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CHAPTER 11 OF THE 1978
BANKRUPTCY CODE

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One of the most drastic, and unquestionably potentially the most
troublesome, provisions of the new Bankruptcy Code is the consolidation
of Chapters VIII, X, XI, and XII of the Bankruptcy Act of 1898
into a single business reorganization chapter, chapter 11 of the 1978
Code.1 Consolidation, some writers say, has made possible a more ex-
peditious and more equitable business reorganization procedure.2 De-
spite such accolades, chapter 11 of the Code is not for the uninhibited
attorney or debtor. The consolidation has made the rehabilitation of
business debtors much more tedious and difficult, so that in all
probability and much like old Chapter X only strong businesses will be
able to survive the new reorganization process. This result is due to the
many concepts carried over into chapter 11 from old Chapter X, to the
greater leverage afforded secured creditors, to the protections and con-
trols afforded unsecured creditors and public holders of equity and
debt securities, and to the limited availability of the Code's only other
alternative to liquidation, chapter 13.3

There is much that is good in the Bankruptcy Reform Act of 1978,
to be sure—improvement that long has been needed. At the head of
the list is the improvement in the stature of the new bankruptcy court.4

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BANKRUPTCY (15th ed. 1979). Member, National Bankruptcy Conference. Bankruptcy Judge, South-
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(West Cum. Supp. 1979), and in scattered other titles, consists of four titles: Title I is the enact-
ment of the new Title 11 of the United States Code, which is herein referred to as the Bankruptcy
Code, or simply the Code; title II contains amendments to Title 28 of the United States Code and
to the Federal Rules of Evidence; title III contains amendments to other acts; title IV contains the
repeal of the Bankruptcy Act of 1898 and the transition provisions. Most provisions of the Act
became effective October 1, 1979.
2. King, Chapter 11 of the 1978 Bankruptcy Code, 53 AM. BANKR. L.J. 107 (1979); Trost,
Business Reorganizations Under Chapter 11 of the New Bankruptcy Code, 34 Bus. LAW. 1309
(1979).
Next in line for praise is the granting to the bankruptcy court of pervasive and exclusive civil jurisdiction over all matters related to the bankruptcy case.\(^5\) This jurisdiction includes removal to the bankruptcy court of cases that were pending in other courts at the time of the filing of the petition in the bankruptcy court.\(^6\) Other reforms worthy of comment are the slate of federal exemptions now available to the individual debtor,\(^7\) the realignment of the avoidance powers with commercial practices now prevalent under the Uniform Commercial Code,\(^8\) and the enhancement of chapter 13 relief to the individual debtor.\(^9\)

These accomplishments may offer little solace, however, to the small or middle-sized firm that is ineligible for chapter 13 relief and thus is faced with the Hobson's choice of instituting a liquidation case under chapter 7 or subjecting itself to the onerous and complex procedures of chapter 11.

I. Why Consolidation?

The idea of consolidating Chapters X, XI, and XII of the Bankruptcy Act originated with the Commission on the Bankruptcy Laws of the United States.\(^10\) Its report pointed out the inability of the Supreme Court and the Commission to articulate clear and positive guidelines to differentiate between debtors that should be reorganized in Chapter X and those that might be reorganized in Chapter XI.\(^11\) The Commission was distressed that Chapter XI was being used by large companies with total indebtedness of as much as eighty million dollars, and with financial structures the Commission considered too complex for the rel-

\(^5\) 28 U.S.C.A. § 1471 (West Cum. Supp. 1979). As the result of a compromise between the House and the Senate, exclusive jurisdiction of all cases under Title 11 is vested in the United States district court. \(id.\) § 1471(a). In turn, the bankruptcy court is vested with all the jurisdiction vested in the district court. \(id.\) § 1471(c). In addition, the bankruptcy court is vested with exclusive jurisdiction over all of the property of the debtor, wherever located, \(id.\) § 1471(e), a provision that was included in the rehabilitation chapters of the Bankruptcy Act §§ 77a, 111, 311, 411, 611, 11 U.S.C. §§ 205(a), 511, 711, 811, 1011 (1976) (repealed 1978), but was not included in Chapters I through VII, the “straight bankruptcy” provisions. The bankruptcy court may, in the interest of justice, abstain from hearing a particular proceeding arising under Title 11 or arising in or related to a case under Title 11, and its decision to abstain is not reviewable by appeal or otherwise. 28 U.S.C.A. § 1471(d) (West Cum. Supp. 1979).


\(^8\) \(id.\) §§ 544-554.

\(^9\) \(id.\) § 1328(a).


Convinced that these companies were resorting to Chapter XI because of its relative informality, and because trustees uniformly were appointed in Chapter X to operate the business of the debtor and to investigate management, the Commission concluded that Chapter XI should be abolished. The report continued:

The only solution is an elimination of the disparate procedures. The Commission therefore recommends a comprehensive business reorganization chapter. The Commission's recommendations that appointment of an independent trustee be discretionary, the absolute priority rule be made more flexible, a finding be required that the survival of the debtor is reasonably probable, and procedural reforms be made possible by the administrative agency dispel the arguments in favor of retaining Chapter XI. Even the desire [of the debtor's management and its attorneys] to retain control is no longer a compelling argument for Chapter XI, since the appointment of an independent trustee is discretionary.

The Commission also felt that consolidation would eliminate costly and unproductive litigation over the debtor's choice of chapters. In particular, consolidation obviated the often futile, but always extremely disruptive and wasteful, motion under section 328 of the old Act and Rule 11-15 that was brought by the Securities and Exchange Commission [SEC], and occasionally by others, to convert the Chapter XI case to one under Chapter X. In numerous cases such a motion was not filed until the case had progressed to a point near resolution of the debtor's problems. Rule 11-15 attempted to halt the inordinate delay that had become commonplace under section 328 by requiring that the motion be filed within 120 days after the date of the first meeting of creditors and stockholders. Unfortunately, much of the

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12. Id. at 247.
13. The Commission recommended the creation of a United States Bankruptcy Administration with extensive powers in connection with liquidation and reorganization cases. Id. at 103-56. The position of United States Trustee, which was created by the Bankruptcy Reform Act of 1978 for 18 pilot districts, is but a pale copy of the Commission's Bankruptcy Administration.
14. Id. at 248.
17. The classic example of late filing is SEC v. Canandaigua Enterprises Corp., 339 F.2d 14 (2d Cir. 1964), in which the filing was delayed until after a Chapter XI plan had been proposed and accepted by quite substantial majorities. With the filing of the transfer motion, the court was compelled to halt all progress in the case to hear the motion. At the conclusion of the hearing the district court denied the SEC request for transfer to a Chapter X proceeding and the SEC promptly appealed. With considerable reluctance the United States Court of Appeals for the Second Circuit reversed and sent the case back for the appointment of a trustee and conduct of the case under Chapter X. Id. at 21. Adjudication followed.
ground that might have been gained was lost by giving the court authority to extend the time for making the motion.\textsuperscript{18}

The Commission believed that a consolidated chapter would net immediate advantages over the old two-chapter approach. Abuses caused by chapter shopping under the old Act would no longer be possible. Costly and wasteful litigation over the debtor's choice of chapters also would be eliminated. Both of these features, it hoped, would lead to a more expeditious, and therefore less expensive, procedure.

Of major concern to the Commission was the viability of a single reorganization chapter—one with sufficient flexibility to accommodate the rehabilitative needs of any business entity, whether the debtor be small, medium, or large and whether doing business as an individual, partnership, or corporation. The reformers contend that the new chapter 11 does possess the needed flexibility. The consolidated chapter, they say, seeks to perpetuate the expeditious contours of old Chapter XI, while maintaining some of the public interest safeguards of Chapter X.\textsuperscript{19}

The Commission never gave a thought to consolidating the railroad reorganization provisions in Chapter VIII of the old Bankruptcy Act\textsuperscript{20} into the single business reorganization chapter of the new Act. The drafters of the Code, however, have folded railroad reorganizations into the new chapter 11\textsuperscript{21} and, amazingly enough, have found it necessary to exclude from railroad reorganization cases only a small number of sections that apply to other business entities.\textsuperscript{22} If, with these relatively minor adjustments, chapter 11 fits this kind of case, it is difficult to contend seriously that any substantial part of Chapter XI of the Bankruptcy Act has been retained.

Only time can tell what has been wrought by the reformers in the new chapter 11. The magnitude of the difficulties that have been cast in the way of the debtor will depend to a major degree upon the strictness of construction with which the courts approach the Code's new provisions. The likelihood of adverse consequences for the debtor will be pointed up in the ensuing discussion of the way the new chapter is intended by the drafters to operate.

\textsuperscript{18} FED. BANKR. R. 11-15(b).
\textsuperscript{19} See Trost, supra note 2, at 1310-11.
\textsuperscript{22} See id. § 1161.
II. Commencement of a Case Under Chapter 11

No chapter of the new Bankruptcy Code is complete in and of itself. The Code is as much a ten-finger exercise as is the Uniform Commercial Code. Chapters 1, 3, and 5 of the Code are applicable to a chapter 11 case.23 The definitions for chapter 11 cases are found partly in chapter 124 and partly in chapter 11.25 Rules of construction26 and specification of entities that may be debtors under chapter 1127 are found in chapter 1. Administrative powers, including the automatic stay,28 use of collateral,29 the borrowing of money,30 rejection of executory contracts,31 and provisions regarding continuation of utility services32 are contained in chapter 3. The turnover of property to the estate,33 the avoiding powers of a trustee or debtor,34 and setoff35 are found in chapter 5. In eighteen judicial districts36 there will be a United States trustee, who is given important powers and duties in chapter 11 cases by chapter 15 of the Code,37 and by provisions added to Title 28 of the United States Code.38

Chapter 11 is available to all businesses, whether operated by individuals, partnerships, or corporations. The case may be commenced by the filing of a voluntary petition by the debtor,39 a joint petition by debtor and spouse,40 or an involuntary petition filed by creditors.41 The requirements for an involuntary chapter 11 petition are the same as for a liquidation case under chapter 7. Three petitioning creditors,42

\[23. \text{11 U.S.C.A. § 103(a) (West 1979).} \]
\[24. \text{Id. § 101.} \]
\[25. \text{Id. § 1101.} \]
\[26. \text{Id. § 102.} \]
\[27. \text{Id. § 109(d).} \]
\[28. \text{Id. § 362.} \]
\[29. \text{Id. § 363.} \]
\[30. \text{Id. § 364.} \]
\[31. \text{Id. § 365.} \]
\[32. \text{Id. § 366.} \]
\[33. \text{Id. §§ 542, 543.} \]
\[34. \text{Id. §§ 544-549.} \]
\[35. \text{Id. § 553.} \]
\[36. \text{Id. § 1501. These districts are referred to hereafter as "pilot districts."} \]
\[37. \text{Id. §§ 151102-151105.} \]
\[39. \text{11 U.S.C.A. § 301 (West 1979).} \]
\[40. \text{Id. § 302.} \]
\[41. \text{Id. § 303(a). A petition filed by less than all of the general partners of a partnership is treated as an involuntary petition. See id. § 303(b)(3).} \]
\[42. \text{Id. § 303(b)(1).} \]
or a single creditor if there are less than twelve,\textsuperscript{43} holding claims that aggregate at least five thousand dollars more than the value of any lien on property of the debtor may file the involuntary petition. The petition need allege no more than that the debtor is not paying his debts as they become due, or that within 120 days before the filing of the petition a custodian\textsuperscript{44} was appointed or authorized to take possession of substantially all of the property of the debtor.\textsuperscript{45} Upon the filing of an involuntary petition, the court may, on request of a party in interest, appoint a trustee to operate the business.\textsuperscript{46} If a trustee is not appointed, the debtor may continue to operate the business and “to use, acquire or dispose of” property as if the case had not be commenced.\textsuperscript{47} If the debtor contests the involuntary petition, a jury trial on the issues is a matter within the discretion of the court.\textsuperscript{48} The idea of an involuntary petition is a radical departure from Chapter XI of the Bankruptcy Act and is clearly derived instead from old Chapter X.\textsuperscript{49} If the involuntary petition is not timely controverted,\textsuperscript{50} the court is required to enter an order for relief under Chapter 11 against the debtor.\textsuperscript{51}

The apparent ease of sustaining an involuntary petition, which has resulted from the abolition of acts of bankruptcy and removal of the need to allege and prove insolvency of the debtor, has made it necessary to build into the Code certain protective devices. If the court should dismiss the involuntary petition other than on the consent of all petitioners and the debtor, and if the debtor does not waive the right to judgment, the court may grant judgment in favor of the debtor against the petitioners for costs, a reasonable attorney’s fee, and any damages proximately caused by the taking of possession of the debtor’s property by a trustee appointed by the court.\textsuperscript{52} Even though no trustee was appointed, a bad faith petitioner may be liable for both compensatory

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\textsuperscript{43} Id. \S 303(b)(2).
\textsuperscript{44} “Custodian” is defined in id. \S 101(10).
\textsuperscript{45} Id. \S 303(h).
\textsuperscript{46} Id. \S 1104(a).
\textsuperscript{47} Id. \S 303(f).
\textsuperscript{50} It is probable that Fed. Bankr. R. 10-112(a)(1) will govern the time to file an answer to an involuntary Chapter 11 petition until new rules are promulgated.
\textsuperscript{51} 11 U.S.C.A. \S 303(h) (West 1979).
\textsuperscript{52} Id. \S 303(i)(1). Subsection (i) states these various elements of damage disjunctively. The term “or” is not exclusive. See id. \S 102(5). The court may therefore grant any or all of the damages provided for under this provision.
and punitive damages.53

III. THE AUTOMATIC STAY

A. Actions Subject to the Stay

The filing of a petition under any chapter of the Code operates automatically as a stay, applicable to all entities,54 of the commencement or continuation of a judicial, administrative, or other proceeding against the debtor that was or could have been commenced before the filing of the petition under Title 11, or to recover a claim against the debtor that arose before the commencement of the case;55 the enforcement against the debtor or against property of the estate56 of a judgment obtained before the commencement of the case;57 any act to obtain possession of property of the estate or property from the estate;58 any act to create, perfect, or enforce any lien against property of the estate;59 any act to create, perfect, or enforce against property of the estate any lien to the extent that such lien secures a claim that arose before the commencement of the case;60 any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case;61 the setoff of any debt owing to the debtor that arose before the commencement of the case;62 and the commencement of continuation of a proceeding before the United States Tax Court concerning the debtor.63

Certain types of actions are excepted specifically from the operation of the automatic stay. These exceptions have been spelled out in the Code largely to set to rest some of the uncertainties that have arisen under the Bankruptcy Rules. The filing of a petition does not stay the commencement of criminal proceedings against the debtor;64 the col-

53. Id. § 303(i)(2).
54. "Entity" includes a person, estate, trust, and governmental unit. Id. § 101(14). "Person" includes an individual, partnership, and corporation, but does not include a governmental unit. Id. § 101(30).
55. Id. § 362(a)(1).
56. Property of the estate is defined in id. § 541.
57. Id. § 362(a)(2).
58. Id. § 362(a)(3).
59. Id. § 362(a)(4).
60. Id. § 362(a)(5).
61. Id. § 362(a)(6).
62. Id. § 362(a)(7). Even though the right of setoff of mutual debts and credits is stayed, the right of setoff is not nullified. See id. § 553.
63. Id. § 362(a)(8).
64. Id. § 362(b)(1).
lection of alimony, maintenance or support from property that is not property of the estate; any act to perfect an interest in property to the extent that the trustee's rights and powers are subject to such perfection under section 546(b); the commencement or continuation of a proceeding by a governmental unit to enforce its police or regulatory power; the enforcement of a judgment, other than a money judgment, obtained in an action by a governmental unit to enforce its police or regulatory power; the setoff of mutual debts and credits involving commodities or securities; the commencement of actions by the Secretary of Housing and Urban Development to foreclose a mortgage or deed of trust, held by the Secretary, on property consisting of five or more living units, which is or was formerly insured under the National Housing Act, or the issuance to the debtor by a governmental unit of a notice of tax deficiency.

B. Duration of the Stay

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

C. Relief from the Stay

In order to obtain relief from the stay, a party in interest must request such relief from the court. The provisions in the Bankruptcy Rules for ex parte relief from the stay in order to prevent irreparable

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65. Id. § 362(b)(2).
68. Id. § 362(b)(5).
69. Id. § 362(b)(6). This provision has no relevance in Chapter 11 cases because stockbrokers and commodity brokers may not be debtors under Chapter 11. See id. § 109(d).
70. Id. § 362(b)(7). It should be noted that although commencement of such a suit is not stayed, prosecution of that suit is stayed. See id. § 362(a)(1).
71. Id. § 362(b)(8).
72. Id. § 362(e)(1).
73. Id. § 362(e)(2).
74. Id. § 362(d).
injury have been carried forward into the Code.\textsuperscript{75} In the more general case, after notice and a hearing,\textsuperscript{76} the stay shall be terminated, annulled, modified, or conditioned for cause, including lack of adequate protection of an interest of a secured creditor.\textsuperscript{77} The stay also may be modified if the debtor does not have any equity in the property that secures the claim and such property is not necessary to an effective reorganization of the debtor.\textsuperscript{78} The party requesting relief from the stay has the burden of proof on the issue of the debtor's equity in the property;\textsuperscript{79} the trustee or debtor has the burden of proof on all other issues.\textsuperscript{80}

The Committee on the Judiciary of the House of Representatives expressed some uneasiness over the delay of the courts in resolving requests for relief from the automatic stay,\textsuperscript{81} despite the mandate of the Bankruptcy Rules,\textsuperscript{82} and decided to bring about a change. The method chosen will have a tremendous impact on, and may well put an end to, the near-current condition of the bankruptcy court dockets across the country. If the court does not hold a preliminary or final hearing on the request for relief from the stay of an act against property of the estate within thirty days after it is filed, the stay is terminated with respect to the party making the request.\textsuperscript{83} If the hearing that is held within the thirty-day period is only a preliminary hearing, the court shall order the stay continued if there is a reasonable likelihood that the party opposing relief from the stay will prevail at the final hearing, and the final hearing shall be commenced within thirty days after that preliminary hearing.\textsuperscript{84} No time is specified in the Code within which the final hearing must be concluded, nor, having been concluded, within which the court must announce a ruling. However, the Sug-

\textsuperscript{75} 11 U.S.C.A. § 362(f) (West 1979).
\textsuperscript{76} See id. § 102(1).
\textsuperscript{77} Id. § 362(d)(1).
\textsuperscript{78} Id. § 362(d)(2).
\textsuperscript{79} Id. § 362(g)(1).
\textsuperscript{80} Id. § 362(g)(2).
\textsuperscript{81} "Too often today, court delay in handling requests for relief amounts to a complete denial of relief. The court can thus avoid the issue, and yet rule in the debtor's favor. This bill prevents such action." House Report, supra note 66, at 595, 175.
\textsuperscript{82} Fed. Bankr. R. 601(c), 8-501(e), 10-601(c), 11-44(d), 12-43(d), 13-401(d): "[T]he . . . court shall . . . set the trial for the earliest possible date, and it shall take precedence over all matters except older matters of the same character."
\textsuperscript{84} 11 U.S.C.A. § 362(e)(2) (West 1979).
gested Interim Bankruptcy Rules, which have been adopted as local rules by the bankruptcy courts in a number of districts, professed to find "a procedural void left by section 362 of the Code" and provided for expiration of the stay thirty days after a final hearing is commenced, unless within that time the court determines that the stay should be continued.

Other remedies than the automatic stay are available to the bankruptcy court to restrain interference with its cases. For example, the essence of section 2(a)(15) of the Bankruptcy Act has been carried into the Code. In addition, the bankruptcy court is invested with the powers of a court of equity, law, and admiralty, and, having at long last been designated officially as a "court of the United States," the bankruptcy court has power to issue writs under the All Writs Statute.

Through these devices, without regard for competing demands on the court's time or the debtor's attention, the court is deprived of any discretion regarding the stay, and lien creditors are handed a ready-made vehicle for hindering the progress of a reorganization, or even bringing the reorganization to a complete halt by the filing of a succession of requests for relief. If these requests for modification of the stay come early in the case, and in sufficient numbers, the debtor will be devoting all his attention and energies to resisting them; the diversion of his attention at this critical stage of the case may very well spell doom for the hoped-for rehabilitation.

The proper procedure for seeking relief from the stay of section 362 remains in doubt pending promulgation of new rules, which is several years away. If Bankruptcy Rule 701 remains in effect insofar as concerns the pleading that must be filed by a party seeking relief from

85. Advisory Committee on Bankruptcy of the Judicial Conference of the United States, Suggested Interim Bankruptcy Rules (1979) [hereinafter cited Suggested Interim Rules]. The recently reconstituted Advisory Committee on Bankruptcy Rules of the Judicial Conference of the United States prepared these interim rules in some haste, transmitted them to bankruptcy and district courts across the nation, and suggested that, for the sake of uniformity, they be adopted as local rules in the various districts. These Interim Rules are unofficial and have no effect except in the districts that have adopted them. That no district is known to have adopted the rules without having made material changes in both the rules and the accompanying forms before their adoption is indicative of the haste in preparation, and perhaps the undesirability or inadequacy of some of these rules. Thus, the Advisory Committee's hoped-for uniformity has failed.

86. See Suggested Interim Rule 4001(a).
90. Id. § 451.
91. Id. § 1651.
the stay, that party will be required to file a complaint seeking such relief.\textsuperscript{92} The court will be required to set the matter for trial at the earliest possible date and to give it precedence over all matters except older matters of the same character.\textsuperscript{93} For cause shown the court will be authorized to terminate, annul, modify, or condition the stay.\textsuperscript{94} The party seeking continuation of the stay against lien enforcement will be required to show that he is entitled such a continuation.\textsuperscript{95}

Two major problems come into focus immediately in the context of requests for relief from the automatic stay of section 362 vis-à-vis the existing Bankruptcy Rules. Bankruptcy Rule 712 controls the time for filing answers to complaints.\textsuperscript{96} Unless a different time is prescribed by the court, a defendant is not required to file and serve his answer until thirty days after issuance by the clerk of the summons provided for by Rule 704. This rule simply does not accommodate the time requirements of section 362.

The second major problem relates to the provisions for affirmative defenses and counterclaims under Bankruptcy Rules 712(b) and 713.\textsuperscript{97} Bankruptcy Rule 713 generally adopts Rule 13 of the Federal Rules of Civil Procedure, with certain exceptions not pertinent to the present discussion. Rule 13 requires the defendant to assert in his answer "compulsory counterclaims," which are defined roughly as any claims that the defendant has against the plaintiff that arise out of the same transaction or occurrence that is the subject matter of the plaintiff's claim.\textsuperscript{98} Since Rule 13 is otherwise generally applicable in adversary proceedings, the trustee or debtor would appear to be subject to the compulsory counterclaim rule when a secured creditor seeks relief from an automatic stay. Certainly this result is consistent with that reached by the federal courts in nonbankruptcy cases prior to the promulgation of the Bankruptcy Rules. If, then, the trustee or debtor does file a counterclaim, has the party seeking relief from the stay submitted to the jurisdiction of the court to determine the counterclaim? This was a major pre-Code issue when the bankruptcy court had only limited or "summary" jurisdiction. Neither the stay rules nor the rules controlling counterclaims could extend the scope of the summary jurisdiction

\textsuperscript{92} See Fed. Bankr. R. 701(b), 703.
\textsuperscript{93} See Fed. Bankr. R. 601(c), 8-501(c), 10-601(c), 11-44(d), 12-43(d), 13-401(d).
\textsuperscript{94} Id.
\textsuperscript{95} Id.
\textsuperscript{97} Fed. Bankr. R. 712(b), 713.
\textsuperscript{98} Fed. R. Civ. P. 13(a).
of the bankruptcy court to determine the controversy raised by a counterclaim, but conventional principles of federal jurisdiction dictate that the court would have jurisdiction unless the counterclaim was permissive and not compulsory.99

The reported cases considering counterclaims in response to complaints for modification of the stay of the Bankruptcy Rules mainly have involved real property in rehabilitation cases. The aversion of the courts to considering these types of responses in the context of complaints to modify the stay has culminated in In re Essex Properties, Ltd.,100 and In re Roloff.101 Feeling that there might be something unfair about requiring a party to come into the bankruptcy court in order to get relief from an automatic stay prescribed by a Rule of Bankruptcy Procedure and then subjecting him to the necessity of defending a counterclaim in a forum that was not of his choosing, these courts seized upon the notion that the complaint for modification of the stay is in essence defensive in nature and does not assert a "claim" at all; that the real subject matter of the complaint is the claim for relief from the stay rather than the underlying claim for money; since the claim for relief from the stay is the substance of the complaint, the validity and amount of the underlying claim for money is not one arising out of the same transaction and, therefore, the counterclaim is improperly filed and cannot be entertained by the bankruptcy court. These courts simply did not feel that the proceeding for the modification of the stay should be slowed down by such counterclaims.

Some of the arguments against slowing down the relief from stay procedure through the counterclaim and affirmative defense mechanisms advanced in the pre-Code cases have some surface appeal. They do not, however, afford satisfactory means for determining well-founded counterclaims.

The congressional reports, one before and one after Essex, both before Roloff, muddled through the problem without seeing it for what it really was or resolving it to anyone's satisfaction. The House report commented:

At the expedited hearing under subsection (e), and at all hearings on relief from the stay, the only issue will be the claim of the creditor and the lack of adequate protection or existence of other cause for relief from the stay. This hearing will not be the appropria-

ate time at which to bring in other issues, such as counterclaims against the creditor on largely unrelated matters. Those counterclaims are not to be handled in the summary fashion that the preliminary hearing under this provision will be. Rather, they will be the subject of more complete proceedings by the trustee to recover property of the estate or to object to the allowance of a claim.  

The Senate report seemed to make a bit of a concession, but still did not recognize or solve the real dilemma:

The action commenced by the party seeking relief from the stay is referred to as a motion to make it clear that at the expedited hearing under subsection (e), and at hearings on relief from the stay, the only issue will be the lack of adequate protection, the debtor's equity in the property, and the necessity of the property to an effective reorganization of the debtor, or the existence of other cause for relief from the stay. This hearing will not be the appropriate time at which to bring in other issues, such as counterclaims against the creditor, which, although relevant to the question of the amount of the debt, concern largely collateral or unrelated matters. This approach is consistent with that taken in cases such as... In re Essex Properties, Ltd.,... that an action seeking relief from the stay is not the assertion of a claim which would give rise to the right or obligation to assert counterclaims. Those counterclaims are not to be handled in the summary fashion that the preliminary hearing under this provision will be. Rather, they will be the subject of more complete proceedings by the trustee to recover property of the estate or to object to the allowance of a claim. However, this would not preclude the party seeking continuance of the stay from presenting evidence of the existence of claims which the court may consider in exercising its discretion. What is precluded is a determination of such collateral claims on the merits at the hearing.  

The considerations posed in these reports are meaningful insofar as they emphasize adequate protection as required by section 361 of the Code. However, they overlook very basic issues: (1) The summary-plenary jurisdiction dichotomy of the bankruptcy court no longer exists because of the pervasive jurisdiction granted to that court by the amendments to Title 28 of the United States Code effected by the Bankruptcy Reform Act of 1978. There is, therefore, no longer any substance to the pre-Code fears that the rules might be used to expand the court's jurisdiction. Under the 1978 Act, foreclosure suits that may be pending at the time of a filing under Title 11 may be removed to the

102. HOUSE REPORT, supra note 66, at 344.
104. See text accompanying notes 4-6 supra.
bankruptcy court.\textsuperscript{105} (2) Some counterclaims and affirmative defenses are genuine, and are not "the product of zeal in attempting merely to create issues of fact," as they were characterized by one court,\textsuperscript{106} or lacking in good faith, as they were characterized by the same court in an earlier case.\textsuperscript{107} (3) Essex, Roloff, and the cases preceding them involved real property in jurisdictions in which judicial foreclosure of real property liens was required and a suit seeking such relief was pending in a state court when the case under the Bankruptcy Act was filed. Now such suits would be removed to the bankruptcy court.\textsuperscript{108} (4) In a number of jurisdictions the creditor secured by real estate collateral need not put the validity and amount of his claim on the line in a judicial foreclosure action but may have his trustee under a deed of trust divest the debtor of his title by a courthouse-steps foreclosure sale.\textsuperscript{109} In addition, a foreclosure of a security interest under Article 9 of the Uniform Commercial Code may be had without court action of any kind. In jurisdictions and instances such as these the only forum realistically available to the debtor for a challenge of the validity of the creditor’s claim or its amount is the bankruptcy court. If that court refuses to hear him, he is effectively denied any forum.

Prior to enactment of the Code, in any context other than in response to a complaint for modification of the stay, there was no question that a counterclaim or an affirmative defense very properly could be used in the bankruptcy court to reduce or even to defeat a claim asserted, whether or not the bankruptcy court had jurisdiction to enter an affirmative judgment against the adverse party in the event that the amount found to be owing on the counterclaim should exceed the amount due to the adverse party on his claim.\textsuperscript{110} This points up in bold perspective a basic weakness in Essex and similar pre-Code cases, as well as in the House and Senate reports quoted above. If there is some compelling public policy that requires such haste to accommodate the secured creditor at the expense of an already financially troubled debtor, it has never been articulated. When an Essex-type case arose in a jurisdiction in which a judicial foreclosure was required, the debtor at

\begin{itemize}
\item \textsuperscript{109} G. Osborne, G. Nelson, D. Whitney, Real Estate Finance Law 475 n.91 (1979).
\end{itemize}
least had a forum in which to assert his counterclaims and affirmative defenses. In jurisdictions in which a more summary form of real estate foreclosure was condoned, and in foreclosures of personal property under Article 9 of the Uniform Commercial Code, denial by the bankruptcy court of the right to be heard on counterclaims and factual defenses effectively denied the debtor any defense. To carry forward the flawed reasoning of these pre-Code cases can produce totally inequitable, even shocking results.

The expanded jurisdiction now possessed by the bankruptcy court eliminates many of the old problems. Accepting for the moment that the section 362 hearing should be held with dispatch, the debtor must be afforded the right to present his counterclaims and defenses against the claim of the secured party, regardless of what they may consist. On the other side of the coin, the secured creditor is entitled to adequate protection of its interest. The House and Senate reports properly emphasize that the primary issue at the section 362 hearing is that of adequate protection. But adequate protection of what interest? And of how much of an interest? The reports are entirely unconvincing when they postulate that counterclaims and affirmative defenses have no place in the stay hearings. In determining the extent of protection that in justice and fairness should be afforded the secured creditor, the court cannot ignore the existence and possible merit of counterclaims that may reduce materially or even defeat the claim asserted by the moving party. Even the Roloff court admitted as much in a footnote:

[T]o the extent that the bankruptcy judge believes that Audubon's lien will be invalidated or reduced in a different forum it may affect his judgment on the Roloffs' equity in the property. . . . Thus, although the Roloffs cannot attack the judgment by counterclaiming before the bankruptcy judge, they may plead facts that are relevant to the equities of continuing the stay, and one such fact would be any flaw in Audubon's claim.\textsuperscript{111}

The request for relief from the stay is nothing more than the pursuit of lien enforcement. The bankruptcy court now has complete jurisdiction to determine all issues between the parties. As long as adequate protection is afforded to the secured creditor in an amount determined after consideration of factors such as the ones suggested in the Roloff footnote, the stay litigation should turn into a trial on the merits of the entire controversy. Denial of this right to the debtor can be justified no longer.

\textsuperscript{111} 598 F.2d at 789 n.23.
IV. OPERATION OF THE DEBTOR'S BUSINESS

Under the new Code, no court order is required for the debtor to continue operation of his business, and unless the court orders otherwise the debtor will continue to do so. The court is removed from any obligation to oversee or otherwise be concerned about the operation of that business. The court is in the case to resolve disputes impartially, and until a pleading is filed creating an issue, the court may not inject itself into the case. However, until the parties in interest become accustomed to the bankruptcy judge's no longer being the official watchdog and no longer being permitted *sua sponte* to curb the debtor's methods of operating the business or order its closing, and until they learn to take the necessary action to bring these matters to issue before the court, it is very likely that assets will be dissipated. In pilot districts the supervision of the debtor in chapter 11 is one of the duties of the United States trustee. In other districts the creditors' committee will have to assume the entire responsibility. On motion the court is empowered to impose limitations or conditions on the debtor's operations.

In the operation of the business, the debtor in possession or the trustee will have full use of the administrative powers provided in subchapter IV of chapter 3, and of the powers in connection with the estate contained in subchapter III of chapter 5. Some of these powers, however, sound better on a cursory reading than they may prove to be in actual operation.

A. Use of Collateral

"Cash collateral" is defined to mean cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents in which the estate and another entity have an interest.

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112. The Code provides that, unless the court orders otherwise, the trustee may operate the debtor's business. 11 U.S.C.A. § 1108 (West 1979). It in turn confers on the debtor in possession, with exceptions not here pertinent, all the rights and powers of a trustee serving in a case under Chapter 11. *Id.* § 1107.

113. Although until rules like *Fed. Bankr. R.* 10-212, 11-25, 12-24, and 13-204 are replaced by new rules, the court must fix dates for creditors' meetings, and may order a meeting of equity security holders, *see* 11 U.S.C.A. § 341(b) (West 1979), the court may not preside at, and may not attend, any such meetings. *See id.* § 341(c).


116. *Id.* §§ 361-366.

117. *Id.* §§ 541-554.

118. *Id.* § 363(a).
In addition, if noncash collateral is converted into proceeds of the type defined as cash collateral, the proceeds must be treated as cash collateral as long as “proceeds” are subject to the prepetition security interest.\textsuperscript{119} Thus, if the debtor sells for cash inventory that is subject to a prepetition security interest, or collects accounts receivable that are subject to a prepetition security interest, these proceeds become cash collateral, and they must be segregated and accounted for.\textsuperscript{120}

The debtor may not use, sell, or lease cash collateral, in the ordinary course of business or otherwise, unless each entity that has an interest in the cash collateral consents, or the court, after notice and a hearing, authorizes such use, sale, or lease.\textsuperscript{121} Noncash collateral that is property of the estate may be used, sold, or leased in the ordinary course of business without notice or a hearing.\textsuperscript{122} In order for noncash collateral to be used otherwise than in the ordinary course of business the court, after notice and a hearing, must authorize it.\textsuperscript{123}

“After notice and a hearing” is a term to which a rule of construction applies.\textsuperscript{124} It means after notice that is appropriate in the particular circumstances, and after appropriate opportunity for a hearing. An actual hearing is not required if notice is given properly and if such a hearing is not timely requested by a party in interest, or if there is insufficient time for a hearing to be commenced before an act must be done and the court authorizes the act.\textsuperscript{125} The matter of “appropriate notice” is left to rules that have not yet been promulgated. Until they are, it must be assumed that the debtor may in writing notify persons asserting an interest in property of the estate that at some stated time in the future he proposes to sell or otherwise dispose of the property. Because ten days’ notice is something of a standard in bankruptcy cases, it is suggested that a ten day notice will be considered to be “appropriate notice.” Unless a party in interest files a pleading with the court objecting to the disposition of the property in question and asks for a hearing on the issue, the debtor may proceed, without court order, to go forward with the proposed disposition of the property and will not be

\textsuperscript{119} Id. § 552(b). The 1972 version of Article 9 of the Uniform Commercial Code, as adopted in most states, automatically applies the security interest to proceeds. U.C.C. § 9-306(2).

\textsuperscript{120} 11 U.S.C.A. § 363(c)(4) (West 1979).

\textsuperscript{121} Id. § 363(c)(2). In an involuntary case, § 363 apparently does not apply unless the court orders it. See id. § 303(f). Thus, cash collateral can be used without notice to the secured creditor in an involuntary case.

\textsuperscript{122} Id. § 363(c)(1).

\textsuperscript{123} Id. § 363(b).

\textsuperscript{124} Id. § 102(1).

\textsuperscript{125} Id.
required to segregate the proceeds.\textsuperscript{126}

It is not at all clear what the debtor or trustee must do during the first few days following the filing of the petition in order to be able to use or dispose of cash collateral or of collateral the proceeds of which become cash collateral. In these days of the all-devouring reach of the security interest of Article 9 of the Uniform Commercial Code, the average business will be destroyed before the debtor will be able to get an order of the court "after notice and a hearing" to authorize the use of cash collateral or of collateral the proceeds of which become cash collateral. An earlier version of section 363 proposed that the debtor or the trustee, without an order of the court, could use or sell what was then called "soft collateral" for not more than five days after notification of other parties who had an interest in that collateral.\textsuperscript{127} This authorization, however, did not make its way into the final draft. It is probable that the debtor or the trustee, as a matter of survival, will continue business as usual, and will continue to use the cash realized from encumbered inventory and accounts receivable until the secured creditor moves to stop him.

\textbf{B. Adequate Protection}

The Code drafters probably intended that before the debtor may use or dispose of any property in which another entity has an interest, either in the ordinary course of business or otherwise, "adequate protection"\textsuperscript{128} of that interest be furnished. The drafters of these provisions optimistically thought that the nature and amount of that protection would be negotiated by the debtor and the interest holders and that the court would not have to become involved.\textsuperscript{129} It is unlikely that it will work out that way in practice. Secured creditors nourish perpetual feelings of insecurity, and agreements will not come easily for the debtor. It is far more likely that the authorization contained in section 363(c) for the debtor to use noncash collateral in the ordinary course of business without an order of the court will place the burden on the secured creditor to invoke the jurisdiction of the court to require the debtor to provide adequate protection of his interest. It is the probable intent of this provision that the debtor take the initiative and reach

\begin{itemize}
  \item \textsuperscript{126} \textit{Id.}
  \item \textsuperscript{127} H.R. 8200, 95th Cong., 1st Sess. \textsection 363(c)(2) (1977), reprinted in \textsc{Collier on Bankruptcy}, App. 3 (15th ed. 1980) & \textsc{12 Bankruptcy Reform Act: A Legislative History} 345 (A. Resnick & E. Wypski eds. 1979).
  \item \textsuperscript{128} Adequate protection is illustrated but not defined in \textsc{11 U.S.C.A. \textsection 361} (West 1979).
  \item \textsuperscript{129} \textsc{House Report}, \textit{supra} note 66, at 338.
\end{itemize}
an agreement with his secured creditors before continuing his operations. In the midst of the confusion that follows the filing of a petition few debtors are likely to pursue this course of action.

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

When the debtor’s right to use collateral does become an issue before the court, the court is not required to provide adequate protection. The court is required, however, to prohibit the use of collateral, or to condition its use, sale, or lease, “as is necessary to provide adequate protection” of the interest in the property that belongs to another entity. In any such hearing, the debtor, or the trustee, has the burden of proof on the issue of adequate protection.

When the use of cash collateral does become an issue before the court, prompt action should be taken by the court, scheduled in accordance with the debtor’s needs. The hearing may be only preliminary or it may be consolidated with a hearing brought on by the secured creditor’s request for modification of the stay to permit foreclosure on the collateral.

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

According to the legislative history, the purpose of adequate protection is to require such relief as will result in “realization by the pro-

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130. Id. at 338-39.
131. Id. at 345 (discussing 11 U.S.C.A. § 363(e) (West 1979)).
132. Id.
134. Id.
135. Id. § 361(1). This provision is derived from In re Bermer Corp., 445 F.2d 367 (2d Cir. 1971).
137. Id. § 361(3).
138. Id.
tected entity of the value of its interest in the property involved." 139 The Code does not make any significant new contribution to the concept of adequate protection, but instead borrows the more effective devices developed by the courts under the Bankruptcy Act. 140 The House Committee Report's attempted restatement of those principles confuses the issues, and in its discussion of the method and purpose of valuation leaves the measure of "realization of value" in a state of total confusion. 141

Whatever adequate protection may really mean, the confusion is heightened by the House Report's valuation discussion, which is couched in terms of "realization of value." The Code, on the other hand, refers repeatedly to compensating the secured creditor to the extent that the debtor's use or sale of the property "results in a decrease in value of [the secured creditor's] interest in" such property, 142 which is not the same thing. This is followed by the further distraction that the adequate protection must result in "the indubitable equivalent of such entity's interest in such property." 143 In any event, to be certain that it does result in the "indubitable equivalent," the Code provides that to the extent that the protection afforded may result in less than the full equivalent of the secured creditor's interest, that creditor is afforded a claim that shall have priority over every other priority claim, 144 thus further reducing any hope of the unsecured creditors that they may ultimately receive something from the estate.

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

Neither is it expected that the courts will construe the term value to mean, in every case, forced sale liquidation value or full going concern value. There is wide latitude between those two extremes. In any particular case, especially a reorganization case, the determination of which entity should be entitled to the difference between the going concern value and the liquidation value must be based on equitable considerations based on the facts of the case. It will frequently be based on negotiation between the parties. Only if they cannot agree will the court become involved.

House Report, supra note 66, at 339.
143. Id. § 361(3).
144. Id. § 507(b).
C. Postpetition Effect of Security Interests

As a general rule, under the Code after-acquired property of the estate is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case.\textsuperscript{145} The legislative history makes clear that this provision is intended to govern the effect of a prepetition security interest in postpetition property and that it applies not only to Uniform Commercial Code security interests\textsuperscript{146} but to all security interests defined in the Code.\textsuperscript{147} If the prepetition security agreement extends to property of the debtor acquired before commencement of the case and to "proceeds, product, offspring, rents, or profits" of such property, the terms of the security agreement and "applicable nonbankruptcy law" will be enforced against postpetition proceeds, rent, and the like, but the court may, after notice and a hearing and based on the equities of the case, order otherwise.\textsuperscript{148} The authority to adjust rights in proceeds, however, is granted subject to the provisions of the Code regarding the use, sale, or lease of property.\textsuperscript{149} Accordingly, equitable adjustments cannot be made without assurance that the secured party's interest in the proceeds is adequately protected.

An earlier version of the provision affecting proceeds provided that the prepetition security interest extended to such proceeds "except to the extent that the estate acquired the proceeds to the prejudice of other creditors holding unsecured claims."\textsuperscript{150} The exception was intended to cover the situation in which the estate expends funds that result in an increase in the value of the collateral. For example, if raw materials were converted into inventory at some expense to the estate, thus depleting the fund available to unsecured creditors, the prepetition security interest was not permitted to improve the position of the secured creditor as it existed at the filing of the petition in the case. The compromise between the House bill and the Senate amendment resulted in altering the earlier language to a provision allowing the court, after notice and a hearing, "and based on the equities of the case," to

\textsuperscript{145} Id. § 552(a).
\textsuperscript{146} See Senate Report, supra note 103, at 91; House Report, supra note 66, at 313.
\textsuperscript{147} Id. § 101(37).
\textsuperscript{148} 11 U.S.C.A. § 552(b) (West 1979).
\textsuperscript{149} Id.
order otherwise.\textsuperscript{151} It is doubtful that this results in any material change in meaning. Thus, the court may still make such adjustment to the valuation of the secured creditor's collateral that the adequate protection that is provided will not recognize any improvement in that creditor's position as it existed at the commencement of the case.

\section*{D. Property of the Estate}

Section 70(a) of the Bankruptcy Act\textsuperscript{152} spoke in terms of "title" to property. The Code drafters considered this to be unduly restrictive, and the Code therefore speaks in terms of "property of the estate."\textsuperscript{153} The commencement of a bankruptcy case creates an estate, which is comprised of all legal or equitable interests of the debtor, wherever located, as of the commencement of the case. The scope of the provision is intended to be broad and to include all kinds of property, tangible or intangible, causes of action, and all other forms of property previously specified in section 70(a) of the Bankruptcy Act. Once the estate is created, no interests in property of the estate remain in the debtor. Only property that is exempt under section 522 or is acquired after the commencement of the case will belong to the debtor thereafter. Subject to certain limitations, the estate also includes the interests of the debtor and the debtor's spouse in community property.\textsuperscript{154} Moreover, it includes property that the trustee recovers under the avoiding powers; property that the debtor acquires by bequest, devise, inheritance, a property settlement agreement with the debtor's spouse, or as the beneficiary of a life insurance policy within 180 days after the filing of the petition; and proceeds, product, offspring, rents, and profits of or from property of the estate.\textsuperscript{155}

\section*{E. Turnover of Property to the Estate}

Anyone holding property of the estate on the date of the filing of the petition, or property that the debtor or trustee may use, sell, or lease, may be required under the Code to deliver it to the debtor or trustee.\textsuperscript{156} If the property is held by a custodian, the turnover proceed-

\begin{itemize}
  \item \textsuperscript{151} 11 U.S.C.A. § 552(b) (West 1979).
  \item \textsuperscript{152} 11 U.S.C. § 110(a) (1976) (repealed 1978).
  \item \textsuperscript{153} 11 U.S.C.A. § 541 (West 1979).
  \item \textsuperscript{154} Id. § 541(a)(2).
  \item \textsuperscript{155} Id. § 541(a). See also House Report, supra note 66, at 367-69.
  \item \textsuperscript{156} 11 U.S.C.A. §§ 542, 543 (West 1979). It should be noted that "property that the trustee may use, sell, or lease" is broader than "property of the estate." Id.
ing is a contested matter. If it is held by anyone other than a custodian, the turnover is an adversary proceeding. If a noncustodian in possession of the property claims an interest in that property, he may demand adequate protection of that interest as a condition precedent to turnover. This turnover proceeding arises in, and is directly related to, the case pending in the bankruptcy court and may be brought only in that court. The bona fides of the claim of the one in possession of the property is no longer of any moment.

F. Sale Free and Clear

The debtor or trustee may sell property free and clear of any interest in the property of another entity, in the ordinary course of business without notice or a hearing, or other than in the ordinary course of business after notice and a hearing. The sale may be free and clear of the interests of other entities if applicable nonbankruptcy law permits it, if the other entity consents, if the interest is a lien and the sale price is greater than the amount secured by the lien, if the interest is in bona fide dispute, or if the other entity could be compelled to accept money satisfaction of the interest in a legal or equitable proceeding. At a sale free and clear of other interests, any holder of an interest will be permitted to bid. If that holder is the high bidder, he will be permitted to offset the value of his interest against the purchase price of the property and be liable to the debtor or trustee only for the balance of the sale price, if any.

G. Sale of Jointly-Owned Property

"Property which the [debtor or] trustee may use" is broader than "property of the estate," and the chapter 11 debtor or trustee may recover from others under section 542 property in which the debtor has only an undivided ownership interest with another. The debtor is per-
mitted to sell a co-owner's interest in property in which the debtor has an undivided ownership interest such as a joint tenancy, a tenancy in common, a tenancy by the entirety, or a community property interest, and to sell property that is subject to any vested or contingent right in the nature of dower or curtesy. The sale free and clear of such other interest is permissible only if partition is impracticable, if the sale of the estate's interest alone would realize significantly less for the estate than sale of the property free of the interests of the co-owners, and if the benefit to the estate of such a sale outweighs any detriment to the co-owners. The community interest of a nondebtor spouse, or the interest of some other co-owner is protected by permitting the co-owner to purchase the property being sold at the price at which the sale is to be consummated.

H. Obtaining Credit

Without credit few debtors can survive in a reorganization proceeding. Under both Chapters X and XI of the Bankruptcy Act, the debtor was not permitted to incur any further debt, either secured or unsecured, without court approval. Under the Code, unless the court orders otherwise, the debtor or trustee may obtain unsecured credit and incur unsecured debt in the ordinary course of business without a court order, and any debt so incurred automatically is entitled to a first priority as an administrative claim. Any unsecured debt incurred other than in the ordinary course of business will be allowed a first priority only if the court has authorized its incurrence after notice and a hearing. However, in order to avoid a later argument with a trustee over whether the credit was extended in the ordinary course of business, and thus the risk of losing his priority, the careful supplier or lender who is willing to extend unsecured credit to the debtor probably will insist on court approval of the transaction.

If the debtor cannot obtain credit on a totally unsecured basis, then with court approval credit may be obtained with priority over all

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169. Id. § 363(h).
170. Id. § 363(g).
171. Id. § 363(h)(1).
172. Id. § 363(h)(2).
173. Id. § 363(h)(3).
174. Id. § 363(i).
175. Id. § 364(a).
176. Id. § 364(b).
other administrative expenses,\textsuperscript{177} that is secured by a lien on property of the estate that is not otherwise subject to a lien,\textsuperscript{178} or that is secured by a junior lien on property of the estate that is subject to a lien.\textsuperscript{179} If the debtor still is unable to obtain credit, the court, after notice and a hearing, may authorize the obtaining of new credit which is secured by an equal or senior lien on property of the estate, but only if adequate protection is provided for the lienholder whose lien is to be equaled or primed.\textsuperscript{180} The debtor has the burden of proof on the issue of adequate protection.\textsuperscript{181}

\textbf{I. Executory Contracts and Unexpired Leases}

Ipso facto or bankruptcy clauses in leases and other executory contracts are invalidated by the Code. Thus, notwithstanding a provision in an executory contract or unexpired lease, or in applicable non-bankruptcy law, the contract or lease may not be terminated or modified because of the insolvency or financial condition of the debtor,\textsuperscript{182} the filing of a case under Title 11,\textsuperscript{183} or the appointment of or taking possession by a trustee in a case under Title 11 or a custodian before the filing of a case under Title 11.\textsuperscript{184}

Coupled with the invalidation of ipso facto clauses are provisions permitting the assumption\textsuperscript{185} and subsequent reassignment\textsuperscript{186} of executory contracts and leases. If there has been a default in a contract or lease, the debtor must cure the default, or provide adequate assurance that he will promptly cure, before he may assume the contract or lease.\textsuperscript{187} In addition, the debtor must compensate, or provide adequate assurance that he will promptly compensate, the other party to the contract for any actual pecuniary loss resulting from the default,\textsuperscript{188} and provide adequate assurance of future performance under such contract or lease.\textsuperscript{189} The requirement of cure does not apply to ipso facto

\begin{itemize}
\item \textsuperscript{177} Id. § 364(c)(1).
\item \textsuperscript{178} Id. § 364(c)(2).
\item \textsuperscript{179} Id. § 364(c)(3).
\item \textsuperscript{180} Id. § 364(d)(1).
\item \textsuperscript{181} Id. § 364(d)(2).
\item \textsuperscript{182} Id. § 365(e)(1)(A).
\item \textsuperscript{183} Id. § 365(e)(1)(B).
\item \textsuperscript{184} Id. § 365(e)(1)(C).
\item \textsuperscript{185} Id. § 365(b).
\item \textsuperscript{186} Id. § 365(f).
\item \textsuperscript{187} Id. § 365(b)(1)(A).
\item \textsuperscript{188} Id. § 365(b)(1)(B).
\item \textsuperscript{189} Id. § 365(b)(1)(C).
\end{itemize}
and there are special limiting provisions applying to the assumption and assignment of shopping center leases. If there has been a default in a lease, the debtor may not require the lessor to provide services or supplies incidental to the lease unless the lessor is compensated for any services and supplies provided under the lease before the assumption. A contract to make a loan, or to extend other debt financing or financial accommodations, to the debtor or for the benefit of the debtor may not be assumed or assigned.

The debtor may assume or reject an executory contract or unexpired lease at any time before confirmation of a plan, but the court, on request of a party to the contract or lease, may order the debtor to determine within a specified time whether to assume or reject it. The effective date of the rejection is stated in section 365(g). There are limitations in the Code on claims of a lessor for damages resulting from the termination of a lease or real property or of an employment contract.

If the debtor as lessor seeks to reject his tenant's lease, the lessee may treat the lease as terminated and assert a claim for damages against the debtor, or he may remain in possession for the balance of the term of the lease, including any renewal or extension of the term that is enforceable under nonbankruptcy law. If the lessee opts to remain in possession, he may offset against the rent reserved under the lease any damages occurring after the date of rejection caused by the nonperformance of any obligation of the debtor-lessee after that date, but he must forego any other claim against the estate on account of damages arising from the rejection. This provision handily avoids the enigma of the provision in section 70(b) of the Bankruptcy Act that rejection of an unexpired lease by the trustee of the lessor "does not deprive the lessee of his estate," which the courts had never been able to resolve.

190. Id. § 365(b)(2).
191. Id. § 365(b)(3).
192. Id. § 365(b)(4).
193. Id. § 365(b)(4).
194. Id. § 365(d)(1). The other party to an executory contract is in an equivocal position because until the contract is rejected he is not a creditor with an allowable claim.
195. Id. § 365(g).
196. Id. § 502(b)(7).
197. Id. § 502(b)(8).
198. Id. § 365(h)(1).
199. Id. § 365(h)(2).
J. Utility Service

The debtor is given some, though possibly short-lived, protection from a cut-off of service by a utility company because of the filing of a case under Title 11. A utility company, be it the telephone, gas, or electric company, may not alter, refuse, or discontinue service, or discriminate against the debtor solely on the basis that a prepetition debt was not paid.\footnote{11 U.S.C.A. § 366(a) (West 1979).} However, if within twenty days after filing the debtor does not furnish adequate assurance of payment, in the form of a deposit or other security, for services after that date, the utility company is free to act as it may see fit.\footnote{Id. § 366(b).} On request of a party in interest, and after notice and a hearing, the court may order reasonable modification of the amount of the deposit or other security necessary to provide adequate assurance of payment.\footnote{Id.} This section is a codification of the holding in In re Security Investment Properties, Inc.\footnote{Georgia Power Co. v. Security Inv. Properties, Inc., 559 F.2d 1321, 1326 (5th Cir. 1977).}

The twenty-day period of the Code does not allow the debtor a very generous length of time to negotiate the amount of the security demanded by the utility company. Even if the debtor should file a motion with the court to intercede in the matter immediately upon the filing of the chapter 11 petition, the court may not be able to schedule a hearing on it within the twenty days provided by the Code. Although the court in Security Investment Properties held that a bankruptcy court under the 1898 Act could not enjoin disconnection of electric service for refusal of the debtor to post security for future services, it would appear that a bankruptcy court would have the authority under the Code to enjoin temporarily a cut-off pending a hearing.

V. Committees of Creditors and Stockholders

As soon as is practicable after the order for relief, the Code requires that the court appoint a committee of unsecured creditors.\footnote{11 U.S.C.A. § 1102(a) (West 1979).} In pilot districts the appointment is made automatically by the United States trustee.\footnote{Id. § 151102(a).} These provisions mean that in every case, large or small, there must be at least one creditors’ committee. The importance of the committee cannot be overstated. The court’s removal from administrative involvement in the case places upon the committee, and
upon the United States trustee in pilot districts, the burden of monitoring the debtor's operations.

The appointment of a committee or committees is a departure from the election of a single committee, which was the practice under old Chapter XI. The announced purpose of the change is to preclude self-seeking attorneys from controlling the election in order to have themselves retained to represent the committee. Moreover, appointment rather than election is intended to ensure that committees are more fairly representative of the interests of the unsecured creditors.

A creditors' committee ordinarily shall consist of persons willing to serve who hold the seven largest claims against the debtor of the kinds represented on the committee. The court, or the United States trustee, is permitted to recognize and appoint a committee organized by creditors before the order for relief if that committee was fairly chosen and is representative of the different kinds of claims to be represented. The court is not compelled to designate a committee consisting of seven persons, nor is it compelled to select the members only from the largest claims in any given case. A party in interest who does not consider the appointed committee to be representative of the class for which it was appointed may request the court to change the membership or the size of the committee to balance the representation of particular classes.

The functions of the committee are to determine whether the business should continue in operation; to determine whether to move the court to appoint a trustee or examiner; to conduct an investigation of the financial affairs of the debtor; and to consult generally with the debtor or trustee in the administration of the case. The most important functions of the committee—participating in the formulation of a plan and deciding whether to recommend it to the creditors—usually will come at a later stage of the case.

Another change from old Chapter XI practice is the court's authority to appoint, or to order the appointment of, additional committees of creditors or of equity security holders in order to ensure adequate representation of affected groups. In pilot districts, the ad-

207. HOUSE REPORT, supra note 66, at 93, 236.
209. Id.
210. Id. § 1102(c).
211. Id. § 1103(c).
212. Id. § 1103(c)(3).
213. Id. § 1102(a)(2).
ditional committees ordered by the court are appointed by the United States trustee.214

Although Chapter X of the Bankruptcy Act contained no provision recognizing "unofficial" committees of either creditors or stockholders, multiple committees representing divergent classes and interests in those cases were not uncommon. Because these committees were not "official," the services for which compensation might be allowed were restricted.215 Chapter XI of the Act recognized only one committee, which usually was referred to as the "official" committee.216 There is no prohibition against "unofficial" committees in chapter 11, as under Chapter X of the Bankruptcy Act. However, an attorney or other professional person employed by an "unofficial" committee may be compensated out of the estate only for having made a substantial contribution in the chapter 11 case.217 This is quite similar to the restrictions on compensation in Chapter X of the Bankruptcy Act. The professional persons employed by committees appointed under section 1102 of the Code, however, are not subject to these restrictions; they may be compensated from the estate based on time, the nature and value of their services, and the cost of comparable services in nonbankruptcy matters.218 This compares favorably with the kinds of services that are considered compensable under old Chapter XI. By providing for compensation based on the "cost of comparable services other than in a case under" Title 11,219 it was the intent to overrule In re Beverly Crest Convalescent Hospital, Inc.220 and similar cases, in which courts, with preachments of economy of administration and a thinly veiled resentment of practicing attorneys' expectation of compensation at higher hourly rates than federal district judges, slashed allowances to the attorneys involved in the cases to little more than subsistence level.221

214. Id. § 151102(b).
218. Id. § 330(a)(1).
219. Id.
220. 548 F.2d 817 (9th Cir. 1976).
221. If [Beverly Crest] were allowed to stand, attorneys that could earn much higher incomes in other fields would leave the bankruptcy arena. Bankruptcy specialists, who enable the system to operate smoothly, efficiently, and expeditiously, would be driven elsewhere, and the bankruptcy field would be occupied by those who could not find other work and those who practice bankruptcy law only occasionally almost as a public service. Bankruptcy fees that are lower than fees in other areas of the legal profession may operate properly when the attorneys appearing in bankruptcy cases do so intermittently, because a low fee in a small segment of a practice can be absorbed by other work. Bankruptcy specialists, however, if required to accept fees in all of their cases that are consist-
There are restrictions on the employment of professional persons by an appointed committee. These persons must be selected at a scheduled meeting of the committee at which a majority of the members are present and may be employed only upon approval by the court. A person employed to represent the committee may not represent any other person or entity in the case.\textsuperscript{222} If that person has been representing a creditor at the commencement of the case, he must give up that representation if he is to serve the committee in the case.

VI. APPOINTMENT OF TRUSTEE OR EXAMINER

The Code presumes that the debtor will remain in possession and continue to operate his business in a chapter 11 case. A trustee may be appointed only on order of the court, made on request of a party in interest, after notice and a hearing, and for cause shown.\textsuperscript{223} The number of holders of the debtor's securities or the amount of assets or liabilities of the debtor are specifically excluded from consideration by the court as cause for the appointment of a trustee.\textsuperscript{224} Cause does include fraud, dishonesty, incompetence, or gross mismanagement of the debtor's affairs by current management, either before or after commencement of the case.\textsuperscript{225} The appointment of a trustee also may be made if it is in the interest of creditors, any security holders, or other interests of the estate.\textsuperscript{226}

These factors referred to in subsections 1104(a)(1) and 1104(a)(2) of the Code are the very ones the SEC has advanced in its motions under section 328 of the Bankruptcy Act and Rule 11-15 as the reasons why a case should be transferred from Chapter XI to Chapter X,\textsuperscript{227} and they will probably be raised again in its motions for the appointment of a trustee in the cases now being filed under chapter 11 of the Code. There is cause to wonder whether the change effected by the Code has done anything more than to give a new name to the same motion and the same hearing.

If the court decides that a trustee should be appointed, the person

\textsuperscript{ent}ly lower than fees they could receive elsewhere, will not remain in the bankruptcy

field.

\textsuperscript{222} See text accompanying notes 15-16 supra.

\textsuperscript{223} 11 U.S.C.A. § 1103(b) (West 1979).
\textsuperscript{224} Id. § 1104(a).
\textsuperscript{225} Id. § 1104(a)(1), (2).
\textsuperscript{226} Id. § 1104(a)(2).
\textsuperscript{227} See text accompanying notes 15-16 supra.
selected does not have to be chosen from the panel of private trustees established under Title 28, section 604(f) of the United States Code.228 In pilot districts, when the court decides that a trustee should be appointed, the appointment is made by the United States trustee; the person selected does not have to be chosen from the panel of private trustees established under Title 28, section 586(b), but is subject to approval by the court.229 The United States trustee also has standing to request the appointment of a trustee or an examiner in these cases.230

The protection afforded by a trustee would be needed in cases in which current management of the debtor has been fraudulent, dishonest, or has grossly mismanaged the debtor's affairs. A trustee would also be needed when the debtor's management has abandoned the business.231 Generally, a trustee would not be needed in any case in which the functions to be performed could be provided by an examiner. If current management is adequate, but there is evidence of some misconduct by former management, the necessary investigation can be conducted by an examiner, presumably at a lesser cost to the estate than if a trustee were to be appointed.

If the debtor's fixed, liquidated, unsecured debts, other than for goods, services, or taxes, or owing to an insider,232 exceed five million dollars the court must, on application of a party in interest, appoint an examiner if it does not appoint a trustee.233 This appointment must be made whether or not there is any evidence of fraud or mismanagement by either current or past management. An examiner shall be appointed also if the appointment is in the interests of creditors, any equity security holders, or other interests of the estate.234

There appears to be a major oversight regarding the examiner. The Code contains provisions detailing the employment of professional persons by a trustee,235 and there are elaborate and detailed provisions.

229. Id. § 151104(e).
230. Id. § 151104(a), (b).
231. This is a situation that may occur with some frequency. It is unlikely that an individual proprietor will stay in place very long after an order for relief is entered against him in an involuntary Chapter 11 case.
233. Id. § 1104(b)(2). The examiner's duties are set out in § 1106(b) and include, in addition to specific duties, "any other duties of the trustee that the court orders the debtor in possession not to perform." Id. § 1106(b). Such "other duties" are not intended to include operation of the business.
234. Id. §§ 1104(b)(1), 151104(b)(1).
235. Id. § 327.
regarding the compensation of the persons so employed.\textsuperscript{236} Conspicuously absent are any provisions for the employment of professional persons by an examiner and any provisions regarding the compensation of these persons. There is no doubt that in conducting an investigation the examiner must have the assistance of accountants, attorneys, and possibly others. This matter seems to have escaped the attention of the committees of both Houses in earlier competing drafts of the proposed Bankruptcy Reform Act,\textsuperscript{237} as well as in the final draft, which was passed amid the great confusion of last-minute amendments and compromises in October 1978.

It is extremely doubtful that the court has inherent power to authorize an examiner to employ professional persons and to allow them compensation. The accepted tenets of statutory construction force the conclusion that Congress, having provided for the employment and compensation of professional assistants by trustees, debtors, and committees, but not by examiners, intended that an examiner should not employ such persons and that no compensation should be permitted in the event that any might be so employed.\textsuperscript{238} It would seem that corrective legislation is required if the provisions in the Code concerning the appointment of an examiner are not to become totally meaningless.

\section*{VII. Meetings of Creditors and Stockholders}

The Code contemplates that within a reasonable time after the order for relief in a case under chapter 11 there shall be a meeting of creditors.\textsuperscript{239} In addition, in a case involving a corporation, the court may order a meeting of equity security holders.\textsuperscript{240} The Suggested Interim Bankruptcy Rules include a provision requiring at least twenty days' notice of that meeting.\textsuperscript{241} The court may not preside at, and may

\textsuperscript{236} Id. \S\S 328, 330, 331.
\textsuperscript{238} \textit{Cf.} \textit{United Merchants and Mfrs., Inc. v. J. Henry Schroder Bank \& Trust Co.}, 597 F.2d 348 (2d Cir. 1979) (compensation denied for services performed in a Chapter XI case because no authority for compensation to attorneys and accountants employed by an indenture trustee could be found in the Bankruptcy Act).
\textsuperscript{239} 11 U.S.C.A. \S 341(a) (West 1979). \textit{SUGGESTED INTERIM RULE 2003(a)} would have this meeting and the meeting of equity security holders occur not less than 20 nor more than 40 days after the order for relief.
\textsuperscript{240} 11 U.S.C.A. \S 341(b) (West 1979).
\textsuperscript{241} SUGGESTED INTERIM RULE 2002(b).
not attend, any such meeting. This, of course, creates a problem regarding the conduct of the meetings. The Suggested Interim Bankruptcy Rules provide that the clerk of the bankruptcy court shall preside at the meeting of creditors and equity security holders. The debtor is required to appear and submit to examination under oath at such meeting, and he may be examined by creditors, any indenture trustee, or the trustee or examiner.

VIII. FILING AND ALLOWANCE OF CLAIMS

The Bankruptcy Act concept of provability of claims is not carried forward into the Code. In its place is the concept of allowability. The purpose of the change is to make all claims allowable and to avoid traps for the unwary, such as the provision in the Bankruptcy Act that denied provability to a claim of damages for negligence unless a suit had been instituted prior to the filing of the bankruptcy petition and was still pending at the time of filing. The Code requires the estimation of such claims, as well as contingent or unliquidated claims, which often were denied allowability in a bankruptcy case because liquidation or estimation of such claims would unduly delay administration of the proceeding under the Bankruptcy Act. Whether the claim was denied provability or allowability, the result was another nondischargeable debt for the bankrupt or debtor.

Section 1111 contains special rules for chapter 11 cases regarding the proof of claims and interests that are not applicable in other cases. If the claim or interest is scheduled by the debtor or trustee as not disputed, not contingent, and not unliquidated, it is deemed filed under section 501. In turn, a claim filed under section 501 is deemed allowed unless a party in interest objects to it. Thus, creditors and interest holders who are scheduled in this manner by the debtor or trustee do not have to file claims in the case in order to vote and to

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243. See SUGGESTED INTERIM RULE 2003(b)(1), (2).
251. Id. §§ 521(1), 1106(a)(2).
252. Id. § 1111(a).
253. Id. § 502(a).
participate in any distribution under any plan that may be confirmed in the case. If the claim or interest is scheduled by the debtor or trustee as disputed, contingent, or unliquidated, however, the holder of that claim or interest is required to file a proof of claim or interest if he is to participate in the case by either voting or sharing in distribution.\textsuperscript{254} The holder of the claim or interest is required to determine for himself how his claim or interest is scheduled. These Code provisions are parallel to the existing Chapter X Rules\textsuperscript{255} rather than the Chapter XI Rules\textsuperscript{256} and the chapter 11 debtor has no possibility of gaining discharge of claims the holders of which fail to file proofs in the case.

As was the case under the Bankruptcy Act and Rules, a proof of claim or interest as filed constitutes prima facie evidence of the validity and amount of the claim or interest.\textsuperscript{257} The Code does not specify the time within which the required proofs must be filed. Accordingly, until new rules are promulgated, a bar order fixing such time must be entered by the court, as under old Chapter X.\textsuperscript{258}

\section*{IX. The Plan}

In the debate over consolidation of the business reorganization chapters, the argument was made that Chapter XI, in permitting a plan to be filed only by the debtor, allowed the debtor too much power. One writer has referred to it as "the almost arrogant power of the Chapter XI debtor to force liquidation if creditors do not agree to his business rescue plan."\textsuperscript{259} This view does not recognize the power over the plan wielded by a strong creditors' committee, and, as was noted earlier, the committees appointed under the Code provisions almost certainly will exercise a great deal more power and control than was ever possible for a committee under old Chapter XI. In the process of negotiating a plan in a case under old Chapter XI, the debtor was always fully aware that the demands of the creditors' committee would have to be met or an adjudication could follow. For management of a corporate debtor, the prospect of adjudication might not have been all that important. If the creditors thought they could get more if the business were kept alive, however, there was nothing to prevent their moving for a conversion to

\begin{itemize}
  \item \textsuperscript{254} Id. \S 1111(a).
  \item \textsuperscript{255} FED. BANKR. R. 10-401.
  \item \textsuperscript{256} FED. BANKR. R. 11-33.
  \item \textsuperscript{257} 11 U.S.C.A. \S 502(a) (West 1979).
  \item \textsuperscript{258} FED. BANKR. R. 10-401(b)(1).
  \item \textsuperscript{259} See Trost, supra note 2, at 1310.
\end{itemize}
Chapter X under old Rule 11-15. Failing that, they could file an involuntary Chapter X petition in the pending Chapter XI case, letting a trustee displace old management and try to resurrect a viable business from the ruins. On the other hand, if the debtor was an individual and he preferred liquidation to a too stern plan insisted on by the committee, nothing could prevent his choosing liquidation. He could ask for adjudication at any time and walk away with his exempt property.

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

A. Who May File a Plan

Whether the case originated with a voluntary or involuntary petition, if the debtor has remained in possession, he has the exclusive right to file a plan for 120 days after the date of the order for relief. If the debtor does file a plan within this period, he has an additional 60 days in which to obtain the necessary acceptances. If the necessary acceptances are obtained within 180 days, the statute apparently continues the exclusive period while the debtor seeks confirmation. On motion of any party in interest and for cause shown, the court may reduce or extend the 120-day period or the 180-day period.

When a trustee is appointed, the debtor loses the exclusive right to

261. Id. § 348(a).
262. Id. § 706(b).
263. Id. § 1123(c).
264. Id. § 1121(b). Moreover, the appointment of an examiner does not affect this right of the debtor.
265. Id. § 1121(e)(3).
266. HOUSE REPORT, supra note 66, discussing the effect of § 1121(e)(3) states: "If a trustee has been appointed, if the debtor does not meet the 120-day deadline, or if the debtor does meet that deadline but fails to obtain the required consents within 180 days after the filing of the petition, then any party in interest may propose a plan." Id. at 406. (emphasis added)
file a plan; any party in interest may file a plan at any time after the appointment.\textsuperscript{268} In this context the debtor is a party in interest\textsuperscript{269} and is entitled to file a plan if he chooses.

B. Classification of Claims or Interests

Basic to the formulation of any plan is the classification of claims and interests. The plan may classify claims or interests as long as each class is composed of substantially similar claims or interests.\textsuperscript{270} However, small unsecured claims, whether or not substantially similar, may be designated as a separate class, subject to court approval, as an administrative convenience.\textsuperscript{271} Under Chapter XI of the Bankruptcy Act and the Rules, the need for this treatment was greater because a filed but nonvoting claim was counted as a negative vote, whereas plan provisions for payment of those claims in full meant that they were not "materially and adversely affected," rendering it unnecessary for the class to vote at all. There is less need for such a provision under the Code because the majorities required for acceptance of a plan are based only on those that actually vote;\textsuperscript{272} a nonvote does not count as a rejection, even if the creditor has filed a proof of claim in the case.

C. Contents of a Plan

The mandatory\textsuperscript{273} and permissive\textsuperscript{274} provisions of a plan under chapter 11 of the Code are lifted almost verbatim from Chapter X of the Bankruptcy Act.\textsuperscript{275} It is therefore not surprising that some of these provisions fit a corporation far better than they do the individual debtor.\textsuperscript{276} One mandatory provision of a plan that merits special attention is found in the confirmation section of the Code rather than in section 1123 where one might expect it: a plan is required to accommodate priority claims.\textsuperscript{277} Administrative expenses\textsuperscript{278} and claims arising in the ordinary course of business after commencement of an involun-

\textsuperscript{268} Id. § 1121(c)(1).
\textsuperscript{269} Id.
\textsuperscript{270} Id. § 1122(a).
\textsuperscript{271} Id. § 1122(b).
\textsuperscript{272} Id. § 1126(c).
\textsuperscript{273} Id. § 1123(a).
\textsuperscript{274} Id. § 1123(b).
\textsuperscript{276} E.g., 11 U.S.C.A. § 1123(a)(5)(I), (5)(J), (6), (7) (West 1979).
\textsuperscript{277} Id. § 1129(a)(9).
\textsuperscript{278} Id. § 507(a)(1).
tary case and before the appointment of a trustee or entry of the order for relief. Priority wage claims, contributions to employee benefit plans, and consumer deposits may be classified and provided for on a deferred basis, but payment in cash will be required for any such class that fails to accept the plan. Priority tax claims, on the other hand, may be paid over a period of time not exceeding six years after the date of assessment of the tax, and consent to such treatment by the taxing authority is not required. These changes in prior law to permit deferred payment are designed to reduce the cash requirements for confirmation.

Some old case law is overruled, and a plan may provide for liquidation of the property of the debtor, in whole or in part, and distribution of the proceeds of the sale among holders of claims and interests.

D. Disclosure Statement

In cases under chapter 11, large and small alike, before there may be any post-petition solicitation of acceptances of a plan, the proponent must submit to the court, and obtain court approval of, a disclosure statement. This requirement is new; nothing comparable to it appeared in the Bankruptcy Act. The disclosure statement requirement may be the most significant aspect of new chapter 11. Indeed, it has been labeled as the pivotal concept of a reorganization case and the "key" to the consolidated chapter. As the House report states:

The premise underlying the consolidated chapter 11 of this bill is the same as the premise of the securities laws. If adequate disclosure is provided to all creditors and stockholders whose rights are to

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279. Id. § 507(a)(2).
280. Id. § 1129(a)(9)(A).
281. Id. § 507(a)(3).
282. Id. § 507(a)(4).
283. Id. § 507(a)(5).
284. Id. § 1129(a)(9)(B).
285. Id. § 507(a)(6).
286. Id. § 1129(a)(9)(C).
287. See, e.g., In re Pure Penn Petroleum Co., 188 F.2d 851 (2d Cir. 1951) (not permitting a liquidating plan); In re Northern Ill. Dev. Corp. 324 F.2d 104 (7th Cir. 1963), cert. denied 376 U.S. 938 (1964).
289. Id. § 1125(b).
be affected, then they should be able to make an informed judgment of their own, rather than having the court or the Securities and Exchange Commission inform them in advance whether the proposed plan is a good plan. Therefore, the key to the consolidated chapter is the disclosure section.\(^292\)

A disclosure statement may be approved by the court only if it contains “adequate information,” which is defined 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, that 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.”\(^293\) A typical investor would be one having a claim or interest of the relevant class and the same ability to obtain information from sources other than the disclosure statement as other holders of the same class generally have.\(^294\)

Despite a specific provision in the Code that the adequacy of the disclosure statement is not to be governed by any otherwise applicable nonbankruptcy law, rule, or regulation,\(^295\) there are indications that the SEC, which has the right to raise an issue in a chapter 11 case and to appear and be heard on it,\(^296\) will attempt to convince the bankruptcy courts that these disclosure statements must comply with its own regulations. While no doubt there will arise some overlap between SEC definitions of “adequate disclosure” and those developed by bankruptcy courts, Congress clearly has made securities laws inapplicable in a reorganization case.\(^297\) Congress also has pared down the authority of the SEC to press this issue beyond the bankruptcy court. The SEC and state blue sky agencies may not appeal from an order approving the disclosure statement.\(^298\) The Code contains a “safe harbor” provision that immunizes any person who, in good faith and in compliance with the provisions of chapter 11, solicits or participates in the offer, issuance, sale, or purchase of a security under a plan from any liability, on account of such solicitation or participation, for violation of any federal or state law, rule, or regulation governing the offer, issuance, sale, or purchase of securities.\(^299\) It provides protection from legal lia-

\(^{292}\) Id.

\(^{293}\) Id. § 1125(a)(1) (West 1979).

\(^{294}\) Id. § 1125(a)(2).

\(^{295}\) Id. § 1125(d)(2).

\(^{296}\) Id. § 1109(a).

\(^{297}\) Id. § 1125(d).

\(^{298}\) Id.

\(^{299}\) Id. § 1125(e).
bility as well as from injunctive action by the SEC or other agency or official.\textsuperscript{300}

The same disclosure statement must be transmitted to each holder of a claim or interest of a particular class, but different disclosure statements, differing in amount, detail, or kind of information, may be transmitted to different classes. This provision is intended to permit flexibility in the preparation and distribution of the required disclosure.\textsuperscript{301} The disclosure statement must be approved prior to submission of the plan for a vote and must accompany the plan or a summary upon the plan's transmittal.\textsuperscript{302}

In the event the debtor seeks confirmation of a prepetition plan based in whole or in part upon prepetition acceptances, the issue of disclosure is treated differently. Prepetition acceptances may be counted only if the solicitation was in compliance with any applicable nonbankruptcy—that is, securities—laws.\textsuperscript{303} If the prepetition solicitation was of a type not governed by any nonbankruptcy law, then these acceptances will be counted only if the court finds that there was in fact adequate disclosure.\textsuperscript{304} Prepetition solicitation is not covered by the "safe harbor" provision of section 1125(e).\textsuperscript{305}

The hearing on approval of the disclosure statement is one of the major procedural hearings in a reorganization case.\textsuperscript{306} Although this hearing essentially replaces the old Chapter X hearing on approval of the plan, the Code does not require a valuation of the business as a predicate to court approval of the disclosure statement unless adequate information cannot be provided without such a valuation. If no securities\textsuperscript{307} are to be issued under the plan, a valuation hearing in all probability will not be necessary.\textsuperscript{308}

Experience has proved that even a relatively simple disclosure statement can be a very expensive exercise. Should a certified audit of the debtor's books and records be required as a predicate for the statement, the combined cost will be frightful. If in addition there must be a valuation of the business, it is clear that the total cost will be of such

\begin{footnotes}
\footnotetext{300}{House Report, \textit{supra} note 66, at 408; Senate Report, \textit{supra} note 103, at 122.}
\footnotetext{301}{House Report, \textit{supra} note 66, at 227.}
\footnotetext{302}{Id. \textit{supra} note 66, at 227.}
\footnotetext{303}{11 U.S.C.A. \textsection 1125(b) (West 1979).}
\footnotetext{304}{Id. \textsection 1126(b)(2).}
\footnotetext{305}{Id.}
\footnotetext{306}{Id.}
\footnotetext{307}{See 11 U.S.C.A. \textsection 101(35) (definition of "security").}
\footnotetext{308}{House Report, \textit{supra} note 66, at 227.}
\end{footnotes}
magnitude that only a major business will be able to survive the process.

E. Acceptance of the Plan

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

Under the Code, a class of creditors has accepted a plan when creditors holding a majority in number and two-thirds in amount of claims in the class vote to accept it. A class of equity security holders has accepted the plan when two-thirds in amount of interests in the class vote to accept it. In both instances, the vote is computed on the basis only of creditors and interest holders who actually vote. The negative vote imputed to a creditor or interest holder who had filed a proof of claim or interest but did not vote on the plan is gone.

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

F. Impairment of Claims or Interests

The Bankruptcy Act concept of “materially and adversely affected” classes has been replaced by the concept of “impairment” of

309. 11 U.S.C.A. § 1126(c) (West 1979).
310. Id. § 1126(d).
312. 11 U.S.C.A. § 1126(c), (d) (West 1979).
313. Id. § 1126(f).
314. Id. § 1126(g).
315. Id. § 1129(b).
claims or interests. A class of claims or interests is impaired under a plan unless the plan “leaves unaltered the legal, equitable, and contractual rights” of the class, cures any default that occurred before commencement of the case, or pays the holders in cash. If by these standards a class is impaired, its acceptance of the plan is required for confirmation: if an impaired class does not accept, the cram down must be invoked, and the plan must be “fair and equitable” to that class and any below it.

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

X. CONFIRMATION OF THE PLAN

The first six requirements for confirmation of a plan are copied from Chapter X of the Bankruptcy Act. There are no surprises here. The vital requirements for confirmation are found in subparagraphs (7) and (8) of section 1129(a) of the Code. It has been reported that the

318. Id. § 1124(1).
319. Id. § 1124(2).
320. Id. § 1124(3).
321. Id. § 1129(a)(8).
322. Id. § 1129(b).
323. Id. § 1129(2).
324. Id.
325. Id. § 365(b)(2).
326. Id. § 1129(a)(1)-(6).
design of the Code drafters was to adopt the interest of creditors test of Chapter XI of the Bankruptcy Act and to avoid the fair and equitable test of Chapter X whenever a chapter 11 plan has been accepted by all impaired classes of claims and interests. The question is whether they have achieved that noble purpose.

Even though each impaired class has accepted the plan by the requisite majorities, the court still must find, with respect to each class, that each holder of a claim or interest within that class who voted against the plan will receive or retain under the plan property of a value that is not less than the amount that he would receive or retain if the debtor were liquidated under chapter 7 on the effective date of the plan. If even one holder of a claim or interest who voted against the plan will receive or retain less, the plan cannot be confirmed. This requirement can produce a result not anticipated by the reformers and the drafters. It can produce a situation in which all necessary classes of claims and interests have accepted the plan by overwhelming majorities and the plan still cannot be confirmed because one dissonant creditor may receive more if the debtor is liquidated under chapter 7.

Determination of the hypothetical distribution in a liquidation under chapter 7 is no simple matter. The court will have to consider the various subordination provisions that apply in chapter 7 as well as the tax-claim postponement provisions. The rules regarding partnership distributions and distributions of community property must be fully accommodated as well.

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

What happens when all classes of creditors and interests do not

329. Senate Report, supra note 103, at 126.
330. Id. § 1129(a)(8).
331. Id. § 1129(a)(7).
332. Id. §§ 510, 726(a)(3)-(4).
333. Id. § 724.
334. Id. § 723.
335. Id. § 726(c).
accept a plan? Impaired classes that do not accept a plan are protected by the fair and equitable rule. The Code attempts to describe the meaning of "fair and equitable" for the purposes of chapter 11. Section 1129(b)(2) is divided into three subsections, dealing with when a plan is fair and equitable insofar as secured creditors, unsecured creditors, and ownership interests are concerned. When the cram down must be invoked, the plan may be confirmed only if the nonaccepting class or classes are dealt with in a manner that meets the appropriate standards announced in the statute. The entire concept is mind-boggling. Even one of the drafters of these provisions has described an understanding of the cram down as requiring "a torturous journey through the statute and legislative history that is fraught with complex concepts, terms of art, and innuendoes." Discussion of those provisions is deferred to those persons who purport to understand them.

XI. THE DISCHARGE

The discharge that results from confirmation of a plan of a corporation or a partnership is a discharge of all obligations of the debtor to creditors, regardless of whether those creditors are dealt with under the plan or participate in the reorganization. These are entities that are not entitled to a discharge in a chapter 7 case. However, the individual debtor, who is entitled to a discharge in chapter 7, gets no better discharge than he would receive in chapter 7; he still must face debts excepted from discharge under section 523 of the Code. No explanation is attempted in the legislative history of this provision, which results in such rank discrimination against the well-intentioned individual debtor.

336. Id. § 1129(b)(1).
337. Id. § 1129(b)(2).
338. Id. § 1129(b)(2)(A).
339. Id. § 1129(b)(2)(B).
340. Id. § 1129(b)(2)(C).
342. Klee, supra note 341; Pachulski, Cram Down and Valuation Under Chapter 11 of the Bankruptcy Code, this symposium.
344. Id. § 727(a)(1).
345. Id.
346. Id. § 1141(d)(2).
XII. Conclusion

The reformers' attempt to cure flaws that they saw in the two-track system of Chapters X and XI of the Bankruptcy Act, some of which may have been real, many of which to these writers seem imaginary, has resulted in a clear case of overkill. The consolidated chapter has not been made more expeditious. New chapter 11 promises a reorganization procedure as time consuming and as expensive as old Chapter X. Early litigation over adequate protection and the appointment of a trustee will lengthen the time and increase the costs associated with the debtor's efforts at reorganization. If the debtor is fortunate enough to make it over this first hurdle, it is then faced with correcting the operational deficiencies that brought it into the court, then with preparing a plan, and then with preparing a disclosure statement that will adequately inform its creditors and investors of its chances of rehabilitation, an exercise that will sap even further the debtor's time, energy, and money.

With the consolidated chapter's failure to maintain the expeditious contours of old Chapter XI, we cannot believe that the new procedure can be "more equitable." If the reformers' definition of that phrase means more leverage and control for the secured creditors, the Code has achieved it. However, a more fundamental question remains unanswered: is the procedure truly more equitable if it diminishes the debtor's chances of rehabilitation to the point that it also undermines the very purposes behind these controls? The fates of unsecured creditors and equity security holders ride in tandem with the fate of the debtor. Equity for these participants depends on continuation of the debtor's business, not on the whim of the auction block or the secured creditor's foreclosure sale.

We predict that the additional strictures and the more burdensome procedures of new chapter 11 will account for increasing failures in the reorganization court. The reformers have needlessly realigned the competing interests in a reorganization case at the expense of small and middle-sized debtors, who in all probability will not survive the process.