may be permitted to remain in possession, or the business may be operated by a court appointed trustee or receiver.[8] Debts contracted during this period are entitled to full payment under the plan of arrangement.[9] Should an acceptable plan prove impossible, or confirmation fail to be achieved, these interim creditors receive first priority as costs of administration in the resulting bankruptcy.[10] Such favorable treatment is justified as necessary to entice credit because of the uncertainties of continued survival.

However, under the present provisions of the Act, all interim creditors are not assured adequate protection in every situation. An arrangement may fail, after confirmation, due to the default of the debtor in

6. Under Section 366 of the Act, 11 U.S.C. § 766 (1946), it is a condition to confirmation that the court be satisfied of the following matters: (1) that the provisions of Chapter XI have been complied with; (2) that the arrangement is for the best interests of the creditors; (3) that the arrangement is fair and equitable and feasible; (4) that the debtor has not been guilty of any acts or failed to perform any of the duties which would be a bar to the discharge of a bankrupt; (5) that the proposal and its acceptance are in good faith and have not been made or procured by any means, promises, or acts forbidden by the Act. See 8 COLLIER, BANKRUPTCY ¶ 9.15 (14th ed., Stephenson & Seligson, 1941).

7. 11 U.S.C. § 767 (1946). The rights of creditors who have claims existing at the time the arrangement is instituted are determined under the plan and delineated thereunder. It is important that these creditors insist that the plan provide for the retention of jurisdiction by the court until all payments provided for in the plan have been made, and if possible for reinstatement of their former claims in the event of nonperformance by the debtor. The Act provides that the court shall retain jurisdiction, after confirmation, only if the arrangement so provides. *Ibid.*

If such a provision is not included the proceedings are dismissed upon confirmation, and if the debtor subsequently defaults in the payments provided by the plan, these creditors are left only with actions against the debtor. The discharge releases the former claims, and, once the proceedings are closed, they can be reopened only for fraud. See generally, AMERICAN LAW INSTITUTE, BANKRUPTCY AND ARRANGEMENT PROCEEDINGS 136, 137 (1951; 8 COLLIER, BANKRUPTCY ¶¶ 9.26-9.34 (14th ed., Stephenson & Seligson, 1941).

8. 11 U.S.C. § 732 (1946).

9. 11 U.S.C. § 767 (1946).

10. This priority is granted under Section 64(a)(1) of the Act, 11 U.S.C. § 104(a)(1) (1946).

carrying out the terms of the plan,[11] or because of a subsequent failure of jurisdiction of the court administering the plan.[12] The Act does not clearly provide for the rights of creditors whose claims arise after confirmation and before the default, nor for those claims arising after a bankruptcy court takes jurisdiction which is later determined to be non-existent.

Lacking specific statutory priorities, upon default of the debtor most courts classify interim creditors merely as general creditors in the subsequent bankruptcy proceedings.[13] However, some courts have afforded priorities as costs of administration under Section 64(a)(1)[14] and as provable claims under Section 64(b).[15] The failure of jurisdiction problem was first suggested by the recent case of *Carolina Motor Express Lines v. Blue & White Service Inc.*[16] A petition for an arrangement under Chapter XI had been presented to the District Court, October 11, 1950. The debtor was permitted to remain in possession and operate the business. Over a year later, on October 17, 1951, the Seventh Circuit reversed the finding of jurisdiction to administer the plan in the lower court because of certain technical deviations from the requirements of Chapter XI.[17]

The principal danger of a determination of lack of jurisdiction to the interim creditors is that they will be deprived of any priorities and be left as resultant general creditors. If, as actually happened in the *Carolina case,*[18] a new plan should be instituted in a court of competent jurisdiction, these creditors would have to come under the new plan. Equitable considerations might well dictate a first priority ahead of all

11. Vogel v. Mohawk Elec. Sales Co., 126 F.2d 759 (2nd Cir. 1942); *In re* Witt Dairy Co., 48 F. Supp. 964 (N.D. Cal. 1942); *In re* Gelaradin, Inc., 41 F. Supp. 17 (E.D. N.Y. 1941); *In re* Ohio Builders & Milling, Inc., 50 Am. B.R.(N.S.) 830 (1941); *In re* Plymack, 48 Am. B.R.(N.S.) 818 (1941).

12. Carolina Motor Express Lines v. Blue & White Service, 192 F.2d 89 (7th Cir. 1951).

13. It is generally recognized that the burden of establishing a priority is upon those asserting the priority and they must show that they come within the intended class. *In re* Witt Dairy Company, 48 F. Supp. 964 (N.D. Cal. 1942); *In re* Gelaradin, Inc., 41 F. Supp. 17 (E.D. N.Y. 1941); *In re* Paradise Catering Corporation, 36 F. Supp. (S.D. N.Y. 1941); *In re* Ohio Builders & Milling, Inc., 50 Am. B.R.(N.S.) 830 (1941).

14 *In re* Plymack, 48 Am. B.R.(N.S.) 818 (1941).

15. Vogel v. Mohawk Elec. Sales Co., 126 F.2d 759 (2nd Cir. 1942); *In re* Irving Electrical Supply Co., 46 F. Supp. 375 (S.D. N.Y. 1942).

16. 192 F.2d 89 (7th Cir. 1951).

17. The debtor failed to file schedules, or a plan, at the time his petition was filed, and the court held that he was not entitled to an extension of time for this purpose. *Id.* at 92.

18. The cause was transferred to the Southern District of Indiana where the debtor proposed a new plan. See, Docket, District Court, Southern District of Indiana, Cause No. 9711 in Bankruptcy.

other creditors, but varying settlements are possible. Under an arrangement, the classification of debts need not be on any basis recognized in ordinary bankruptcy. The division of debts in such a plan must accord with the necessities of the case rather than any specific pattern.[19] It is unlikely that equitable considerations could be allowed to control should there be a subsequent bankruptcy adjudication instead of a new plan. Although a bankruptcy court is generally considered to be equitable in nature, and its powers must necessarily be so, these powers are to be administered in accord with the Act and not by virtue of any broad unlimited equity power.[20] A court may not determine priorities for distribution on the basis of equitable rules in conflict with the terms of Section 64.[21]

In the case of In re *Plymack*,[22] the debtor filed a voluntary petition for an arrangement and on confirmation continued the business subject to the order of the court. The debtor then defaulted and was subsequently adjudicated bankrupt. It was held that the debts incurred in operating the business after confirmation were entitled to a 64(a)(1) priority as costs of administration. The court explained that a 64(b) priority could not be obtained as the arrangement was not "set aside" within the meaning of that Section. These interim claims were construed to be costs of administration on the ground that the plan had expressly provided for retention of jurisdiction by the bankruptcy court until fulfillment. This view has not been generally accepted, since a claim for expenses of administration cannot ordinarily be sustained after confirmation. The period of administration must end no later than the entry of the order confirming the plan.[23] Even if it seemed advisable to follow the holding of this court, that such creditors are to be granted a 64(a)(1) priority, it could not logically be extended to the circumstance in which the court is found to want jurisdiction. The *Plymack* decision is expressly conditioned on the fact that the business was operated *under the court's* jurisdiction.[24]

If a plan is never confirmed the persons who have extended credit since the introduction of the plan are ordinarily entitled to a 64(a)(1)

19. See COLLIER, BANKRUPTCY MANUAL 1060 (Oglebay, Kelliher & Newkirk ed., 1948).

20. *In re* Judith Gap Commercial Company, 5 F.2d 307 (9th Cir. 1925).

21. 1 COLLIER, BANKRUPTCY ¶ 2.09 (14th ed., Moore & Mulder, 1940).

22. 48 Am. B.R.(N.S.) 818 (1941).

23. Vogel v. Mohawk Elec. Sales Co., 126 F.2d 759 (2nd Cir. 1942). ". . . [T]he period of administration certainly ends no later than the entry of the order of confirmation." *Id.* at 761.

24. *In re* Plymack, 48 Am. B.R.(N.S.) 818 (1941). "To constitute expenses of administration there must be an operation under the jurisdiction of the court, with a receiver, trustee or debtor-in-possession in operation." *Id.* at 825.

priority in the subsequent liquidation.[25] Whether this priority could be allowed when the plan is defeated because of a lack of jurisdiction and a bankruptcy results is a matter of conjecture. It might well be concluded that any action taken under the administration of a court without jurisdiction is void, and thus interim creditors would be relegated to the position of general creditors. Conversely, a 64(a)(1) priority could be accorded under a liberal interpretation of "costs of administration." Clarification awaits future legislative or judicial action.

Conceivably, interim creditors might be afforded some consideration under Section 64(b)[26] when their claims arose after confirmation. Literally, Section 64(b) provides for priority as a provable claim only where the plan is set aside, after confirmation, for fraud by the debtor. However, in *Vogel v. Mohawk Electric Sales Co.*,[27] the Second Circuit decided that interim creditors were entitled to a 64(b) priority, the arrangement failing due to a non-fraudulent default by the debtor in carrying out the plan. Judge Learned Hand reasoned that the overriding Congressional intent behind this Section was protection of the creditors that furnished the debtor a chance for survival, thereby facilitating the acquisition of necessary credit by debtors undergoing an arrangement.[28] Hence, he broadly construed a "dismissal" of the arrangement upon default to be the "setting aside" essential to come within the purview of 64(b).

It remains to be seen whether a "dismissal for want of jurisdiction" could be brought within this expansion of Section 64(b). For those courts willing to adopt the liberal approach of the *Vogel* case, granting a 64(b) priority should not be difficult. Interim creditors under an arrangement eventually found to be without the jurisdiction of the bankruptcy court contribute to the debtor's financial rehabilitation at least as much as where there is dismissal for default, and are equally deserving of protection. However, this conclusion is somewhat weakened by the nature of the dismissal involved. The basis for granting priorities under either Section 64(a)(1) or 64(b) has frequently been the retention of jurisdiction by the court during the fulfillment of the plan,

25. See note 10 *supra.*

26. 11 U.S.C. § 104(b) (1946), which provides, "Debts contracted while a discharge is in force or after the confirmation of an arrangement shall, in the event of a revocation of the discharge or setting aside of the confirmation, have priority and be paid in full in advance of the payment of the debts which were provable in the bankruptcy or arrangement proceeding, as the case may be."

27. 126 F.2d 759 (2nd Cir. 1942).

28. *Id.* at 761. ". . . [T]he underlying theory must be that he shall have a chance to establish himself again, and that he cannot have unless he can do business upon equal terms with his competitors; it is idle to ask him to fight his way with one arm tied."

or a specific provision in the plan for the granting of such a priority.[29] Where the court is finally found to want jurisdiction, these important factors are lacking and any action the court has taken in administering the plan may be void. Nevertheless, if the basic theories of the *Vogel* case are correct they might well override other considerations.

Assuming that a 64(b) priority is granted to parties that advance credit after confirmation, the nature of this priority is uncertain. There is a theory[30] that Section 64(b) may afford creditors given that priority precedence over *all* other claims.[31] Such a construction would be in accord with the intention of Congress to provide the greatest protection for interim creditors, and better conform with the statutory scheme of priorities. Nevertheless, Section 64(b) states in clear and unequivocable language that 64(b) claims shall have priority only over other *provable* claims.[32] Therefore, 64(b) claims would follow non-provable claims in order of precedence. Provable claims, other than those coming under Section 64(b), are those existing when the petition for an arrangement is filed.[33] Non-provable claims are those arising subsequent to the petition and not falling within 64(b). At present, the rank in order of priorities given to 64(b) creditors remains undecided.

The existing doubts in this area of the Bankruptcy Act are inimical to the certainty necessary to dissipate the reluctance of potential creditors to deal with businesses undergoing the hazardous ordeal of an arrangement. Furtherance of the rehabilitory purposes of the Act would be enhanced by an amendment providing a first priority to all interim creditors should there be an eventual bankruptcy, regardless of whether the plan of arrangement terminated because of inability to reach an accord with creditors, refusal of confirmation, fraud, default, or failure of jurisdiction.[34]

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29. See 3 COLLIER, BANKRUPTCY ¶ 64.602 (14th ed., Moore & Oglebay, 1941) and cases cited.

30. *Id.* at ¶¶ 64.601, 64.602.

31. *Id.* at p. 2187.

32. Specifically enumerated in Section 63 of the Act, 11 U.S.C. § 103 (1946).

33. Unquestionably, Congress has the power to designate what claims are, and what claims are not, provable in bankruptcy proceedings. City Farmers Bank Trust Co. v. Irving Trust Co., 299 U.S. 433 (1937); West Coast Life Ins. Co. v. Merced Irr. Dist., 114 F.2d 654 (9th Cir. 1940).

34. To the contrary, it has been suggested that Section 64(b) be repealed, and a bill was introduced in Congress for that purpose on August 7, 1951. The bill is presently before the House Committee on the Judiciary. H.R. 5064, 82d Cong., 1st Sess. (1951).