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THE ROLE OF THE SECURITIES AND
EXCHANGE COMMISSION UNDER
CHAPTER X, CHAPTER XI AND PROPOSED
AMENDMENTS TO THE BANKRUPTCY ACT

MICHAEL E. HOOTON

Chapters X\(^1\) and XI\(^2\) of the Bankruptcy Act\(^3\) seek to effectuate the rehabilitation of corporate debtors\(^4\) by means of a unique collaboration between the federal district court and the Securities and Exchange Commission (SEC or Commission)\(^5\). Chapter X reorganizations involve "the judicial process whereby both unsecured and secured debt, as well as the interests of stockholders, may be adjusted, modified or otherwise dealt with."\(^6\) In contrast, Chapter XI arrangements comprise simpler, more expedited procedures for the settle-
ment, satisfaction or extension of unsecured debts. In each case, however, the statute contemplates procedures, short of bankruptcy, which conserve the going-concern values of the debtor’s property and avoid foreclosures and forced sales. Far from liquidating the business, Chapters X and XI are designed to facilitate its continued operation, while at the same time affording full consideration to the claims of stockholders and creditors.

Because Chapters X and XI contemplate the continued operation of the debtor corporation, reorganization proceedings are only “incidentally” lawsuits. Instead, the rehabilitation of the debtor presents “an administrative problem in the solution of which the public, as well as the litigants, have an interest.” A corporate reorganization, therefore, is “primarily an exercise in corporate finance and management,” which necessitates a searching inquiry into broad economic and business issues, including:

general economic factors, competitive conditions in the industry, its trend of demand, ... its price policies, ... the quality of the debtor’s management[,] ... earnings in the past, ... prediction of future earnings, and ... a determination of what would constitute a sound capitalization and financial structure.4

To resolve this fundamentally “administrative” problem, the Bankruptcy Act envisions repeated resort, by the court and other parties in interest, to the expertise of the Securities and Exchange Commission. Ultimate authority rests with the bankruptcy court

8 6 COLLIER, supra note 4, ¶ 0.11 at 116-17. Thus, the corporate debtor is only liquidated through ordinary bankruptcy proceedings in the event of the failure of the reorganization or arrangement. See Bankruptcy Act, §§ 327, 376, 377, 386(1), 11 U.S.C. §§ 727, 776, 777, 786(1) (1970) (Chapter XI cases); Bankruptcy Act, § 238, 11 U.S.C. § 638 (1970) (Chapter X).
9 6 COLLIER, supra note 4, ¶ 0.11 at 116-17. The SEC seeks to protect not only those investors holding securities in corporations reorganized under the Act, but also those offered securities issued in the course of the reorganization proceedings. SEC REPORT ON PROPOSED LEGISLATION, supra note 5, at 5. Similarly, in its advisory role, the Commission looks beyond the particular plan proposed to assist the court in effectuating “uniform principles and practices.” Id.
10 SEC PROTECTIVE COMMITTEE STUDY, supra note 5, at 898-902 (part I, 1937).
12 SEC PROTECTIVE COMMITTEE STUDY, supra note 5, at 1 (part VIII, 1937).
13 Id. at 1-2.
which, under the statute, may exercise extensive powers, including the authority to approve and confirm the arrangement or plan of reorganization. The Commission’s role, on the other hand, resembles that of an amicus curiae. Its function is advisory, rather than adjudicative, and thus differs radically from that under those statutes which it administers. It neither initiates the proceedings, nor holds hearings on the plan and entertains no authority to decide the issues presented. Instead, the SEC’s chief function is to act as an impartial representative of public investors and to provide expert assistance to the court.

This article seeks to assess the character of the SEC’s role in both Chapters X and XI. The isolation of the issues which have caused the SEC particular concern, as well as the exploration of the positions it is likely to take, should enable the parties to anticipate problems arising in the course of a corporate reorganization which are likely to trigger SEC intervention. This sensitivity to the prospect of SEC intervention, in turn, may permit the parties, through advance planning, to resolve issues in a manner which will forestall such intervention and thereby expedite the debtor’s rehabilitation. Furthermore, the evaluation of the SEC’s participation will provide the necessary conceptual framework for a critique of pending legislation which proposes sub-

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17 6 COLLIER, supra note 4, ¶ 0.09 at 105. See Herzog, Reorganizations and Arrangements under Chapters X and XI: Problems of Administration From the Standpoint of the Court, 35 REY. J. 113, 116 (1961).
19 38 SEC ANN. REP. 113 (1972).
20 To fulfill its advisory role in Chapter X and XI cases, the SEC maintains a special Corporate Reorganization Division, staffed with attorneys and financial analysts, based in Washington and four of its regional offices. From 1938-1975, the SEC participated in 605 Chapter X proceedings, involving aggregate liabilities of approximately $3.5 billion, SEC REPORT ON PROPOSED LEGISLATION, supra note 5, at 4. This work is accomplished at “comparatively modest cost.” Id. In 1975, for example, combined salaries, travel and other expenses totalled $827,027 for staffing computed as equalling 35.1 man years. Id.
Chapter X Reorganizations

Chapter X reorganizations are initiated by the filing of a petition\(^\text{21}\) which must be approved by the court.\(^\text{22}\) Copies of the original petition, as well as all notices subsequently mailed to creditors, must be sent to the SEC.\(^\text{23}\) This information enables the SEC to monitor all developments affecting the rights of public stockholders and creditors and to decide whether or not to intervene in the case.\(^\text{24}\) In order to conserve its financial and human resources, the SEC restricts its discretionary involvement to proceedings which affect substantial public investor interest.\(^\text{25}\) Accordingly, it is less likely to participate in a case involving only trade or bank creditors, and is more inclined to intervene where "an unfair plan has been or is about to be proposed, public security holders are not represented adequately, the reorganization proceedings are being conducted in violation of important provisions of the Act, [or] the facts indicate that the Commission can perform a useful service . . . ."\(^\text{26}\) Even where the Commission does not intervene on its own motion, the court may request it to make an appearance.\(^\text{27}\)

Once the Commission intervenes in a case, it becomes a "party in interest, with the right to be heard on all matters arising in such proceeding . . . ."\(^\text{28}\) As a party in interest, the Commission is represented at all hearings and it files legal memoranda to support its position on

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\(^{21}\) A voluntary petition may be filed by the debtor. Bankruptcy Act, § 126, 11 U.S.C. § 526 (1970). An involuntary petition may be filed either by three or more creditors holding certain specified claims or by an indenture trustee. \textit{Id.}

\(^{22}\) The court will dismiss the petition unless it is satisfied that it has been filed in good faith and complies with the statutory requirements. \textit{Id.}, § 141, 11 U.S.C. § 541 (1970). All petitions are required to include certain information. \textit{Id.}, § 130, 11 U.S.C. § 530 (1970). Additional information must be included in petitions filed by creditors or indenture trustees. \textit{Id.}, § 131, 11 U.S.C. § 531 (1970).


\(^{24}\) \textit{Id.}, § 208, 11 U.S.C. § 608 (1970). The Commission’s requests to participate “have been granted almost without exception.” 2 Loss, supra note 5, at 757.


\(^{26}\) \textit{Id.}

\(^{27}\) Bankruptcy Act, § 208, 11 U.S.C. § 608 (1970). (“The Securities and Exchange Commission shall, if requested by the judge, and may, upon its own motion if approved by the judge, file a notice of its appearance in a proceeding under this chapter.”)

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various issues which arise in the proceeding. In addition, the SEC par-
ticipates regularly in informal conferences and discussions with the
parties. The Commission views its informal participation as having at
least equal importance as its more formal appearances in fulfilling its
function of protecting public investors. The only limitations on the
Commission's status as a party in interest are that it has no right to
appeal and no right to claim compensation from the debtor's estate.
Denial of appellate standing, however, does not prevent the
Commission from joining, as a party or amicus curiae, in appeals filed
by other participants in the proceedings. In addition, the SEC may
also seek mandamus in order to vindicate its position in appropriate
cases. Section 208, therefore, gives the SEC "participation rights
similar to those of other parties in a chapter X proceeding" except
insofar as it denies the Commission the right to appeal.

B. Administration of the Debtor's Estate

After the court has approved the petition, the judge will ap-
point a "disinterested" trustee if the corporation's indebtedness ex-
ceeds a specified amount; otherwise, the debtor may continue in
possession. Both the trustee and the debtor in possession are court
officers who have primary responsibility for administering the

39 10 SEC ANN. REP. 144 (1944).
Exchange Commission and Corporate Reorganizations under Chapter X, 34 REF. J. 37 (1960)
[hereinafter cited as Windle]. There is no legislative history explaining the congres-
sional intent in preventing the SEC from initiating an appeal. SEC REPORT ON PROPOSED
LEGISLATION, supra note 5, at 13. The Commission, however, speculates that Congress
felt that a government agency should not be allowed to delay the proceeding by taking
an appeal when none of the parties with an economic interest in the court's order had
chosen to do so. Id. Nevertheless, it has been suggested that affording the Commission
a right to appeal would increase its effectiveness. Windle, supra at 43.
42 See, e.g., In re Imperial "400" Nat'l, Inc., 432 F.2d 232, 234 (3d Cir. 1970); In
re American Nat'l Trust, 426 F.2d 1059, 1066 (7th Cir. 1970); Ashbach v. Kirtley, 289
F.2d 159, 162 (8th Cir. 1961); 2 Loss, supra note 5, at 756.
43 SEC v. Krentzman, 397 F.2d 55, 59 (5th Cir. 1968). The Commission had been
denied the right to cross examine witnesses and offer evidence by the district court. In
granting the SEC's requested writ, the court of appeals noted that in the context of a
denial of the Commission's right to participate effectively in the proceedings: "The ab-
sence of review at the behest of the Commission makes all the more appropriate a writ
to enable it to perform its task." Id. But see SEC v. Templar, 405 F.2d 126, 128 (10th
Cir. 1969) (denying writ of mandamus sought by SEC where none of the stockholders
whom the SEC sought to protect had raised timely claims).
44 SEC v. Templar, 405 F.2d 126, 128 (10th Cir. 1969) (footnote omitted).
45 See note 22 supra.
mandatory when "the indebtedness of a debtor, liquidated as to amount and not con-
tingent as to liability, is $250,000 or over . . . ")
47 Id.
debtor's estate and for formulating the plan of reorganization for submission to the court. As court officers, their titles, rights and powers derive from the extensive authority enjoyed by the court in the administration of the debtor's estate during the reorganization proceedings. The court, for example, exercises plenary jurisdiction over actions brought by the trustee or debtor in possession against third persons on claims belonging to the estate. Furthermore, as a court of equity, it has summary jurisdiction to protect the res within its control. Accordingly, the statute specifically confers upon the court the authority to enjoin or stay suits, to permit the trustee to reject executory contracts of the debtor, to authorize him to issue certificates of indebtedness and to lease or sell any of the debtor's property. With respect to these administrative matters, the SEC's participation in the proceedings has tended to focus on three central concerns: the qualification and performance of fiduciaries, the jurisdiction of the court to take certain actions, and the sale of substantial assets of the debtor.

1. Scrutiny of the Qualification and Performance of Fiduciaries.

The Commission is particularly active in scrutinizing the quali-

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Because a debtor continued in possession "shall have all the title, be vested with all the rights, be subject to all the duties, and exercise all the powers of a trustee appointed under this chapter," Bankruptcy Act, § 188, 11 U.S.C. § 588 (1970), the SEC's role, whether or not the debtor continues in possession, is substantially the same. One distinction, however, is that the continuation of the debtor in possession obviates the need to scrutinize the "disinterested" status of a trustee who otherwise might have been appointed. Nevertheless, it would authorize the SEC to object to the retention of the debtor in possession upon the ground that he is not qualified or is not disinterested. Id., § 162, 11 U.S.C. § 562 (1970). A second distinction stems from the fact that the retention of the debtor in possession indicates that the debtor's liabilities are less extensive such that the Commission, as a practical matter, may be less likely to exercise its discretionary power to intervene because the public holdings are not as large. See text infra at notes 47-53. The marked contrast in the procedures of Chapter X and Chapter XI ensures that the Commission's role in a Chapter X case in which the debtor continues in possession is not simply analogous to its participation in a Chapter X case where the debtor generally remains in possession. See note 147 infra. For a discussion of the contrast between Chapters X and XI, see text & notes infra at 143-58 and at 173-77. Thus, it is the character of the proceedings, rather than the simple fact that the debtor continues in possession, which governs the nature of the Commission's role.

40 Bankruptcy Act, §§ 167, 169, 11 U.S.C. §§ 567, 569 (1970). If, however, the debtor is continued in possession, the plan may be filed by the debtor, by any creditor or indenture trustee, by a stockholder, if the debtor is not insolvent, or by an examiner appointed by the judge. Id., § 170, 11 U.S.C. § 570 (1970).

41 See Bankruptcy Act, §§ 2a(6), 2a(7), 102, 11 U.S.C. §§ 11a(6), 11a(7), 502 (1970); 6 COLIER supra note 4, ¶ 3.18 at 557.


cations of persons assuming fiduciary obligations under Chapter X. The statute, for example, specifically requires that the trustee\textsuperscript{47} and the attorney appointed to represent him shall be "disinterested"\textsuperscript{48} and defines the circumstances in which a person shall not be deemed to meet the statutory standard.\textsuperscript{49} These provisions are designed to ensure that the court's appointees be "free of connections not only with the old management but with all of its associates" in order to effectuate the ultimate purpose of securing "independent and faithful administration of distressed properties."\textsuperscript{50} Therefore, when confronted with evidence of even a possible conflict of interest,\textsuperscript{51} the Commission will urge that the fiduciary voluntarily resign.\textsuperscript{52} If the fiduciary refuses to resign, the SEC may file a formal objection to his appointment thus requiring the court to rule on his qualification.\textsuperscript{53} In \textit{Calvin Christian Retirement Home, Inc. v. Paire, Inc.},\textsuperscript{54} for example, the SEC petitioned for a disqualification of the attorney appointed as general counsel for the trustee on the ground that he was not disinterested since he concurrently represented the creditors who had petitioned for an involuntary reorganization of the debtor.\textsuperscript{55} The Commission, then, generally seeks to ensure that persons employed as trustees and attorneys in the course of Chapter X proceedings meet the statutory standard of "disinterest" which was considered one of the central aims of that chapter.\textsuperscript{56}
Just as the Commission seeks to oversee the disinterested character of trustees and their attorneys, it also has been active in monitoring the fiduciary status of corporate officers and committees representing creditors or stockholders and will challenge their failure to comply with the statutory authorization process. The SEC will oppose efforts by unauthorized individuals to solicit funds from public investors for the ostensible purpose of organizing and representing protective committees. Similarly, the Commission will seek the disqualification of committees subject to possible conflicts of interest. Accordingly, it may oppose committees seeking to represent different classes of creditors or stockholders or committees composed of former insiders who have been charged with mismanagement. When a committee, however, is duly authorized under the statute, the Commission will support it in its battle to retain representative status.

Reorganization Revised, 48 YALE L. J. 573, 574 (1939). Significantly, in its reports which were an important factor prompting the enactment of the Chandler Act, the SEC devoted considerable attention to the problems created by the presence of conflicts of interest in corporate reorganizations. See SEC PROTECTIVE COMMITTEE STUDY, supra note 5, Part I, at 355-57; Part II, at 164-294.

Section 209 authorizes any creditor or stockholder to "act in person, by an attorney at law, or by a duly authorized agent or committee." Bankruptcy Act, § 209, 11 U.S.C. § 609 (1970). Section 211 requires each such representative committee to file with the court a statement which includes a statement of the terms of its employment, a copy of the instrument empowering them to act on behalf of creditors or stockholders and a showing of the claims or stock represented by such committee. Id., § 211, 11 U.S.C. § 611 (1970). Section 210, 11 U.S.C. § 610 (1970) requires an attorney for creditors or stockholders to file a similar statement. The right of appearance of every person or committee, representing more than twelve creditors, and every indenture trustee, is conditioned on the filing of this statement. 6A COLLIER, supra note 4, ¶ 9.30 at 345. These committees and representatives are subject to the court's regulation and control. Bankruptcy Act, § 212, 11 U.S.C. § 612 (1970). Furthermore, committees purporting to represent creditors or stockholders may not be heard in the proceedings until they have complied with all other applicable laws, including the federal securities laws. Id., § 213, 11 U.S.C. § 613 (1970); In re First Home Investment Corp., 368 F. Supp. 597, 602 (D. Kan. 1973).

In re First Home Investment Corp., 368 F. Supp. 597, 599 (D. Kan. 1973). In that case, the Commission obtained a court order enjoining a former officer and director of the debtor from further solicitations for representative status. Furthermore, the SEC also moved the court to order the former officer to account for all receipts and disbursements. Id. at 603. Once the accounting was filed the Commission promptly objected to it and requested disallowance of all claimed expenses. 40 SEC ANN. REP. 125 (1974). See also Imperial-American Resources Fund, Inc., (D. Colo., No. 72-B-556), reported in 39 SEC ANN. REP. 119 (1973), where the district court, on application of the Commission, ordered an individual to cease soliciting funds and representative authority from certain limited partnerships in which the debtor was a general partner because he had not complied with the applicable provisions of Chapter X.

Cf. American Nat'l Trust v. Shanklin, 420 F.2d 1117, 1118-19 (7th Cir. 1970), cert. denied, 400 U.S. 823 (1971), reh'g denied, 404 U.S. 979 (1971), where the court affirmed a district court order dismissing a motion by a certificate holder of the debtor trusts to vacate the orders approving the reorganization petitions filed by other certificate holders. The motion had questioned the standing of the certificate holders. How-
Protective Committee v. Kirkland, for example, the SEC supported the common stockholder committee's appeal of a lower court order requiring the committee to file new authorizations from the stockholders. Ruling in its favor, the Fifth Circuit stated that it was "unwilling to see the role of the Committee downgraded or impeded by the court's order and agree[d] with the SEC that the order [was] without adequate justification." Thus, the SEC will oversee the fiduciary status of committees, and may either challenge their failure to observe the statutory authorization process, or may support their compliance therewith, whether on its own motion or on motions brought by other parties in interest.

Once it has scrutinized the qualification of fiduciaries, the SEC also may assist them in the performance of their duties. In particular, the Commission staff regularly aids the trustee both in his investigation of the debtor and in his compliance with statutory reporting requirements. This accounting of corporate affairs is one of the trustee's primary duties in Chapter X proceedings and it stems from two distinct but overlapping sources. Section 167(1), as augmented by section 167(3), requires the trustee, when so directed by the court, to report to the judge on the "acts, conduct, property, liabilities, and financial condition of the debtor," as well as to communicate "any facts . . . pertaining to fraud, misconduct, mismanagement and irregularities, and to any causes of action available to the estate." The assistance rendered by the SEC in the course of this investigation takes many forms. Initially, it may urge the court to direct the trustee to conduct the investigation once the reorganization court has taken jurisdiction. Thereafter the Commission's investigation may disclose misconduct by persons connected with the debtor which otherwise might not have been uncovered. In addition to uncovering such

ever, the court held that the orders approving the petitions had become final and that objections should have been raised at the hearing at which the court first approved the petition.

481 F.2d 606, 607 (5th Cir. 1973) (per curiam).
49 Id. at 607.
causes of action, the SEC will notify the court of any failure on the part of the trustee to pursue them.\textsuperscript{69} Furthermore, once the trustee takes action and begins to negotiate with the alleged malfeasants or to compromise other claims, the Commission will scrutinize any proposed settlement agreements especially where the alleged violations involve the federal securities laws.\textsuperscript{70} Thus, the Commission may urge the court confronted with such a compromise agreement to "hold a hearing so that evidence can be presented to permit a fair assessment of the compromise."\textsuperscript{71}

Not only does the SEC assist the trustee in investigating the debtor's estate pursuant to the request of the judge under section 167(1), but it may also become involved in enforcing the requirement of section 167(5) that the trustee file reports on the continued management of the debtor’s estate.\textsuperscript{72} Unlike the investigation under section 167(1) which is made only upon the order of the judge and which seeks in particular to uncover fraud or misconduct in the debtor's affairs which might give rise to claims against the estate, the periodic reports made under section 167(5) are mandatory and their subject matter—the financial condition of the debtor—is more restricted in scope.\textsuperscript{73} Although the statute fails to specify an established form for these reports, minimally they should contain "[a] periodic balance sheet and profit-and-loss statement...; statements of bank deposits...; [separate statements of] the financial condition of subsidiaries...; and annual reports..."\textsuperscript{74}

The SEC's involvement in the trustee’s compliance with these investigation and reporting requirements imposed by the bankruptcy laws is particularly appropriate in view of the fact that these requirements effectively parallel the investigation and reporting provisions of the federal securities laws. The Securities Acts require the SEC to in-

\textsuperscript{69} Committee v. Kent, 143 F.2d 684, 686 (4th Cir. 1944) (per curiam).

\textsuperscript{70} See Arlan's Dept. Store, Inc., (S.D.N.Y., No. 73-B-468), \textit{reported in 41 SEC ANN. REP.} 153 (1975), where the court approved, over the objection of the SEC, a cash settlement of a shareholder's derivative action against the debtor's management. Since the trustee had not had the opportunity to conduct the required investigation, the Commission urged that the investigation be made so that the trustee could then present facts from which an informed judgment could be reached on the adequacy of the settlement figure. The SEC had contended that the cash figure was not so significant in light of the debtors' needs to warrant relinquishing possible claims. \textit{Id.}


\textsuperscript{73} See \textit{6 COLIER}, supra note 4, \textsection 7.22 at 1233-34.

\textsuperscript{74} Corotto, \textit{supra} note 72, at 1572.
investigate any actual or threatened violations of their provisions.\textsuperscript{75} The scope of such an investigation clearly overlaps with an investigation conducted by the trustee under section 167(1) of the Bankruptcy Act to the extent that both "contemplate to some extent, the devolution of fraudulent practices by persons in control and operation of the debtor corporation."\textsuperscript{76} Similarly, the registered reporting status of a corporate debtor\textsuperscript{77} requires it to disclose information to the SEC\textsuperscript{78} which is very similar in character to that which the trustee must submit to the court under section 167(5) of the Bankruptcy Act.\textsuperscript{79} As a result of this overlap, the SEC may already have received or gathered much information pertinent to a corporate reorganization and therefore may readily assist the trustee or ensure his compliance with his statutory duties under the Bankruptcy Act.

2. Activities on Behalf of the Jurisdiction of the Court.

In addition to the performance and qualification of fiduciaries, a second major concern of the Commission's participation in Chapter X proceedings has been to thwart attempts to interfere with the exclusive jurisdiction of the reorganization court. A reorganization court has exclusive jurisdiction of the property of the debtor, wherever located,\textsuperscript{80} and may enjoin or stay "the commencement or continuation of a suit against a debtor."\textsuperscript{81} Bankruptcy courts are "essentially courts of equity" and have "the power to issue an injunction when necessary to prevent the defeat or impairment of [their] jurisdiction."\textsuperscript{82} In rec-


\textsuperscript{77} Securities issued by the debtor corporation may have been registered under § 12(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78l(b) (1970) (when traded on a national securities exchange); under § 12(g) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78l(g) (1970) (when engaged in interstate commerce or whose securities are traded by means of the mails or by an instrumentality of interstate commerce and which has total assets exceeding $1,000,000); or may have been issued by a registered offering under § 5 of the Securities Act of 1933, 15 U.S.C. § 77(e) (1970).

\textsuperscript{78} Section 13(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78m(a) (1970).\textsuperscript{79} The information required is that which ensures that previously filed registrations are "reasonably current" and therefore includes transactions leading to changes in the control of the registrant; acquisitions or disposessions of assets; legal actions; changes in securities, or in amounts of securities outstanding; financial statements, etc. SEC Form 8-K in PRACTICING LAW INSTITUTE, SECURITIES REGULATION SOURCEBOOK 7-83 (R.L. Krauss ed. 1972-73). See generally Corotto, supra note 72, at 1571-76, 1605-08.


ognition of the increasingly liberal interpretations courts have given to
the scope of the reorganization court's authority, the SEC often will
appear in support of the court's jurisdiction to take whatever actions
are necessary to effectuate the rehabilitation of the debtor. Thus, in
In Re Imperial "400" National, Inc., the Commission appeared in sup-
port of the lower court's order, affirmed on appeal, which enjoined
further prosecution in another court of an ordinary bankruptcy pro-
cceeding involving a partnership in which the debtor corporation was a
partner. Similarly, in In re Traders Compress Co., the SEC joined
with the trustees of a corporate propane gas distributor undergoing
reorganization in seeking an injunction restraining the gas supplier
from terminating its supply contract. Notwithstanding that the sup-
ply agreement gave the supplier the right to terminate the contract,
the district court held that it had jurisdiction to issue a permanent in-
junction to delay the enforcement of the contract in order to effect
the reorganization of the distributor. The SEC, then, generally ap-
pears in order to uphold the jurisdiction of the court where necessary
to accomplish the debtor's reorganization. To the extent, however,
that the SEC considers that the court's exercise of that jurisdiction will
conflict with the ultimate purpose of corporate rehabilitation, it may
oppose the proposed action on the merits.

3. Lease or Sale of Substantial Assets of the Debtor.

One primary area of administration in which the SEC consis-
tently has opposed court-authorized proposed action on the merits in-
volves the lease or sale of the debtor's property. Section 116(3) ena-
bles the judge, upon the approval of a petition, to "authorize a re-
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creeve or a trustee or a debtor in possession, upon such notice as the
judge may prescribe and upon cause shown, to lease or sell any prop-
erty of the debtor, whether real or personal, upon such terms and
conditions as the judge may approve." The complexities of corpo-
rate business have made the need to "prune a debtor's business" in
order to facilitate its reorganization an almost "routine aspect" of
Chapter X administration. While the Commission recognizes the
need to avoid freezing the debtor in the same position which caused
its insolvency, it nevertheless subjects sales of major assets of the
debtor, pursuant to section 116(3), to close scrutiny because these
sales may lead to the liquidation of the debtor without a vote by
security holders and may thereby reduce the plan of reorganization to
the ratification of a fait accompli. Accordingly, the Commission has
adopted a presumption against proposed sales of all or a critical
portion of a debtor's assets under the summary procedure of section
116(3) and will support them only in "exceptional circumstances." In
the absence of the requisite "exceptional circumstances," the
Commission's opposition to the sale may take various forms. It may
oppose the sale outright. Alternatively, it may agree with the basic
decision to sell, but may predicate its support on the court's
disposition of secondary factors. For example, the SEC may take the
position that the offer being considered is inadequate. Similarly, it

89 39 SEC ANN. REP. 120 (1973). In addition to noting the "increasing complex-
ities" of corporations, the SEC expressly faulted "the indiscriminate diversification
which may precede corporate failures . . . ." Id.
90 Id.
91 See 39 SEC ANN. REP. 120 (1973); 38 SEC ANN. REP. 115-16 (1972). The sum-
mary procedure of § 116(3) should be contrasted with § 216(10), dealing with plans of
reorganization, which expressly allows the plan to provide for the sale of any or all of
the debtor's assets. 11 U.S.C. § 616(10) (1970). A sale pursuant to a plan of reorganiza-
tion under § 216(10) is not committed to the court's sole discretion, but requires com-
pliance with the statutory protective devices surrounding the adoption of the plan. A
sale in the latter case, therefore, must be approved by a majority of creditors and stock-
holders who are the beneficial owners of the property in question. 39 SEC ANN. REP.
120 (1973).
92 39 SEC ANN. REP. 120 (1973); 38 SEC ANN. REP. 115-16 (1972). "Exceptional
circumstances" authorizing a sale, however, are not limited to emergencies or situations
where there is imminent danger of loss to the corporation. In re Equity Funding Corp.,
492 F.2d 793, 794 (9th Cir.) (per curiam), cert. denied, 419 U.S. 964 (1974). In that case,
the court affirmed the bankruptcy court's order authorizing the debtor's trustee, as sole
stockholder of a wholly owned subsidiary of the debtor, to consent to a sale of assets of
subsidiary Id. The court determined that the trial court could properly have concluded
that there was "cause shown" for the approval of the sale on the basis of findings of
fact that the market value of the subsidiary was likely to decline substantially in the near
future. Id.
93 In re Solar Mfg. Corp., 176 F.2d 493, 494 (3d Cir. 1949), aff'd in part, rev'd in
part on other grounds, 190 F.2d 273 (1951), cert. denied, 342 U.S. 895 (1951); Bubble Up
Det., Inc. (C.D. Cal., Nos. 78641-FW, 78950-FW, 79596-FW, and 80470-FW), reported in
94 In re Bermec Corp. (S.D.N.Y. No. 71-B-291, 1971) reported in 39 SEC ANN.
REP. 121 (1973). For a case where the court scrutinized the adequacy of the considera-
may advocate that the court mandate a particular disposition of the sale proceeds. Furthermore, where different potential purchasers submit bids, the Commission may recommend that the parties submit proposed plans of sale to the trustee; so that the sale would be made pursuant to a plan and therefore would require a vote of the security holders affected by it. In effect, therefore, with respect to this aspect of the administration of the debtor's estate, the Commission assumes an overseer role whereby it seeks to avoid the expansion of a fiduciary's authority in a manner which it views as potentially conflicting with the very philosophy of reorganization.

C. Plan of Reorganization

Although the SEC is actively concerned with the administration of the debtor's estate, the statute, aside from the notice provisions, only mandates its participation in conjunction with the formulation and confirmation of a successful plan whose consummation is the "focal point of the reorganization process." While the trustee has the primary responsibility for the preparation of a plan, and the judge has sole responsibility for its ultimate approval, Chapter X institutionalizes the potential for SEC participation at every step of the process. The SEC's involvement will be most extensive in cases in which

97 In In re Equity Funding Corp., for example, the SEC's support of the trustee's decision to sell the subsidiary was partially conditioned on the court's requiring the sale proceeds to be deposited in an interest-bearing account from which no withdrawal could be made without approval of the court after notice to interested parties. In re Equity Funding Corp. (C.D. Cal., No. 73-03467, 1973), reported in 40 SEC ANN. REP. 125 (1974), aff'd, 492 F.2d 793, 794 (9th Cir.) (per curiam), cert. denied, 419 U.S. 964 (1974).
100 Windle, supra note 30, at 39.
101 Bankruptcy Act, §§ 167, 169, 11 U.S.C. §§ 567, 569 (1970). If, however, the debtor is continued in possession, the plan may be filed by the debtor; by any creditor or indenture trustee; by a stockholder, if the debtor is not insolvent; or by an examiner appointed by the judge. Id., § 170, 11 U.S.C. § 570 (1970).
103 After appointment of the trustee, the judge will fix a time for a hearing on the plan. Bankruptcy Act, §§ 169, 170, 11 U.S.C. §§ 569, 570 (1970). Notice of the time of this hearing must be given to the Commission. Id., § 171, 11 U.S.C. § 571 (1970). After the hearing and before approval of the plan, the judge may submit the plan to the SEC for report if the scheduled indebtedness is less than $3,000,000, and must do so where the scheduled indebtedness exceeds $3,000,000. Id., § 172, 11 U.S.C. § 572 (1970). The judge may not approve a plan submitted to the SEC until it has filed a report. Id., § 173, 11 U.S.C. § 573 (1970). After the judge approves the plan, the trustees submit the plan, together with the Commission's report, to all creditors and stockholders affected by it. Id., § 175, 11 U.S.C. § 575 (1970). After the plan has been accepted by a specified percentage of the debtor's creditors, the judge fixes a hearing for consideration of the confirmation of the plan and must notify the SEC. Id., § 179, 11 U.S.C. § 440
which it files a formal report on the plan. If the corporation's scheduled indebtedness exceeds $3,000,000, the court must submit the proposed plan to the Commission for an advisory report; the judge may submit the plan to the SEC where the scheduled indebtedness is less than $3,000,000. In such a situation, however, the Commission is likely to file a formal advisory report "only in a case which involves substantial public investor interest and presents significant problems." This report, while merely advisory, often has considerable influence on the eventual acceptance or rejection of a plan.

Yet, even in cases where no formal report is filed, the SEC becomes involved as the court and other parties to the proceeding seek to draw on its expertise. The person charged with responsibility for preparing the plan may engage the Commission's assistance in its formulation. Similarly, the SEC will often advise the court of its opinion by letter or may authorize its counsel to present its views orally or in written memoranda.

In making either formal or informal reports on reorganization plans, the Commission has given particular attention to the valuation of the debtor's assets. Valuation is the starting point for the determination of the fairness, equity and feasibility of any proposed plan. In Consolidated Rock Products Co. v. DuBois, the Supreme Court approved the capitalization of earnings valuation technique there recommended by the SEC. Although the SEC generally continues to adhere to the capitalization of earnings approach, it may vary its recommendations in particular cases. Despite recent criticism of


105 40 SEC ANN. REP. 127 (1974). The statute clearly contemplates that the SEC may choose not to file a formal report. See Bankruptcy Act, § 173, 11 U.S.C. § 573 (1970). In practice, the Commission chooses to file such reports in only a small number of cases. In the last five years, for example, it has prepared formal reports only in five cases. 41 SEC ANN. REP. 153 (1975) (none); 40 SEC ANN. REP. 127 (1974) (2); 39 SEC ANN. REP. 123 (1973) (none); 38 SEC ANN. REP. 120 (1972) (3); 37 SEC ANN. REP. 184 (1971) (none).


107 When soliciting the acceptance of a plan on the part of the creditors, the trustee must transmit to them a copy of the SEC's report. Id., § 175, 11 U.S.C. § 575 (1970). See 6 COLIER supra note 4, ¶ 7.30 at 1263.

108 See 6 COLIER supra note 4, ¶ 7.30 at 1264.


110 312 U.S. 510, 526 (1941). This technique is founded on "the premise that 'value' represents a capitalization of prospective earning power at an appropriate rate which recognizes the risks inherent in the industry and in the particular enterprise." Frank, Epithetical Jurisprudence and The Work of the Securities and Exchange Commission in the Administration of Chapter X of the Bankruptcy Act, 18 N.Y.U. L.Q. REV. 316, 341 (1941) [hereinafter cited as Frank].

111 Thus, capitalization of estimated net operating profits may be appropriate in one case whereas in another case the proper method may be to discount to present worth the net cash receipts over the life of the enter-
valuation techniques urged by the SEC, its approach generally is accorded substantial weight by the court.

Beyond providing input on the proper method for the valuation of the debtor's assets, the SEC also attempts to ensure that the court apply appropriate standards in determining the fairness and feasibility of the proposed plan. For the purposes of assessing the fairness of a plan, the Commission consistently has advocated the application of the "absolute priority rule," which posits that a plan is not "fair and equitable" unless it provides participation for claims and interests in complete recognition of their strict priorities, and unless the value of the debtor's assets supports the extent of the participation afforded each class of claims or interests included in the plan. In evaluating the feasibility of a plan, the Commission, therefore, will consider a number of different factors:

- whether the total debt is reasonable when compared with the capitalized valuation of the debtor, whether the expected earning power will be sufficient to meet the fixed charges, whether proposed dividends can be paid, whether there are provisions for adequate working capital, the effect of the new capitalization on prospective credit, the adequacy of sinking fund provisions, and whether the proposed capital structure is in conformity with sound business and accounting practice.

The Commission's assessment of the feasibility of a proposed plan is particularly significant because it is closely related to its duties under the federal securities laws. Because the sale and distribution of securities issued pursuant to a plan of reorganization is exempt from the registration requirements of section 5 of the Securities Act.
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of 1933, the Commission can safeguard the rights of both present security holders and future security purchasers only by insisting on strict compliance with the feasibility requirement which will help prevent the circulation of unsound securities. Furthermore, these provisions affording the reorganization court the technical facilities and expert advisory assistance of the SEC are particularly critical because the character of the proceeding as "a complex admixture of legal, business, financial and economic problems" is at no point "more manifest than in the formulation and scrutiny of the reorganization plan itself." Accordingly, the general consensus is first that the Commission's participation provides the necessary input for making the statutory determination that a plan is "fair and equitable and feasible" and second that its services have been most valuable.

D. Compensation

Chapter X provides "detailed machinery" which governs both claims for costs and expenses incurred in the administration of the debtor's estate as well as claims of compensation for services rendered. While the bankruptcy court has exclusive jurisdiction

119 Note, The Role of the SEC in Corporate Reorganizations under the Bankruptcy Act, 1958 Ill. L. F. 631, 640-41 (1958). In this connection, the Commission has remarked: Bankruptcy reorganization ... is a significant source of entry of new securities into the public trading markets. Under the exemption from registration these securities may not be accompanied by disclosure of fundamental information available for other new issues. For this and other reasons of a technical nature, such as a probable preponderance of sellers immediately after reorganization, the 'after-market' for such securities is particularly sensitive to distortion and disruption. SEC REPORT ON PROPOSED LEGISLATION, supra note 5, at 101-02.

To protect security holders, the Commission will insist that securities issued pursuant to a plan be in exchange for the debtor's securities; that the old stock have some intrinsic value; and that the exemption be merely transactional and does not in and of itself create an exempt security. 40 SEC ANN. REP. 129 (1974). See generally Corotto, Debtor Relief Proceedings Under the Bankruptcy Act and the Securities Act of 1933—The Registration Requirement and Its Implications, 25 HASTINGS L.J. 389 (1974).

120 6 COLIER, supra note 4, ¶ 7.30 at 1258.
121 See authorities collected in Id. ¶ 7.30 at 1258 n.16.
122 6 COLIER, supra note 4, ¶ 13.02 at 899.
123 The statute vests the judge with the authority to "allow reimbursement for proper costs and expenses incurred by the petitioning creditors and reasonable compensation for services rendered and reimbursement for ... expenses incurred ... by" referees, special masters, trustees or other officers and their attorneys, the attorney of the debtor, and the attorney for the petitioning creditors. Bankruptcy Act, § 241, 11 U.S.C. § 641 (1970). Similar awards may be made to indenture trustees, depositaries, reorganization managers, committees or representatives of creditors or stockholders, as well as to "any other parties in interest." Id., § 242, 11 U.S.C. § 642 (1970). Additional provision is made for expenses and compensation for creditors, stockholders and their attorneys in connection with the submission of suggestions or proposals of a plan. Id., § 243, 11 U.S.C. § 643 (1970). See id., §§ 244, 245, 11 U.S.C. §§ 644, 645 (1970) (when petition is filed in pending bankruptcy proceeding); id., §§ 246, 248, 11 U.S.C. §§ 646, 648 (1970) (upon dismissal of proceeding or adjudication of bankruptcy); id., § 249, 11.
over all compensation and expenses, the Commission has played a major role in the court's determination of the propriety and amount of such allowances. Courts commonly will request the SEC to submit its recommendations on the disposition of fee applications. In response to such requests, the Commission often conducts extensive investigations resulting in detailed reports to the court. The magnitude of the task, together with the experience and independence of the Commission, in practice have insured that the SEC's recommendations will be afforded substantial weight.

The substance of the SEC's recommendations is, in turn, a


29 The magnitude of the problem as it may arise in any particular case is exemplified by In re Yuba Consol. Indus., Inc., 260 F. Supp. 930 (N.D. Cal. 1966), where the transcript alone of the hearings on compensation applications occupied 10 volumes with 946 pages of transcript. Id. at 933.


31 The SEC can also draw on its experience with allowances in its own reorganization proceedings under the Holding Company Act, 2 Loss, supra note 5, at 762.


33 See, e.g., In re Imperial "400" Nat'l Inc., 432 F.2d 232, 240 (3d Cir. 1970) ("Because of...[the SEC's]...experience in such matters, its impartiality, and its sole familiarity with the relevant facts in this case, its recommendations should be given great weight."); In re TMT Trailer Ferry, Inc., 434 F.2d 804, 806-07 (5th Cir. 1970) (per curiam). cert. denied, 402 U.S. 907 (1971) ("The SEC having participated fully in these proceedings (now in their thirteenth year), from the very beginning of the filing of the chapter X reorganization, is intimately familiar with the services rendered by the Committee's counsel..."). Therefore, the Court determined it "should follow the SEC recommendation...which we consider fair and reasonable...""); Scribner & Miller v. Conway, 238 F.2d 905, 907 (2d Cir. 1956) (The court should follow the SEC's recommendations "unless the reorganization judge showed reasons otherwise based on specific findings."). But see In re Yuba Consol. Indus., Inc., 260 F. Supp. 930, 950-51 (N.D. Cal. 1966) (criticism of SEC recommendations).

function of the dual purpose of the statutory fee provisions. On one hand, the Chapter X allowance machinery seeks to protect the assets of the reorganized corporation against unnecessary depletion. On the other hand, it seeks to broaden the base of allowances to encourage more active participation by creditors, stockholders and their attorneys, thereby insuring that the reorganization proceedings are not dominated by a minority of the parties in interest. To effectuate these underlying purposes, the SEC, in rendering its recommendations to the court, has focused on three major issues: whether the services were compensable, whether the applicants are disinterested, and whether the amounts requested are reasonable. Furthermore, the Commission has participated most actively in cases requiring a construction of section 249 which disallows compensation to any applicant who has traded in the debtor's securities. Nevertheless, categorization of the Commission's role is difficult. Aside from its uniformly rigorous review of allowance applications for evidence of possible conflict of interest or inside


In addition to making recommendations concerning the merits of particular claims, the Commission also may comment on the feasibility of awarding the total requested claims in view of the particular status of the debtor's finances. Note, The Role of the SEC in Corporate Reorganizations Under the Bankruptcy Act, 1958 U. Ill. L. For. 631, 641 (1958).

133 Section 249, 11 U.S.C. § 649 (1970) provides:

Any persons seeking compensation for services rendered or reimbursement for costs . . . incurred . . . shall file with the court a statement . . . of [of] claims against, or stock of, the debtor . . . in which a beneficial interest . . . has been acquired or transferred . . . after the commencement of such proceedings. No compensation or reimbursement shall be allowed to any . . . person acting . . . in a fiduciary capacity, who [has traded in] such claims or stock . . . without the prior consent or subsequent approval of the judge.


135 The Supreme Court has long been of the view that "reasonable compensation for services rendered' necessarily implies loyal and disinterested service in the interest of those for whom the claimant purported to act." Wood v. City Nat'l Bank & Trust Co., 312 U.S. 262, 268 (1941). For an example of a case where the SEC successfully challenged allowances to applicants with conflicts of interest, see London v.
trading, its position varies as it attempts, in different fact situations, to effectuate the somewhat conflicting purposes of the fee provisions of the statute. Thus, in the name of the economy, the SEC has participated in numerous cases with the end of eliminating claims that are excessive or that seek compensation for services that are suspect, not beneficial to the estate or only tenuously connected with the reorganization. At the same time, with the end of encouraging increased participation, the SEC also has appeared to argue the necessity of higher fees and to support the recognition of the rights of a larger class of claimants. However, the courts' natural predilection for economy suggest that the Commission's influence may be more

Snyder, 163 F.2d 621, 626 (8th Cir. 1947). The SEC's advisory recommendations on awards for allowances from the debtor's estate are one of its most effective sanctions in monitoring the qualification and performance of fiduciaries.


In re Postal Tele. & Cable Corp., 119 F.2d 861, 863 (2d Cir. 1941) (compensation denied attorney of debtor who worked with committee in opposing unsuccessfully, adoption of a plan); Four Seasons Nursing Centers of Am., Inc., (W.D. Okla., No. BK 70-1008), reported in 39 SEC Ann. Rep. 125-26 (1973) (recommending reduction in allowances claimed by indenture trustee who spent a large portion of its time reviewing papers filed by others in the proceeding and many of whose efforts duplicated the activities of its counsel). Similarly, the SEC will contest allowances made without adequate compliance with the mandatory notice provisions. In re Cybern Educ., Inc., 478 F.2d 1340, 1344-45 (7th Cir. 1973) (per curiam).

In re Farrington Mfg. Co., (4th Cir., No. 75-1355), reported in 41 SEC Ann. Rep. 157 (1975); In re General Economics Corp., 360 F.2d 762, 764 (2d Cir. 1966). In In re Farrington, the Commission supported an appeal from an order of allowance for services taken by counsel to the trustee and urged that trustee's counsel was a court-appointed officer entitled to reasonable compensation, not a volunteer who is compensated on the basis of the benefit to the estate. 41 SEC Ann. Rep. 157 (1975). In particular, the Commission cited three factors which it argued that the district judge had failed to balance against the needs for economy: (1) the importance of awarding reasonable compensation in cases where the standard of counsel's performance was not questioned in order to encourage the participation of competent counsel; (2) the crucial importance of the section 167 investigation and (3) that the result of the investigation and of the trustee's participation in certain lawsuits was to increase both participation in the plan and the distribution to creditors.


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...strongly felt when exercised in the promotion of that purpose.142

II. CHAPTER XI ARRANGEMENTS

There is a marked contrast between the procedures of Chapter X which contemplate “reorganization in the grand manner”143 and the more summary provisions of Chapter XI.144 In contrast to the broader scope of Chapter X which is carefully designed to protect the interests of stockholders and creditors,145 Chapter XI simply affects the rights of “general creditors who have been deemed by Congress to need only the minimal disinterested protection provided by that chapter.”146 Accordingly, for all practical purposes, the entire Chapter XI proceeding is in the hands of the debtor who generally remains in possession,147 operates the business148 and proposes the arrangement.149 Furthermore, little independent oversight is contemplated by Chapter XI, in that it makes no provision for a study of the debtor by a trustee, nor does it authorize the court to approve the plan or to communicate its advice to creditors in advance of the debtor’s solicitation of their acceptances.150 These summary pro-


144 For a comparison of the different characteristics of Chapters X and XI, see SEC v. American Trailer Rentals Co., 379 U.S. 594, 603-07 (1965); REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. Doc. No. 93-137, 93d Cong., 1st Sess., part I, 244-45 (1973) [hereinafter cited as BANKRUPTCY COMMISSION REPORT].


150 The debtor may solicit acceptances of the plan of arrangement even before the filing of the proceeding and must solicit them before the court’s approval of the plan. SEC v. American Trailer Rentals Co., 379 U.S. 594, 606 (1965); Bankruptcy Act, § 336(4), 11 U.S.C. § 736(4) (1970); see note 175 infra. In addition, creditors have only the choice of accepting or rejecting the plan. SEC v. American Trailer Rentals Co., 379 U.S. 594, 606 (1965).

Furthermore, while Chapter X applies the absolute priority rule, Chapter XI tests the fairness of a plan as to general creditors against what they would receive in a liquidation. BANKRUPTCY COMMISSION REPORT, supra note 144, at 245.

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cedures, however, are consistent with the basic purpose of Chapter XI
which is "to provide a quick and economical means of facilitating sim-
ple compositions among general creditors ...."151

The significant differences in both the scope and source of the
Commission’s involvement in Chapter X and Chapter XI cases reflect
the distinct character of the two proceedings. While the SEC, by
statutory mandate,152 plays a major role under Chapter X, the
Commission’s involvement is far more restricted in the simpler, more
expedited procedures of Chapter XI. Its statutory role, in fact, simply
reflects the fact that the choice between proceeding under Chapter X
or Chapter XI is not optional with the debtor. Indeed, "Congress has
made it quite clear that [they] are not alternate routes," but instead
constitute "legally, mutually exclusive paths to attempted financial
rehabilitation."153 Thus, Chapter XI only expressly grants standing to
the Commission for the purpose of making a conversion motion "to
have the case proceed under Chapter X ...."154 In SEC v. American
Trailer Rentals Co.,155 however, the Supreme Court expanded the
Commission’s Chapter XI role and held that "under the statutory
scheme, while not charged with express statutory rights and responsibil-
ities ..., the SEC is entitled to intervene and be heard in a
Chapter XI proceeding."156 Although the Commission, in the past,

152 See text & notes 24-33 & 100-09 supra.
under Chapter XI may be dismissed, or in effect transferred, if they "should have been
Chapter X petition will be deemed not to have been filed in good faith, and therefore
will be subject to dismissal, if "adequate relief would be obtainable" under Chapter XI.
that

[the judge may, upon application of the Securities and Exchange Com-
mission or any party in interest, and upon such notice to the debtor, to the
Securities and Exchange Commission, ... if he finds that the proceedings
should have been brought under Chapter 10 ..., enter an order dismiss-
ing the proceedings under this Chapter ... .

In 1940, the Supreme Court, in SEC v. United States Realty & Improvement Co.,
held that the Commission could properly intervene in Chapter XI proceedings to advo-
cate dismissal of the case on the ground that Chapter XI, when compared to Chapter
X, was inadequate to protect public investors. 310 U.S. 434, 458 (1940). When Congress
amended Chapter XI in 1952, it specifically codified this holding in § 328. Act of July

Under Ch. XI R. 11-15, which became effective as of July 1, 1974, the Commis-
sion or other party in interest, has 120 days from the first date set for the first meeting
of creditors to file a motion, which time may be extended for good cause. The debtor,
however, may move for transfer to Chapter X at any time. Because the Rule requires a
showing that the case may properly proceed under Chapter X, in effect, the court can
grant the motion only if it finds both that Chapter XI is inadequate and that Chapter X
is feasible. 41 SEC ANN. REP. 158 (1975).

156 Id. at 613.
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has played a more limited role in Chapter XI cases, this difference in the scope of its involvement may tend to narrow in practice as the SEC’s role in Chapter XI expands to reflect the fact that larger corporations, with more extensive public holdings, increasingly rely on Chapter XI as the vehicle for their rehabilitation. Nevertheless, the two central issues with respect to the SEC’s role in Chapter XI cases continue to be those surrounding its decisions of when to petition for conversion to Chapter X and whether to intervene in the Chapter XI proceeding.

A. Conversion Motions

Delineation of the factors that the Commission considers important in determining whether to move for conversion is essential because there is no clear standard for choosing between Chapters X and XI other than the vague “needs to be served” test and because the Commission is often the sole participant advocating removal. The courts have consistently rebuffed the SEC’s position that the mere presence of numerous public investors is alone sufficient to mandate resort to Chapter X. Nevertheless, large

157 See Manufacturers’ Credit Corp. v. SEC, 395 F.2d 833, 842 (3d Cir. 1968), where the court noted that the SEC’s standing to intervene in Chapter XI cases “should not be equated with the SEC’s full power to investigate and report under Chapter X . . . .”

158 Bankruptcy Commission Report, supra note 144, at 246. Although proponents of Chapter XI generally laud its speed and economy, the real reason underlying the preference for Chapter XI is the extent of control retained by the debtor under that chapter. Id. at 247. For the suggestion that the Supreme Court, in granting the SEC standing to intervene in Chapter XI cases, did not contemplate a comparable degree of administrative participation, see text infra at note 196.

159 See American Trailer Rentals Co., 379 U.S. at 610; General Stores, Inc. v. Schlensky, 350 U.S. 462, 466 (1956). The “needs to be served” test was first applied by Justice Douglas in General Stores where he noted that neither the character of the debtor, nor its capital structure was the controlling consideration. 350 U.S. at 466. Instead, he observed that [i]t may well be that in most cases where the debtor’s securities are publicly held c. X will afford the more appropriate remedy. But that is not necessarily so. A large company with publicly held securities may have as much need for a simple composition of unsecured debts as a smaller company. And there is no reason . . . why c. XI may not serve that end. The essential difference is not between the small company and the large company but between the needs to be served. Id.

The “needs” identified by Justice Douglas which might mandate the use of Chapter X include: the necessity of sacrifice by the stockholders and the need for an accounting by the management for misdeeds or for new management. Id.

160 See Weintraub & Levin, Chapter VII (Reorganizations) as Proposed by the Bankruptcy Commission: The Widening Gap Between Theory and Reality, 47 Am. Bankr. L.J. 323, 324 (1973). Occasionally, when other parties petition for review on the ground that a proceeding under Chapter XI should have been brought under Chapter X, the SEC may appear in support of the court’s jurisdiction to confirm the arrangement. See In re Post-S ease Int’l, Inc., 457 F.2d 237, 238-39 (2d Cir. 1972) (per curiam).

161 See, e.g., American Trailer Rentals Co., 379 U.S. at 607, 611; General Stores, Inc. v. Schlensky, 350 U.S. 462, 466 (1956); In re Lea Fabrics, Inc., 272 F.2d 769, 771 (3d
public holdings clearly invite close SEC scrutiny\cite{162} as the Commission continues to stress the number and sophistication of the debtor's public investors in advocating removal.\cite{163} Furthermore, on a case by case basis, the Commission successfully has argued the significance of the fact that the debtor's rehabilitation requires "a substantial adjustment of widely-held public debt."\cite{164} Additional criteria stressed by the SEC in arguing for removal include the need either for new competent management\cite{165} or for a thorough investigation of the debtor by an independent trustee.\cite{166} A successful petition for conversion will serve to address these problems because Chapter X may require the appointment of a disinterested trustee to take possession of the assets of the debtor,\cite{167} whereas Chapter XI generally permits the debtor to continue in possession subject to the supervisory control of the court.\cite{168} Furthermore, the Commission is likely to press for removal where the possibility of federal securities laws violations raises the question of whether these contingent claims

\begin{itemize}
\item Cir. 1959), appeal vacated as moot sub nom. SEC v. Lea Fabrics, Inc., 363 U.S. 417 (1960); SEC v. Liberty Baking Corp., 240 F.2d 511, 514 (2d Cir.), cert. denied, 353 U.S. 930 (1957). When the Court in General Stores, \textit{supra}, rejected the Commission's position that the presence of publicly held securities was determinative, the SEC introduced corrective legislation to preclude resort to Chapter XI by a corporate debtor that had securities owned by 100 or more persons. See 6 SEC ANN. REP. 55-57 (1940). The legislation did not pass. \textit{Bankruptcy Commission Report, supra} note 144, at 246.
\item 8 \textit{COLLIER, supra} note 131, \textit{§4.22} at 467. See \textit{American Trailer Rentals Co.}, 379 U.S. at 614.
\item 163 40 SEC ANN. REP. 131-33 (1974). See Norman Fin. & Thrift Corp. v. SEC, 415 F.2d 1199, 1203 (10th Cir. 1969) (unsophisticated depositors in "Thrift Saving Accounts").
\item 165 See, \textit{e.g.}, \textit{American Trailer Rentals Co.}, 379 U.S. at 614-15; Norman Fin. & Thrift Corp. v. SEC, 415 F.2d 1199, 1204 (10th Cir. 1969); SEC v. Grumpion Builders, Inc., 337 F.2d 907, 911-12 (5th Cir. 1964); \textit{cf. In re Meister Brau}, Inc., 355 F. Supp. 515, 517 (N.D. Ill. 1972) (mem.) (petition filed by debtor's shareholders; SEC took no position on the merits of the petition. \textit{Id.} at 517 n.3).
\item 166 See, \textit{e.g.}, \textit{American Trailer Rentals Co.}, 379 U.S. at 615; Norman Fin. & Thrift Co. v. SEC, 415 F.2d 1199, 1204 (10th Cir. 1969); SEC v. Liberty Baking Corp., 240 F.2d 511, 515 (2d Cir.), cert. denied, 353 U.S. 930 (1957). One commentator has argued that evidence of past corporate mismanagement should be the determining factor in choosing between Chapters X and XI. See Katskee, \textit{The Calculus of Corporate Reorganization Chapter X v. XI and the Role of the SEC Assessed}, 45 \textit{AM. BANKR. L.J.} 171, 189-90 (1971).
\item In some cases, however, courts have refused to transfer a Chapter XI arrangement, and have discounted the necessity of a trustee's investigation on the grounds that an investigation accomplished by the referee would be sufficient. \textit{See In re American Guaranty Corp.}, 221 F. Supp. 961, 967 (D. R.I. 1963). \textit{Cf. In re Lea Fabrics}, 272 F.2d 769, 772 (3d Cir. 1960), vacated as moot sub nom. SEC v. Lea Fabrics, Inc., 363 U.S. 417 (1960) (per curiam).
\item 167 See text at notes 36-37 supra.
\item 168 See note 147 supra. For a comparison of these aspects of Chapters X and XI, see \textit{American Trailer Rentals Co.}, 379 U.S. at 606.
\end{itemize}
can be discharged under the limited scope of Chapter XI.\textsuperscript{169} By moving for conversion to Chapter X, the SEC facilitates the adjudication of contingent securities fraud claims and their inclusion in the Chapter X plan of reorganization.\textsuperscript{170}

The SEC's ability to petition for conversion from Chapter XI to Chapter X is critical to its ability to protect the interests of public investors. Although there is no absolute rule that Chapter X must be used when the debtor is publicly owned, Chapter X, nevertheless, is generally the "appropriate proceeding for adjustment of publicly held debt."\textsuperscript{171} By seeking to insure that the rehabilitation of corporate debtors with widespread public holdings proceed under Chapter X, the SEC guarantees that the interests of public investors will be safeguarded by the more extensive provisions for disinterested protection included in that chapter.

B. Intervention by the SEC

In cases where the Commission has determined not to exercise its statutory authority to petition for a conversion to Chapter X, it nevertheless is crucial to identify those factors which may lead it to exercise its judicial grant of standing to intervene. In the past, the Commission has intervened most frequently in Chapter XI cases where the plan of arrangement contemplates the issuance of securities.\textsuperscript{172}

The likelihood that a proposal to issue securities pursuant to a plan of arrangement will trigger SEC intervention highlights one of the critical differences between Chapter X and Chapter XI. The issuance of securities pursuant to a Chapter X reorganization plan is hedged with statutory protective devices. Thus, there can be no solicitation of acceptances of the Chapter X reorganization plan until after it has been approved by the court.\textsuperscript{173} Furthermore, a wide range of disclosure information, including the opinion of the judge and any reports filed by the SEC, must be submitted to the creditors and stockholders in conjunction with the solicitation of their acceptances of the


\textsuperscript{170} A Chapter X proceeding is not limited to the adjustment of unsecured or fixed claims. On the contrary, it defines claims to "include all claims of whatever character . . . , whether or not such claims are provable . . . and whether secured or unsecured, liquidated or unliquidated, fixed or contingent." Bankruptcy Act, § 106(1), 11 U.S.C. § 506(1) (1970).

\textsuperscript{171} American Trailer Rentals Co., 379 U.S. at 618.

\textsuperscript{172} The Commission staff has made a practice of communicating with referees around the country requesting notification of arrangements which may propose this type of issuance. 38 SEC ANN. REP. 130 n.60 (1972).

plan. In a Chapter XI case, however, there is a far greater potential for the issuance of deceptive securities. Acceptances of a Chapter XI plan of arrangement may be solicited even before the filing of the procedure and always before the court's approval of the plan. Furthermore, the debtor who proposed the plan is also the one to solicit acceptances and such solicitation is accomplished with only limited judicial scrutiny. This comparative lack of protection afforded public investors in the consummation of a Chapter XI plan of arrangement sensitizes the Commission to attempts to circumvent applicable provisions of the federal securities laws.

Because the Commission often intervenes expressly in order to thwart attempts to circumvent the federal securities laws, its role in Chapter XI cases is perhaps more narrowly directed to securing appropriate protection for the rights of the public investors in conjunction with the issuance of securities pursuant to a plan of arrangement. In particular, the SEC has characterized the purpose of its intervention in these circumstances as twofold. It seeks both to develop the record as to adequacy of the disclosure of material facts and to assist the court in its task of scrutinizing securities which were to be issued pursuant to an arrangement and thus prevent the distribution of stock of doubtful value to an unsuspecting public.

As well as participating in order to insure adequate disclosure, the Commission also will intervene to challenge a plan on the grounds that it lacks the “good faith” required by section 366(4) when the issuance of securities pursuant to the plan appeared to be motivated more by a desire to participate in a rising market than by a good faith attempt to resuscitate the debtor.

In addition to its efforts in monitoring the issuance of securities

176 Corotto, supra note 175, at 1579. The application of SEC proxy requirements to Chapter X and XI plans reflects these differences in the statutory framework. Solicitations of acceptances of Chapter X plans are exempt from the proxy requirements under the Securities Exchange Act of 1934. Securities Exchange Act of 1934, R. 14a-2(e), 17 C.F.R. § 240.14a-2(e) (1974). Corotto, supra note 175, at 1580-81. However, these proxy requirements may apply to the debtor's solicitation of consents under Chapter XI. Id.
177 The trustee, receiver or debtor in possession is responsible for compliance with the requirements of applicable state and federal laws. 6A COLLIER, supra note 131, ¶ 8.12 at 47-50. See Corotto, supra note 175, at 1587-71.
pursuant to the plan of arrangement, the Commission also assumes a familiar, albeit a more limited, role as expert advisor with respect to other issues arising in the course of a Chapter XI proceeding. Thus, in keeping with its practice in its appearances in Chapter X cases, the SEC is actively concerned with the status and performance of other parties in interest. The Commission, for example, often intervenes for the purpose of replacing a debtor continued in possession with a receiver, particularly in cases involving allegations of mismanagement or violations of federal securities laws. Similarly, the SEC may assist the court in determining the qualifications of the attorney retained by the debtor. Furthermore, the SEC may lend its investigative resources to the court. However, because Chapter XI makes no provision for an independent study by the court or a trustee or for the communication of their advice to creditors in advance of the acceptance of the plan, the investigation conducted by the SEC in these circumstances is likely to be more limited and to become significant primarily when the court is ruling on conversion petitions brought by another party.

181 The Commission's role, however, is perforce more limited because in Chapter XI there is no regulation of creditor representatives whereas Chapter X imposes fiduciary standards and full disclosure of relationships. Bankruptcy Commission Report, supra note 144, at 245.

182 See, e.g., In re Peoples Loan & Inv. Co., 410 F.2d 851, 854 (8th Cir. 1969) (The Court, however, adopted the recommendation of the referee and denied the SEC's motion); In re Investors' Equity, Inc., (S.D. Iowa, No. 74-464-C), reported in 41 SEC Ann. Rep. 160-61 (1975).


185 In re Longchamps, Inc., (S.D.N.Y., No. 75-B-953), reported in 41 SEC Ann. Rep. 162 (1975), the debtor sought to retain, as its counsel in the proceeding, a law firm which asserted a substantial secured claim for services rendered prior to the filing of the Chapter XI petition. When the court turned to it for advice, the SEC concurred with the court's decision disqualifying the firm on the grounds that questions might arise with respect to the amount of the firm's claim or the validity of its security interest. Id.

186 American Trailer Rentals Co., 379 U.S. at 606.

187 In re Meister Brau, Inc., (N.D. Ill., No. 72-B-3965), reported in 39 SEC Ann. Rep. 127 (1973), for example, the SEC prepared an investigation at the request of the court which was prepared entirely from the debtor's records and other public information.

188 See In re Posi-Seal Int'l, Inc., 457 F.2d 237, 238-39 (2d Cir. 1972) (per curiam); In re Meister Brau, Inc., (N.D. Ill., No. 72-B-3965), reported in 39 SEC Ann. Rep. 127 (1973). In that case, in connection with a § 328 conversion motion filed by shareholders, the Commission conducted a preliminary investigation, but declined to take any position on the motion because of its doubts that the debtor could be reorganized. The court subsequently denied the motion and requested the SEC to continue its investigation. Ultimately, the debtor was adjudicated a bankrupt. Id.
The Commission also has intervened infrequently in conjunction with other matters arising in the course of the administration of the debtor's estate. It may appear to support or to contest the jurisdiction of the bankruptcy court to take certain action. In *Cavanagh Communities Corp. v. New York Stock Exchange, Inc.*, the Commission filed an amicus curiae brief in support of the New York Stock Exchange's appeal from the bankruptcy court's order enjoining the Exchange from filing an application with the Commission to delist the debtor's common stock and convertible subordinated debentures. The bankruptcy judge had ruled that the stock exchange listing constituted "property" of the debtor which therefore fell within the exclusive jurisdiction of the court. On appeal, however, the court agreed with the SEC's contention that the bankruptcy court lacked jurisdiction because section 12(d) of the Securities Exchange Act of 1934 vests exclusive jurisdiction over the delisting process with the Commission. In addition to concerning itself with jurisdictional matters, the SEC also has appeared to contest the sufficiency of consideration offered in a sale of major assets of the debtor.

Despite this evident variety of purposes for which the Commission will intervene in a Chapter XI case, its participation has been considerably more circumspect than the major role it has played in Chapter X reorganizations. This marked distinction in the scope of its involvement presumably results from three major factors. First, the vehicle for its participation is not an express statutory provision but is rather a judicial grant of standing to intervene. This judicial grant of standing is qualified by the Supreme Court's suggestion that it did not thereby indicate "the desirability of the [SEC's] performing its full Chapter X functions." Second, Chapter XI itself offers less opportunity for intervention by a public agency because, consistent with its purpose of facilitating simple compositions among general creditors, its procedures are more summary. Third, by pressing for conversion to Chapter X in cases which involve the substantial adjustment of widely held public debt, the SEC itself may limit the necessity for subsequent appearance on behalf of public investors in  

\[supra\] at notes 146-51.  
\[supra\] at notes 159-71.
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Chapter XI proceedings. These three factors serve to indicate that while the restricted role assumed by the SEC in Chapter XI cases represents an accommodation with that chapter's more summary character, it does not necessarily entail any lapse in the agency's efforts to protect the public investor.

III. ROLE OF THE SEC UNDER PROPOSED REVISIONS OF THE BANKRUPTCY ACT

Recent proposed legislation aimed at revising the Bankruptcy Act raises the prospect of a substantial alteration of the Commission's current role in corporate reorganizations and arrangements. One bill, prepared by the Commission on the Bankruptcy Laws of the United States, virtually abolishes the SEC's participation. It provides for the creation of a new administrative agency which would exercise the administrative functions now performed by bankruptcy judges and also would assume the Commission's present responsibilities. A second bill, proposed and introduced at the request of the National Conference of Bankruptcy Judges, makes more limited changes and apparently contemplates the SEC's continued participation in reorganization proceedings. The SEC is generally opposed to the alterations in its role as proposed in both pieces of legislation. The most recent bill proposing revisions in the bankruptcy laws, introduced by Congressman Edwards in the 95th Congress, appears to eliminate the SEC's advisory participation in administrative aspects of reorganization proceedings. At the same time, however, it would restructure the procedure governing the confirmation of the plan and explicitly provide for SEC participation at that time. The SEC has not yet commented officially on the substance of these proposed changes.


201 See text and notes infra at 219-20 and 238-39.

202 The bill was introduced by Congressman Edwards, of California, for himself and for Mr. Butler, as H.R. 6, 95th Cong., 1st Sess. (1977) [hereinafter cited as the Edwards Bill].
A. The Bankruptcy Commission Bill

The Bankruptcy Commission Bill, as first introduced in 1973, incorporates major substantive changes in the law of corporate reorganization, many of which stem from its proposed creation of a new administrative agency. The Commission recommends the severance of the administrative from the judicial functions within the bankruptcy system. Accordingly, its bill would create a new United States Bankruptcy Administration, to be operated through regional and local officers within the executive branch of the federal government. The Bankruptcy Administration would be “empowered to handle almost all matters in proceedings under the Act which do not involve litigation.” The judicial functions, on the other hand, would be performed by bankruptcy judges appointed to bankruptcy courts also established by the Act.

That the new Bankruptcy Administration effectively would supplant the SEC's present role in corporate reorganizations is most evident in the sections of the proposed Act governing the formulation of the plan. Although the bill would require a report regarding a plan to be submitted for a vote in every case where the plan would adversely affect any publicly held securities, it would transfer this function from the SEC to the new Bankruptcy Administration. The pro-

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The Commission concluded, in effect, that there was no reason to involve the judge in matters which were purely administrative in nature. Id. at 5. Furthermore, it found that there were substantial reasons for not entrusting litigation to bankruptcy judges who had previously been involved in the administration of the litigated estates. The tribunal's prior involvement in the resolution of administrative matters impaired the litigants' confidence in the impartiality of its decision of a subsequently litigated controversy. Also, it cast doubt on the court's ability to adjudicate that controversy solely from evidence presented to the trier. Id. Therefore, analogizing to the division of function between the Internal Revenue Service and the Tax Court, the Commission recommended the creation of a new agency to handle administrative matters and thereby implement the proposed severance of administrative and judicial functions. Id. at 6.


207 Commission Bill, §§ 7-306, 7-307. The proposed act would define “publicly held securities” as meaning “securities of a class the ownership of which is held of record by 300 or more persons.” Id., § 1-102(36). This should be distinguished from the present practice which only requires the judge to submit the plan to the SEC for report if the scheduled indebtedness exceeds $3,000,000. Bankruptcy Act, § 172, 11 U.S.C. § 572 (1976).

208 Commission Bill, § 7-306(b), provides that “[p]rior to the date set for the hearing on approval, the administrator shall file with the court an advisory report and a summary thereof concerning the plan and modifications .... ” One commentator, noting a serious inconsistency in the statutory scheme, has questioned “by what sort of jurisdictional legerdemain” the court may approve or confirm a plan in a case pending before the Administrator. Lee, A Critical Comparison of the Commission Bill and the Judges' Bill for the Amendment of the Bankruptcy Act, 49 Am. Bankr. L.J. 1, 46 (1975) [hereinafter cited as Lee].

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posed Act is somewhat less explicit as to the SEC's continued performance of those advisory functions which it presently assumes pursuant to its statutory authority to intervene. The bill clearly contemplates some continued participation by the SEC. It would provide that the SEC will continue to receive "written notice ... of the commencement of a [reorganization] case ... if the debtor is a corporation having 300 or more security holders and such other notices as it may request in connection with the case or a class of cases." Furthermore, it would authorize the SEC, together with other agencies and persons given standing to intervene, to "appear and be heard in the bankruptcy court respecting any matter that arises in the administration of a case under Chapter VII," and enumerates a wide range of matters as to which the bill expressly contemplates their appearance. The Bankruptcy Commission, however, has described the purpose of these notice and standing provisions insofar as they apply to the SEC as being merely to solicit the cooperation and aid of the Securities and Exchange Commission in any case where it has previously conducted an investigation of the affairs of the debtor corporation or where it may be peculiarly equipped to conduct such an investigation during the course of the proceedings.

Thus, it appears that the Commission's reading of the proposed Act would virtually eliminate SEC participation in corporate reorganizations except insofar as the SEC might appear in order to fulfill its responsibilities under the federal securities laws or might afford the Bankruptcy Administration the benefits of its prior discharge of its duties under those Acts.

In recommending that the new Bankruptcy Administration supplant the SEC, the Bankruptcy Commission, in effect, is attempting to

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208 The Commission, however, explicitly contemplated that the Bankruptcy Administrator, rather than the SEC, would make recommendations concerning fee and expense applications. BANKRUPTCY COMMISSION REPORT, supra note 199, Part I, at 249.
209 Commission Bill, § 7-107(c).
210 Id., § 2-205(b).
211 The bill expressly accords standing to: the debtor, an indenture trustee, a creditor, an equity security holder, authorized committees, the administrator, the SEC and any State or Federal Commission having regulatory jurisdiction over a debtor that is a public utility. Id. The enumerated matters of administration include the appointment of an additional committee, the appointment or removal of a trustee, the dismissal or conversion of the case to one for liquidation, a sale of all or substantially all of the property of the estate, the approval and confirmation of the plan, and the setting aside of such order of confirmation.
212 BANKRUPTCY COMMISSION REPORT, supra note 199, Part I, at 26. See § 7-107(c), Advisory Committee note 4, which characterized the notice provision as enabling the SEC "to participate in any investigation where violations of federal securities law may have occurred and to make available to the trustee the information accumulated from any prior investigation by the Commission." See also § 7-306(b), Advisory Committee note 3, which notes that the "present Chapter X functions of the [SEC] are to be performed by the administrator."
give more comprehensive statutory recognition to the theory that corporate reorganizations are only incidentally law suits and, in fact, primarily constitute an exercise in corporate finance and management. In setting forth its rationale for supplanting the SEC, the Bankruptcy Commission began from the premise that the "requirement for the representation by a public agency of the public interest and the interest of public investors in a reorganization proceeding is essential."\textsuperscript{213} For two reasons, however, it concluded that the Bankruptcy Administration should assume this responsibility.\textsuperscript{214} First, the Commission reasoned that the SEC alone was not equipped to handle the wider grant of administrative responsibility envisioned by the Act. Although the SEC had played a "very constructive" role in Chapter X cases, that role had been "very limited,"\textsuperscript{215} both because the SEC's participation in reorganization proceedings is "tangential to its major statutory duties" and because "that function has not been adequately funded in the past."\textsuperscript{216} Therefore, the Commission concluded that these new responsibilities—the "general policies of all bankruptcy proceedings"—should be transferred to a new agency which "will be intimately involved and familiar with all aspects of all bankruptcy proceedings."\textsuperscript{217} Secondly, the Commission determined that not only was the SEC ill-equipped to perform these new administrative functions but also that it should not continue to fulfill its former duties because "it would be undesirable for two agencies to perform similar functions."\textsuperscript{218}

Both reasons advanced by the Bankruptcy Commission in support of its recommendation to displace the SEC's role in corporate reorganizations are open to serious challenge. It is difficult to conceive of the SEC's role in Chapter X cases as "tangential" to its main duties because Chapter X, at least in part, is an investor protection statute.\textsuperscript{219} Furthermore, if the SEC can be faulted for playing only a "limited" role, the appropriate solution would be to advocate increased funding.\textsuperscript{220} Further, it is not necessarily undesirable for two

\textsuperscript{214}Id. at 26.
\textsuperscript{215}Id. at 249.
\textsuperscript{216}Id. at 26.
\textsuperscript{217}Id. at 26, 249. In addition, the Commission noted that the new agency would be better able to obtain adequate funding for this particular function and to respond promptly when called upon to render an advisory report. Id. at 26. Furthermore, the proposed statute would authorize it to adopt rules and regulations governing the solicitation of acceptances of all reorganization plans. Id.
\textsuperscript{218}Id. at 249.
\textsuperscript{219}See American Trailer Rentals Co., 379 U.S. at 614 ("Chapter X is one of the many Acts in which the SEC has the statutory right and responsibility to protect public investors," (footnote omitted)); Report of the Securities and Exchange Commission on Proposed Bankruptcy Legislation (S. 235 & S. 236), submitted to Subcommittee on Improvements in Judicial Machinery, Senate Committee on the Judiciary, December 8, 1975, at 16 [hereinafter cited as SEC REPORT ON PROPOSED LEGISLATION].
\textsuperscript{220}This is the position taken by the SEC. See SEC REPORT ON PROPOSED LEGISLATION, supra note 219, at 17.
agencies to perform similar functions as long as the focus of their role is different. Rather than lose the substantial experience in corporate reorganizations acquired by the SEC, it seems preferable to allow it to continue to concern itself with the investor protection aspects of corporate reorganization proceedings.

B. The Judges' Bill

The Bankruptcy Commission's proposal to establish a U.S. Bankruptcy Administration drew particularly angry criticism from the bankruptcy judges who had not been included in the Commission's membership. The National Conference of Bankruptcy Judges thereafter issued its own proposal (the Judges' Bill) which paralleled the Commission Bill in many respects, but recommended maintaining the judicial delivery system while shifting some administrative responsibilities from the bankruptcy judges to an administrative branch within the judiciary. The Judges' Bill would create within the Administrative Office of the United States Courts a Branch of independent United States bankruptcy courts.

See SEC REPORT ON PROPOSED LEGISLATION, supra note 219, at 18, where the SEC comments “if the Administrator is concerned with administrative matters for the bankruptcy system as a whole, there is no conflict if the SEC should continue to concern itself with the investor protection aspects of a reorganization proceeding.”

For a comparison of the major differences between the two bills, see generally Lee, supra note 208. One critical distinction is that the Commission Bill would consolidate the present chapters X, XI and XII into a simple reorganization Chapter VII, whereas the Judges' Bill would combine Chapters XI and XII into a single chapter on arrangements but otherwise would maintain the current distinction between reorganizations and arrangements. Id. at 38.

of Bankruptcy Administration. Through this Branch, the Director of the Administrative Office would enjoy primary responsibility for administrative matters such as the adoption of rules, the appointment of trustees and creditors' committees, and the receipt and disbursement of the funds of the debtor's estate. Thus, whereas the Commission Bill proposes a delivery system controlled by an Administrator exercising both administrative and judicial functions, the Judges' Bill would continue the present "court-oriented" delivery system under which the courts would merely delegate certain administrative responsibilities.

Because the Judges' Bill retains the "court-oriented" delivery system, the Director of the Administrative Office would not usurp the SEC's current role. Instead, the Judges' Bill envisions the SEC's continued participation but effectuates certain important changes in the provisions governing the advisory report and the service of documents. With respect to the service of documents, the Judges' Bill eliminates the current requirement of section 265 which provides for the service of copies of all pleadings and orders on the SEC. Instead, the proposed bill merely requires that the SEC receive notices. The Commission has criticized the change as likely to inhibit its efforts to identify cases appropriate for its intervention. In addition to changing the provision relating to service of documents, the Judges' Bill institutes two changes relating to the SEC's role in the confirmation of a plan of reorganization. Although it continues to provide that the SEC may file advisory reports on plans with the Court, the bill eliminates the present requirement that the Court submit the proposed plan to the Commission for an advisory report if the corporation's scheduled indebtedness exceeds $3,000,000. Secondly, the Judges' Bill indicates that the SEC's advisory report must be filed before, rather than after, the plan

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229 Lee, supra note 208, at 13.
230 The bill provides for the SEC's right to be heard on any matter arising in the proceeding but omits the present language deeming the Commission to be "a party in interest." Judges' Bill, § 2-205. In addition, the bill continues to provide that the SEC or any party in interest may petition for the conversion of a case from the new Chapter VIII on arrangements to a reorganization proceeding under the new Chapter VII. Judges' Bill, § 8-201.
232 Judges' Bill, § 4-701(c).
233 SEC REPORT ON PROPOSED LEGISLATION, supra note 219, at 16. In addition, receipt of copies of the pleadings and orders enables the SEC to fulfill an important service for creditors and investors who can turn more conveniently to the Commission's public reference rooms than to the files of the clerk of the court where the case is pending. Id. Accordingly, the SEC recommends that the Judges' Bill, if enacted, should be amended to provide that it should receive all documents filed in the case. Id. at 19.
234 Judges' Bill, § 7-305.
236 Judges' Bill, § 7-305.
The SEC is strongly opposed to both these proposed changes. In particular, it contends that the time change for the filing of its advisory report is "critical" because a prehearing report would not provide much assistance to public investors since it would necessarily be limited to a textual analysis of a plan which is often revised in the course of the hearing and would fail to take into account the crucial evidence adduced at the hearing.

Whether the Judge's Bill might effectuate other changes in the role of the SEC is somewhat unclear. The proposed legislation clearly envisions the SEC's continued participation insofar as it provides for the SEC's right to be heard on any matter arising in the proceeding. However, this provision authorizing the SEC to appear omits the language in the current Act which deems the Commission a "party in interest." This omission may suggest that the Judge's Bill intends to limit the SEC to presenting its views in the course of a motion made by another party rather than to petition on its own in the first instance for similar relief. Thus, whereas in proceedings under the present Chapter X the SEC can file a formal objection to the appointment of a trustee, the provisions of the Judge's Bill may indicate that it cannot initiate such action but instead is limited to presenting its views when the objection is raised by another party. If, indeed, this is the result intended, the change is probably motivated by the same sentiment which prompted the current Act's denial to the SEC of the right to appeal: a government agency should not be allowed to delay the proceedings when none of the parties with an economic interest in the proceeding have chosen to do so. Just as the denial of the right to appeal has been criticized as limiting the Commission's effectiveness, the failure to accord it status as a party in interest is equally likely to curtail its ability to protect public investors.

C. The Edwards Bill

The most recent proposed legislation seeking to revise the bank-
Bankruptcy laws is that introduced by Congressman Edwards in the 95th Congress. Like the Commission Bill and the Judges' Bill, the Edwards Bill provides for the creation of United States bankruptcy courts. Furthermore, the Edwards Bill, like the Judges' Bill, envisions the continuation of the present "court-oriented" delivery system. The administrative component of the Edwards Bill, however, is even more limited in authority than the Branch of Bankruptcy Administration within the Administrative Office of the United States Courts proposed by the Judges' Bill. The Edwards Bill creates an office of a United States trustee, appointed in each district by the United States Attorney General, who would operate under the general supervision of a Bankruptcy Division to be created in the Department of Justice. The duties of this United States trustee, in general, would be to "serve as and perform the duties of a trustee in a case under title 11 when required under title 11 to serve as trustee ...." Although the bill confers certain additional specific authority upon the United States trustee, the trustee would not exercise a general independent administrative authority which, for example, would authorize him to adopt bankruptcy rules. Furthermore, he would not serve as trustee in all cases arising under title 11 because the bill expressly declines to denominate him as the exclusive person eligible for such service. Thus, the Edwards Bill, in creating the United States trustee, does not thereby provide for the disinterested intervention of

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244 Id.
246 Id. Title I, § 151.
247 Id., Title III, § 581.
248 Id., Title II, § 586(b).
249 Id., Title II, § 586(a)(1).
250 The United States trustee, for example, may request that the court order the appointment of a trustee or an independent investigator. Id., Title I, § 1104. Similarly, he may request that the court terminate the trustee's appointment and restore the debtor to possession. Id., Title I, § 1105.
251 Compare provisions of the Judges' Bill governing the administrative authority of the Branch of Bankruptcy Administration at note 228 supra.
252 Section 321 would allow a person to serve as trustee when he is—(1) an individual that is competent to perform the duties of trustee, and resides or has an office in the judicial district within which the case ... is pending; (2) a corporation authorized by [its] charter or bylaws to act as trustee ...; or (3) the United States trustee for such judicial district.

Significantly, there is no floor on the amount of a corporation's indebtedness below which consideration of the appointment of a trustee is unwarranted. Id., Title I, § 1104. Instead, a court "may order the appointment of a trustee if—(1) the protection afforded by a trustee is needed; and (2) the costs and expenses of a trustee would not be disproportionately higher than the value of the protection afforded." Id. Compare, for example, § 7-102(a) of the Commission Bill which authorizes the administrator to apply to the court to determine whether a trustee should be appointed when "the debtor is a corporation having debts of $1,000,000 or more and three hundred or more security holders."
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a public agency on the same scale as would the Commission Bill and the Judges' Bill in establishing, respectively, the Bankruptcy Administration and Branch of Bankruptcy Administration within the Administrative Office of the United States Courts.

The Edwards Bill, on the other hand, does contemplate an extensive role for the SEC, at least in connection with the procedures leading to the confirmation of the plan of reorganization. The bill expressly provides for SEC participation at two crucial stages in the process: the solicitation of acceptances to the plan and the hearing on its confirmation. Thus, the SEC first may become involved in order to monitor the adequacy of the disclosures made to creditors who are being solicited to accept or reject the plan. Section 1125(b) provides that "[a]n acceptance or rejection of a plan may not be solicited . . . from a holder of a claim or interest . . . unless . . . there is transmitted to such holder the plan or a summary of the plan, and a written disclosure statement approved, after notice and a hearing, by the court as containing adequate financial information about the debtor."255

While the court, therefore, need not approve the plan itself before the solicitation of acceptances, it must approve the written disclosure statement and can only do so once it has held a hearing and determined that the statement meets the statutory disclosure standard.256 Furthermore, the bill provides that the SEC may appear and be heard at the hearing on the adequacy of the written disclosure statement.257

255 Id., Title I, § 1125(b).

256 The bill defines "adequate financial information about the debtor" to mean: information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records, as would enable a hypothetical reasonable investor typical of holders of claims or interests of the relevant class to make an informed judgment about the plan . . . ." Id., § 1125(a)(1).

257 Section 1125(d) provides that [s]olicitation . . . is not governed by any otherwise applicable nonbankruptcy law, rule or regulation, but an agency or official whose duty is to administer or enforce such law, rule or regulation may be heard on the issue of whether a disclosure statement contains adequate financial information about the debtor. Such an agency or official may not appeal from an order approving a disclosure statement.

Since the proposed provision is conditioned on a finding that the SEC, or other agency, is subject to the duty of administering or enforcing a law or regulation which otherwise would be applicable to the solicitation, there might be situations in which the SEC could not participate because the federal securities laws and rules and regulations issued thereunder would not otherwise be applicable to the proxy solicitation of acceptances or rejections of the plan of reorganization. For example, under the current Act, the proxy requirements of the Securities Exchange Act of 1934 do not apply to solicitations of a Chapter X plan because a limited exemption has been provided in recognition of the fact that the Chapter X provision for transmitting the SEC's own report and recommendations largely negate the necessity of complying with the statutory proxy requirements. Securities Exchange Act of 1934, R. 14a-2(e), 17 C.F.R. § 240.14a-2(e) (1974). These same proxy requirements do apply, however, to the solicitation of consents in a Chapter XI case. See Corotto, supra note 72, at 1581. As the present exemption which applies to solicitations of a Chapter X plan is conditioned on the adequacy of the disclosure already provided by the Bankruptcy Act, it would seem that the Edwards'
In addition to authorizing the SEC to appear in order to ensure the adequacy of the disclosure statement, the Edwards Bill also entitles it to appear at the hearing on the plan and to object to its confirmation. Because the bill enumerates a wide range of requirements which the plan must meet to entitle it to judicial confirmation, the provision allowing the SEC to object to its confirmation effectively gives it leeway to express its view on a considerable number of issues arising in the course of the reorganization proceedings.

While the Edwards Bill permits a two-step appearance by the SEC in conjunction with the plan of reorganization and thereby guarantees more effective protection of the interests of public investors, it does not expressly permit the SEC to continue to appear and be heard in connection with the variety of issues arising in the course of the administration of the debtor's estate. Unlike the Judges' Bill and the Commission Bill, the Edwards Bill does not contain any general grant of standing to the SEC. The bill's failure to provide for standing unnecessarily would hinder the SEC in its ability to safeguard the interests of public investors. The role of the United States trustee envisioned by the bill is not necessarily so extensive as to render the SEC's performance of its advisory role merely duplicative. Nor can the provisions for its appearance, however extensive, in connection with the acceptance and confirmation of the plan obviate the necessity for impartial representation during the earlier administration of the debtor's estate. On the contrary, the SEC, for example, views its current role with respect to those administrative matters as serving to prevent the confirmation of the plan from becoming little more than a ratification of a fait accompli. If the bill proponents, however, are concerned that SEC intervention in these earlier stages of a corporate reorganization operates to add unnecessary expense and delay to the proceedings, a possible compromise is suggested by the Judges' Bill which apparently would allow the SEC to present its views only in the course of an objection raised by another party in in-

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258 Edwards Bill, supra note 202, Title I, § 1128(b).

259 Id., § 1129. The requirements include, for example, the necessity of finding that payment of allowances made before the confirmation of the plan were reasonable. Id., § 1129(a)(4).

260 A conversation the author had with congressional staff counsel on March 22, 1976 suggests that the Edwards Bill, in fact, may be revised to grant the Commission standing.

261 See, in particular, its position on the sale of all or a substantial part of the debtor's assets when the sale is not made pursuant to a plan of reorganization, as discussed in the text supra at notes 90-99.
terest and not to petition on its own in the first instance for similar relief. Although this restriction may limit the SEC's effectiveness, to some extent it would continue to afford the participants, and the court, the benefit of the expertise acquired by the SEC in nearly forty years of such appearances.

**CONCLUSION**

Because corporate reorganizations and arrangements present what is fundamentally an administrative problem in corporate finance and management, the SEC has assumed a major role under Chapter X and Chapter XI of the Bankruptcy Act. The Commission's function resembles that of an amicus curiae which monitors the performance and qualification of other parties in interest, acts as an impartial representative of public investors and provides expert assistance to the court. The general consensus is that:

the service being rendered by the Commission to the Courts in connection with the reorganization of corporations [is] most valuable, if not indispensable, for the proper disposition of this vital segment of court business according to the Congressional intent. The Commission affords the necessary expert knowledge, the skill, and the uniform approach which individual justices cannot have; ... the assistance is unique in its usefulness, and not otherwise to be obtained. The judge is not bound to observe all suggestions of the Commission, but the very fact that he has them before him is assurance of his complete preparation for adjudication, with the public interest adequately protected.²⁶²

In light of the extent to which the SEC's participation has been welcomed by the federal judiciary, the alterations in its role envisioned by proposed legislation aimed at revising the Bankruptcy Act warrant careful scrutiny. Rather than lose the benefit of the substantial expertise acquired by the SEC, such legislation should seek to secure the SEC's continued participation in corporate reorganization proceedings. Therefore, in order to ensure the SEC's ability to continue to concern itself with the investor protection aspects of these proceedings, the proposed amendments should accord the SEC standing to intervene and also should institutionalize its participation in conjunction with the confirmation of the plan.

²⁶² 21 SEC ANN. REP. 89 (1955), quoting a comment received from Chief Judge Charles E. Clark, written on behalf of all the judges of the Second Circuit Court of Appeals. The Commission had sought comments from the federal judiciary in connection with a reappraisal of its functions in corporate reorganization proceedings.