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PROCEDURE AND REHABILITATION UNDER CHAPTER XII OF THE BANKRUPTCY ACT

Chapter XII of the Bankruptcy Act, which provides for real property arrangements for persons other than corporations, has had a torpid existence since it was enacted as part of the Chandler Act in 1938. Recently, however, Chapter XII and its provisions, particularly section 461(11) which has been termed the “cram-down” provision, have been the subject of renewed interest and controversy prompted by a dramatic increase in the number of petitions filed under the Chapter. The principal factor contributing to the increase in filings is a growing awareness that limited partnerships are eligible for protection under Chapter XII. Because of income tax advantages,

3 See note 132 infra.
4 Between June, 1938 and March, 1974, only one petition under Chapter XII was filed in the Northern District of Georgia. In the twenty months subsequent to March, 1974, thirty-five such petitions were filed. In re Pine Gate Assoc., 2 Bankr. Ct. Dec. 1478, 1480 n.12 (N.D. Ga. 1976), cert. denied, 45 U.S.L.W. 3501 (U.S. Jan. 25, 1977) (No. 76-742). Approximately one third of all Chapter XII petitions ever filed were filed in 1975 and 1976. Id.
5 A catalyst for the reawakened interest in Chapter XII was the publicity given the filing under the Chapter by the $100 million Colony Square development project in Atlanta, Georgia. Harvey, A Guide to Real Property Arrangements Under Chapter XII of the Bankruptcy Act, 5 REAL ESTATE L.J. 211 (1977) [hereinafter cited as Harvey]. See BUS. WEEK, Nov. 3, 1975, at 70; Montgomery, Reopened Chapter: Real-Estate Slump Helps to Revive Use of Long-Dormant Bankruptcy Provision, Wall St. J., Sept. 29, 1976, at 12, col. 1. See also Minard, Numbers Game: The Chapter 12 Cloud, FORBES, April 15, 1977, at 74.
6 See note 4 supra, and text accompanying note 26 infra.

Investment in a limited partnership secures for the limited partner a tax shelter for his income. The partnership is not subject to tax liability as an organization; instead, the partners are liable in their individual capacities. I.R.C. § 701. Thus, a limited partner is insulated from liability for partnership obligations in excess of his investment, but his income from the partnership is not additionally taxed at the organizational level as it would be had the partner invested in a corporation. P. ROHAN, REAL ESTATE TRANSACTIONS: REAL ESTATE FINANCING § 2.02 [1,2], at 2-4, 2-5-6 (1976). Consequently, a limited partner may deduct from personal income such items as the share attributable to his contribution to the partnership of partnership losses up to the amount of his contribution, of interest on loans to the partnership, and of depreciation of completed real estate projects owned by the partnership. Watkins, The Real Estate Debtor - I, in BANKRUPTCY: REORGANIZATION AND REHABILITATION 227, 229 (1972) (prepared for a Practicing Law Institute Seminar, Macey, Chairman) [hereinafter cited as Watkins]. See I.R.C. §§ 702(a), 704(d). Formerly, the limited partner could qualify for loss deductions in excess of his investment in the partnership.
within the past twenty years limited partnerships have become a favorite vehicle for owning, capitalizing, and managing real estate developments. The recent economic recession has resulted in many of these partnerships becoming either insolvent or, because of diminishing cash-flow, unable to pay their obligations as they accrue. Chapter XII provides a unique opportunity for insolvent individuals and partnerships to adjust the terms of their obligations while operating their businesses and retaining possession and control of their property.

An "astounding paucity of authority" on Chapter XII impedes analysis of the Chapter and creates uncertainty concerning the scope and ramifications of its provisions. In contrast with other chapters of the Bankruptcy Act, relatively few judicial decisions have been recorded that deal with Chapter XII. Furthermore, the Chapter's meager legislative history provides little illumination of its intended scope. Consequently, Chapter XII is best understood through analysis of its basic provisions in relation to analogous provisions of other Bankruptcy Act chapters, particularly Chapters X and XI.

because his proportionate share of partnership liabilities were added to his contribution to determine his basis in the partnership. Treas. Reg. § 1.752-1(e) (1956). The limited partner may no longer include in his basis any proportion of partnership obligations for which he is not personally liable. Tax Reform Act of 1976 § 213(e), 90 Stat. 1547, amending I.R.C. § 704(d).


Arnold, New Interest in Chapter XII Bankruptcy Proceedings, 5 Real Est. L.J. 66 (1976); Lifton, supra note 7, at 1981. See note 4 supra.

The purpose of Chapter XII is to allow the debtor to rehabilitate himself by extending the time for payment of his creditors and by adjusting the terms of his obligations while remaining in possession of his property. Bass v. Dick, 296 F.2d 912, 914 (7th Cir. 1961).


CHAPTER XII

I. Who May File a Chapter XII Petition

Only a debtor may file a petition for an arrangement under Chapter XII. "Debtor" is defined as a person, other than a corporation, who may become a bankrupt under section 3 of the Act.

A Chapter XII arrangement is "any plan which has for its primary purpose the alteration or modification of the rights of creditors. . . . holding debts secured by real property or a chattel real" legally or equitably owned by the debtor. Bankruptcy Act § 406(1), 11 U.S.C. § 806(1) (1970). Under Chapter XI an arrangement is a plan providing for the settlement, satisfaction, or extension of time for payment of the debtor's unsecured debts. Bankruptcy Act § 306(1), 11 U.S.C. § 706(1) (1970).


Bankruptcy Act § 1(8), 11 U.S.C. § 1(8) (1970) defines "corporation" as including bodies having powers and privileges of private corporations not possessed by individuals or partnerships, partnership associations if the subscribed capital alone is responsible for association debts, joint-stock companies, unincorporated businesses and associations, and any business conducted by trustees when ownership or beneficial interest is evidenced by written instrument. This definition is crucial because it includes a variety of companies and associations not normally considered corporations. See generally 1 COLLIER, supra note 18, ¶ 1.08.

Although limited partnership interests may be considered securities, see Hrusoff, Securities Aspects of Real Estate Partnerships, 11 CALIF. W.L. REV. 425, 425-29 (1975), no provision is made in Chapter XII for intervention by the Securities and Exchange Commission (SEC). Hunt, The Proper Use of the Chapters X, XI, and XII of the Bankruptcy Act, 13 Ref. J. 97, 100 (1939). If limited partnership interests or obligations of the partnership are held by the investing public, the SEC might seek to intervene in the Chapter XII proceedings through Fed. R. Civ. P. 24, although it is doubtful such an attempt would be successful. See Give the Debtor Relief, 15 Ref. J. 22, 26-27 (1940). But see SEC v. United States Realty & Improvement Co., 310 U.S. 434 (1940) (where statutory duties of SEC require intervention in Chapter XI proceedings, SEC may intervene under Fed. R. Civ. P. 24 to seek dismissal of Chapter XI petition). Bankruptcy Act § 328, 11 U.S.C. § 728 (1970), permitting the SEC to intervene in Chapter XI proceedings to seek conversion to Chapter X proceedings, was added to the Bankruptcy Act in 1952 in response to United States Realty. See H.R. REP. NO. 2320, 82d Cong., 2d Sess. 19, reprinted in [1962] U.S. CODE CONG. & AD.
who files a petition\textsuperscript{23} under Chapter XII, and who is the legal or equitable owner of real property or chattel real\textsuperscript{24} which stands as security for any debt. The person’s interest in the property subject to the proposed arrangement, however, must be more than merely a right of redemption from a sale before the petition was filed.\textsuperscript{25} A

News 1960, 1979. The reasoning of United States Realty might be applied to permit intervention by the SEC in Chapter XII proceedings where real property of a corporation is transferred to private ownership for the sole purpose of filing a Chapter XII petition. Cf. Sherman v. Collins, 75 F.2d 62 (8th Cir. 1934) (corporate entity not ignored where sole proprietor of corporation transferred corporation’s trust deed).


\textsuperscript{23} The significance of § 3 of the Bankruptcy Act is that it culls certain persons who cannot become bankrupt. A person other than a municipal, banking, or insurance organization, or a building and loan association may become a voluntary bankrupt. Bankruptcy Act § 3a, 11 U.S.C. § 22(a) (1970). Any natural person or corporation, with certain exceptions, may become an involuntary bankrupt. Bankruptcy Act § 3b, 11 U.S.C. § 22(b) (1970). \textit{See generally} 1 \textit{COLLIER}, supra note 18, at \S 4.01-.21.

\textsuperscript{24} "Petition" is defined as a document filed in a court of bankruptcy or with the clerk thereof which initiates bankruptcy proceedings. Bankruptcy Act § 1(24), 11 U.S.C. § 1(24) (1970). The official form for an original petition under Chapter XII is Form No. 12-F1. The official form for a Chapter XII petition in a pending bankruptcy proceeding is Form No. 12-F2.

\textsuperscript{25} A chattel real is an interest in real estate that is less than a freehold interest. 9 \textit{COLLIER}, supra note 18, \S 2.02, at 755. The estate for years is an example of such an estate. T. BERGEN & P. HASKELL, \textit{Preface To Estates in Land and Future Interests} 42-43 (1966).

\textsuperscript{26} The limitation that a debtor must be legal or equitable owner of an interest in real property correlates with the requirement under Bankruptcy Act § 406(1), 11 U.S.C. § 806(a) (1970), that a Chapter XII arrangement must have for its primary purpose the arrangement of secured obligations. 9 \textit{COLLIER}, supra note 18, \S 2.07, at 763. The purpose of the provision excluding from the category of debtors anyone holding merely the right to redeem from a sale prior to filing of the petition is to restrict the bankruptcy court’s jurisdiction to property not actually sold as of the date of the petition. \textit{Id.} at 765. Equity of redemption after a sale is distinguished from an equity of redemption prior to sale remaining in a mortgagor after execution of a mortgage deed in a title theory jurisdiction. The latter transaction leaves equitable title remaining in the mortgagor; this interest is sufficient to enable the mortgagor to become a debtor
partnership may be a person and thus eligible to petition for an arrangement under Chapter XII.26


Whether a person has an interest in property sufficient to invoke bankruptcy court jurisdiction has been one of the more frequently litigated issues under Chapter XII. A person whose property has been sold at a foreclosure sale prior to the filing date of his petition, and who has no equity of redemption cannot qualify as a debtor under Chapter XII. 9 REMINGTON, supra note 21, § 3699, at 378. See Tinkhoff v. Gold, 156 F.2d 405 (7th Cir. 1946). In other instances, whether a person may be a debtor is not readily apparent.

A beneficiary under a so-called “Illinois” land trust is owner of a “fundamental” interest in land sufficient to qualify him as a debtor under Chapter XII. In re Gordon & Picard, 2 Bankr. Ct. Dec. 1269, 1273 (N.D. Ill. 1976). For general discussions of “Illinois” land trusts, see Arntson, The Virginia Land Trust - An Overlooked Title Holding Device for Investment, Business & Real Estate, 30 WASH. & L. REV. 73 (1973) (“Illinois” land trust as adopted by statute in Virginia); Turner, Some Legal Aspects of Beneficial Interests Under Illinois Land Trusts, 39 ILL. L. REV. 216 (1945). Similarly, owners of fractional interests in a parcel of property that is part of a shopping center, but whose interests are in the nature of an investment because they have no right to partition the property, no right of possession, and no right to encumber, lease, or improve the property, are nevertheless entitled to file a Chapter XII petition. Owners of “SW 8” Real Estate v. McQuaid, 513 F.2d 558, 562 (9th Cir. 1975). Where, however, members of a partnership hold property not as partners, or in trust for the partnership, but as individual trustees in common, the partnership may not file. Ellis v. Yumen, 324 F. Supp. 1314, 1318 (D. Hawaii 1971). Neither may only one of two tenants by the entirety petition under Chapter XII. In re Chalkley, 34 F. Supp. 969, 970 (E.D. Tenn. 1940). Whether the devisee of a life estate in encumbered property may file under the Chapter is questionable. 9 REMINGTON, supra note 21, § 3699, at 378. See Iden v. New York Life Ins. Co., 107 F.2d 695 (4th Cir. 1939) (per curiam) (“assuming without deciding” that devisee of life estate may file Chapter XII petition).

The person filing need not be personally obligated on the debt that is secured by the property. If he acquires property subject to a mortgage without assuming the obligation, he may file a Chapter XII petition. Watkins, supra note 6, at 248.


Generally, state law is applied to determine whether a partnership has those characteristics which enable it to become a debtor under Chapter XII. 9 COLLIER, supra note 18, ¶ 4.02, at 833. See In re Helmwood Apts., 2 Bankr. Ct. Dec. 1151, 1152 (N.D. 1977).
In contrast, only corporations can qualify for reorganization under Chapter X, and although under Chapter XI persons and therefore partnerships may petition and file plans for arrangements, only unsecured obligations can be adjusted under that Chapter. Thus, a proceeding under Chapter XII is the appropriate avenue for persons other than corporations to seek adjustments in both their obligations secured by real property and unsecured obligations.

Additionally, the Chapter XII petition must allege that the debtor is either insolvent or unable to pay his obligations as they accrue. A person is deemed insolvent when the fair value of his real property is less than the total amount of his debts.

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30 In re Potts, 47 F. Supp. 990, 991 (E.D. Ky. 1942), aff'd in part, rev'd in part, 142 F.2d 883 (6th Cir. 1944).

31 Bankruptcy Act § 423, 11 U.S.C. § 823 (1970). Inability to pay debts as they accrue is the equitable definition of "insolvency." Finn v. Meighan, 325 U.S. 300, 303 (1945). The equitable test of insolvency is separate and distinct from that defined in the Bankruptcy Act. Langham, Langston & Burnett v. Blanchard, 246 F.2d 529, 532 (5th Cir. 1957). For the statutory definition of "insolvency," see text accompanying note 32 infra. The principal significance of the provision permitting an equitably insolvent debtor to petition under Chapter XII is that the debtor may obtain relief under the Chapter at a time prior to when his creditors might seek to force a sale of the debtor's property in order to enforce their liens on the property. 9 COLLIER, supra note 18, ¶ 4.06 [5], at 845-46.

II. The Petition and Its Effects

A debtor may file an original petition under Chapter XII with any court that would have jurisdiction to adjudicate the petition. The mere filing of the petition operates as an automatic stay of any proceeding to enforce a lien on the real property of the debtor. Consequent-
sequently, the property comes within the exclusive jurisdiction of the court when the petition is filed, and if the property is sold in enforcement of a lien after filing of a petition, such sale is invalid. After notice to the debtor and other parties in interest and a hearing, the automatic stay may be dismissed in whole or in part.


When the petition is filed, the debtor’s estate is usually entitled to receive rents and payments from the property, with expenditure of such receipts limited to expenses of administration. Charlestown Sav. Bank v. Martin (In re Colonial Inv. Co.) 516 F.2d 154, 160 (1st Cir. 1975). If, however, the mortgage provides that immediately upon default the mortgagee becomes entitled to receive such payments, subsequent filing of a Chapter XII petition does not divest the mortgagee of his right to such receipts. Great W. Life Assurance Co. v. Rothman (In re Ventura-Louise Properties), 490 F.2d 1141, 1145 (9th Cir. 1974). Where a trustee, despite a clause in the mortgage granting the mortgagee an immediate right to receipts upon default, collects and disburses receipts from the property, the mortgagee is deemed to have held an equitable lien on such proceeds and is entitled to an order directing reimbursement from the trustee of proceeds received subsequent to the filing of a Chapter XII petition. In re Pittsburgh-Duquesne Dev. Co., 482 F.2d 243, 244 (3d Cir. 1973). If under such a clause in the mortgage an assignment of the right to receive rents and payments is not absolute, the bankruptcy court obtains jurisdiction over those receipts. In re 1616 Reminic Ltd. Partnership, 2 Bankr. Ct. Dec. 563, 564 (E.D. Va. 1976).

36 Meyer v. Rowan, 181 F.2d 715, 716 (10th Cir. 1950). See Potts v. Potts, 142 F.2d 883, 888 (6th Cir. 1944).


During pendency of the Chapter XII proceedings the value of the debtor’s property may diminish resulting in loss to creditors if the petition is subsequently dismissed. See text accompanying notes 58-61 infra. Thus, the hearing on whether the stay should be dismissed, if such hearing is sought by creditors, should be held promptly so as to comply with initial due process requirements that creditors not be deprived finally of their interest in the debtor’s property without notice and an opportunity to be heard. First Nat’l Bank v. Robinson (In re B & B Properties, Ltd.), 423 F. Supp. 23, 25 (N.D. Ga. 1976). See Mitchell v. W.T. Grant, 416 U.S. 600, 611 (1974). An automatic stay, however, should not be dismissed so far as it concerns proceedings to enforce liens on
cause for dismissal of the stay with respect to particular proceedings is indicated if the proceedings stayed are for collection of a nondischargeable obligation. Thus, a stay of proceedings to collect child support payments in default should be dismissed if the proceedings do not interfere with administration of the debtor’s estate or affect the real property that is the subject of the proposed Chapter XII arrangement.

If a debtor is involved in pending bankruptcy proceedings he may file a Chapter XII petition prior to his adjudication. Section 425 of the Bankruptcy Act provides that the filing of a petition under these circumstances does not operate as a stay of other bankruptcy proceedings, but invests the court with power to grant such a stay if necessary for protection of the debtor’s estate. The Federal Bankruptcy Rules change the thrust of this provision, however, by auto-

real property unless there is a substantial likelihood that no plan for arrangement will eventually be confirmed. Dismissal of the stay would permit creditors to foreclose on the debtor’s property, thus effectively ending the Chapter XII proceeding. See Reliance Standard Life Ins. Co. v. Pembroke Manor Apts., 547 F.2d 805 (4th Cir. 1977).

Various other sections of Chapter XII provide for issuance of stays and injunctions. See Bankruptcy Act § 507, 11 U.S.C. § 907 (1970) (court may enjoin prior foreclosure, equitable or other proceedings in federal or state courts in which receiver or trustee of debtor’s property has been appointed). Section 414 of the Bankruptcy Act empowers the court for cause shown to stay or enjoin suits against a debtor, or other proceedings to enforce liens on a debtor’s property. 11 U.S.C. § 814 (1970). See In re Kunz, 28 F. Supp. 730 (D. Mont. 1939). In view of § 428 which provides that the filing of a Chapter XII petition operates as an automatic stay of proceedings against the debtor’s real property, § 414 appears superfluous. In re Decker, 465 F.2d 294, 297 (3d Cir. 1972). The language of § 414 is broader than that of § 428, however, and permits the court to enjoin any suit against the debtor, not merely suits to enforce a lien on the debtor’s real property. The bankruptcy rules supercede § 414 by providing that filing of the Chapter XII petition stays any proceedings, whether or not to enforce a lien on property, against a debtor. Fed. Bankr. R. 12-43(a). See generally 9 COLLIER, supra note 18, at ¶¶ 3.06, 4.16.

Section 477 of the Bankruptcy Act, 11 U.S.C. § 877 (1970), provides the bankruptcy court with an additional power to issue injunctions. Upon confirmation of a proposed plan for an arrangement, see text accompanying notes 119-125 and 127-130 infra, the court may enter such injunctions which are equitable and necessary to put the plan into effect. Bankruptcy Act § 477, 11 U.S.C. § 877 (1970).

Debts exempt from discharge are enumerated in Bankruptcy Act § 17a, 11 U.S.C. § 35(a) (1970).

Hernandez v. Borgas, 343 F.2d 802, 806-07 (1st Cir. 1965).


matically staying the adjudication and administration of the debtor's estate within the pending proceeding. Similarly, as where an original petition is filed, the court may dismiss or modify the stay for cause shown.

Prior to enactment of the Chapter XII rules, the debtor's petition was required to contain the provisions of his plan for arrangement. Under the rules, however, the plan may accompany the petition, or be filed within a time as required by the court. The petition must be accompanied by payment of fees, a statement of the debtor's executory contracts, schedules of all his debts, and a general statement of his affairs. The debtor, however, need not comply with the requirements for filing of statements and schedules if he includes with his petition a list of his creditors, their addresses, and a summary statement of his assets and amounts owed. When such statements are included, a plan will be accepted by the court if filed within 15 days of the filing date of the petition. Upon application, the court may grant up to 30 additional days within which the petition can be filed. The statutory provision for time extensions was added in 1952 to standardize filing procedures. The requirement that exten-

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43 Id. See generally 9 COLLIER, supra note 18, at ¶ 4.13.
45 Fed. Bankr. R. 12-36(a). The requirement that a petition be accompanied by debtor's plan for arrangement was formerly an occasional deterrent to filing of petitions under Chapter XII. Lifton, supra note 7, at 1961 n.114. Debtors often petitioned under Chapter XII because of the threat of foreclosure proceedings, with the result that the debtor either did not have an opportunity to draft a plan, or filed hastily drafted and unrealistic plans. See 9 COLLIER, supra note 18, at ¶ 4.08. Cf. S. Rep. No. 2094, 86th Cong., 2d Sess. 2, reprinted in [1958] U.S. CODE CONG. & AD. NEWS 3804, 3805 (discussion of reasons for amending similar § 323 of Chapter XI of the Bankruptcy Act, 11 U.S.C. § 723 (1970)). The new rule liberalizes the requirement within which time the plan must be filed. Lifton, supra note 7, at 1963. No provisions of Chapter XII indicate, however, that a debtor is provided with an indefinite period of time for rehabilitation. Therefore, if the debtor fails to file his plan within the time set by the court, dismissal of the petition is appropriate. In re Matthewson, 406 F.2d 406, 407 (3d Cir. 1969).
47 “Executory contract” is defined as including unexpired leases of real property. Bankruptcy Act § 406(4), 11 U.S.C. § 806(4) (1970). The definition is not restrictive, but is broad enough to include all contracts pertaining to any subject matter so long as future performance is required by the debtor. 9 COLLIER, supra note 18, at ¶ 2.05.
49 The 15 day time extension is provided by Fed. Bankr. R. 12-11(b).
50 Id.
sions be granted only for cause shown should, however, be strictly enforced.53

After the Chapter XII petition is filed the bankruptcy court has power, upon notice to the contractual parties, to cancel any executory contracts of the debtor.54 A contract is executory if any future performance by the debtor is required.55 If not, the contract is not executory and cannot be rejected. Any person injured by the rejection of an executory contract is considered an unsecured creditor possessing a claim in the amount by which he was injured.56

The bankruptcy court also may authorize the lease or sale of the debtor’s property57 so long as the lease or sale benefits the debtor’s estate or aids in achieving the objectives of the Chapter XII proceedings.58 If, however, the court approves continuing the operation of the debtor’s business, any sale or lease of real property that is a normal incident of the business need not be approved by the court.59

During pendency of the Chapter XII proceedings the value of the debtor’s estate may diminish from its value on the date the petition was filed.60 Correlated with this possibility is the further possibility that the Chapter XII petition might be dismissed, prompting adjudication of the debtor as bankrupt and liquidation of his estate as in ordinary bankruptcy proceedings.61 Consequently, to protect credi-

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56 See note 48 supra.
59 9 Collier, supra note 18, ¶ 3.04, at 801.
60 Id. See text accompanying notes 71-75 infra.
61 9 Collier, supra note 18, ¶ 4.14 [1], at 866.
62 Id. See, e.g., Nanz Trustee, Inc. v. American Nat’l Bank & Trust Co., 423 F. Supp. 930 (E.D. Wisc. 1977). Fed. Bankr. R. 12-41 (a,b) specifies the conditions under which a Chapter XIII proceeding may be converted to an ordinary bankruptcy proceeding and the debtor adjudged a bankrupt. Conditions under which the proceeding may be converted include, for example, failure of the debtor to comply with orders for indemnification, and failure to secure confirmation of a plan for arrangement. See Bankruptcy Act §§ 481, 482, 511, 11 U.S.C. §§ 881, 882, 911 (1970). When the debtor
tors from diminution of the debtor's assets in the event he is eventually adjudicated a bankrupt, the court may order the debtor to post bond indemnifying creditors against possible diminution of his estate.\textsuperscript{2} If the debtor fails to comply with such an order, the court either may adjudicate the debtor a bankrupt or may dismiss the Chapter XII proceedings.\textsuperscript{3}

\section*{III. Proceedings Subsequent to Filing of Petition}

The primary reason cited for the infrequency of petitions filed under Chapter XII prior to 1975 is that courts formerly, as a matter of common practice, appointed trustees to administer debtors' property.\textsuperscript{4} Appointment of a trustee is disadvantageous to the debtor for several reasons. First, the trustee is vested with the right to possess-

is adjudicated a bankrupt in ordinary bankruptcy proceedings his non-exempt estate is liquidated and the proceeds are distributed to his creditors. \textit{See} note 38 \textit{supra}, and text accompanying note 171 \textit{infra}.

\textsuperscript{2} Section 426 of the Bankruptcy Act provides that a court may require the debtor to indemnify his creditors against loss subsequent to the filing of an original petition filed under Chapter XII. 11 U.S.C. § 826 (1970). \textit{Fed. Bankr. R. 12-19(d)} grants the bankruptcy court power to require such indemnification, but does not restrict exercise of that power to cases where an original petition is filed. The rule is intended to broaden the scope of the statutory provision by permitting courts to require indemnification where a Chapter XII petition is filed in a pending bankruptcy proceeding. \textit{See} Advisory Committee's Note, \textit{Fed. Bankr. R. 12-19(d)}.

The court's power to require indemnification of creditors for losses during pendency of the Chapter XII proceedings is discretionary. Indemnification should not be required unless creditors demonstrate that the value of the debtor's estate is likely to diminish, particularly if the debtor probably will be unable to obtain indemnification bonds, because failure to provide such a bond, if required, would result in dismissal of the Chapter XII petition. \textit{In re Pine Gate Assoc.}, Bankr. Dec. (CCH) \# 66,322 (N.D. Ga. 1976), \textit{cert. denied}, 45 U.S.L.W. 3501 (U.S. Jan. 25, 1977) (No. 76-742). \textit{See} text accompanying note 61 \textit{infra}.


\textsuperscript{4} Lifton, \textit{supra} note 7, at 1964 ("it was generally expected that the court would exercise its discretion" to appoint a trustee). Bankruptcy Act § 432, 11 U.S.C. § 832 (1970) provides that "[t]he court may, upon the application of any party in interest, appoint a trustee of the property of the debtor." Bankruptcy Act § 444, 11 U.S.C. § 844 (1970), provides that if no trustee is appointed the debtor "shall" retain possession and control of his property. \textit{See} Preas \textit{v. Kirkpatrick & Burks}, 115 F.2d 802 (6th Cir. 1940). \textit{Fed. Bankr. R. 12-17(b)}, however, changes the focus of the permissive language of § 444 of the Act, and creates a presumption that where an original petition is filed, or where the Chapter XII petition is filed in a pending bankruptcy proceeding in which no trustee has been appointed, the debtor shall remain in possession and control of his property. \textit{See} text accompanying note 67 \textit{infra}.
sion of all real property and chattels real of the debtor. Second, the trustee is empowered to collect and disburse rents and payments received from the property. Third, if operation of the debtor's business is continued, the trustee assumes management and control. Further, the trustee is entitled to receive compensation from the debtor's estate for his services. Thus, where a trustee is appointed in Chapter XII proceedings, the debtor loses his rights to possession and control of his property, and incurs an additional obligation that must be paid from his estate.

The new Chapter XII rules, however, eliminate this impediment to the filing of petitions under Chapter XII by creating a presumption that a debtor filing either an original petition, or a petition in a pending bankruptcy proceeding in which no trustee has been appointed, shall remain in possession of his property. Although under this rule the debtor initially may remain in possession, upon application of a party in interest and for cause shown the court may appoint a trustee. In contrast, if the Chapter XII petition is filed in a pending bankruptcy proceeding where a trustee has already been ap-

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63 Bankruptcy Act § 441, 11 U.S.C. § 841 (1970) prescribes that a trustee appointed in Chapter XII proceedings becomes vested with the rights and title of a trustee appointed in ordinary bankruptcy proceedings under Bankruptcy Act § 44a, 11 U.S.C. § 72(a) (1970). Under § 70a of the Act, which describes the rights and powers of such a trustee, the trustee when appointed becomes vested with all the debtor's title and rights to possession of his property. 11 U.S.C. § 110(a) (1970). See 9 COLLIER, supra note 18, ¶ 6.01, at 963-64. See also 44 COLLIER, supra, at ¶ 70.04.

64 See note 35 supra.


66 Bankruptcy Act § 491(2), 11 U.S.C. § 891(2) (1970); FED. BANKR. R. 12-28(a). See generally 9 COLLIER, supra note 18, at ¶¶ 11.01, 11.01A.


A debtor in possession retains all his title and rights to possession of his property and, subject to the control of the court, may exercise all the rights of a trustee appointed under Chapter XII. Bankruptcy Act § 444, 11 U.S.C. § 844 (1970). See generally 9 COLLIER, supra note 18, at ¶ 6.04.

68 FED. BANKR. R. 12-17(b). See Bankruptcy Act § 432, 11 U.S.C. § 832 (1970). Circumstances that would indicate there is sufficient cause to appoint a trustee include that the debtor has been out of possession for a significant period of time, that no plan for arrangement has been filed, that, when filed, there exists little reasonable likelihood the plan will be confirmed, and that there is a great likelihood that the property value will deteriorate. Industrial Nat'l Bank v. Gillen, 2 Bankr. Ct. Dec. 95, 96 (S.D.N.Y. 1975).
pointed and has qualified, the same trustee automatically will be appointed as trustee in the Chapter XII proceeding.

Express authorization must be obtained from the court before the debtor in possession or trustee is permitted to continue operation of the debtor's business. Although the power to grant such authorization is discretionary, continuation of the debtor's business represents the norm under Chapter XII proceedings. The bankruptcy court may, however, impose limitations on the conduct of the business, one of the most frequently imposed of which is that the debtor or trustee indemnify creditors against probable losses arising from future business operations. The court's power to require such indemnification is independent of its power to require indemnification of creditors against possible diminution of the value of the debtor's estate during pendency of the bankruptcy proceedings.

Upon application of any parties in interest to the Chapter XII proceedings the court is empowered to appoint one or more appraisers to determine the value of the debtor's property. Appraisal is desirable because it provides creditors with an independent valuation of the property that can be considered in later deciding whether to accept a proposed arrangement. Furthermore, appraisal aids the court in determining at what price the debtor's property should be sold if a sale is to be made either after the petition is filed, or as a part of the proposed Chapter XII arrangement.

After the petition is filed the court must "promptly" call a meeting of the debtor, his creditors, and other interested parties. The meeting must be held within 20 to 40 days after the date the petition

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71 Generally, to qualify as a trustee under Chapter XII a person must have no interest adverse to the estate, be competent to perform his duties, and have a residence or office in the state in which the proceedings are pending. Fed. Bankr. R. 209(d). Rule 209(d) is made applicable to Chapter XII by Fed. Bankr. R. 12-17(d). See generally 9 Collier, supra note 18, at ¶ 5.02.
76 9 Collier, supra note 18, ¶ 6.05, at 974.
77 Id. See text accompanying notes 58-61 supra.
79 9 Collier, supra note 18, ¶ 5.03, at 910.
80 See text accompanying notes 55-57 supra.
81 See text accompanying notes 135-39 infra.
was filed. At the meeting the presiding judge must determine the validity of creditors' claims, may examine witnesses on any matters pertinent to the proceedings, and must also receive and determine the validity of creditors' written acceptances of a proposed Chapter XII arrangement. The requirement that the judge receive acceptances indicates that acceptances, to be considered and counted, must be filed with the court. The further responsibility of the court to determine validity of acceptances involves a twofold inquiry by the court. First, because only creditors affected by the plan are entitled to accept or reject a plan for arrangement, the court must determine which creditors are affected and how many of them have accepted.

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85 The schedule filed by the debtor of his debts and affairs, see text accompanying notes 47-52 supra, is received by the court as prima facie evidence of the validity and amount of those claims if the schedules are uncontested. Fed. Bankr. R. 12-30(a). If allowance of a claim is objected to, the objection must be made in writing. If the objection is coupled with a demand for relief the proceeding becomes an adversary proceeding. Fed. Bankr. R. 12-30(f). Fed. Bankr. R. 701-814 control adversary proceedings in bankruptcy.
86 Before he is able to accept or reject a plan for arrangement, the creditor's claim must first be allowed pursuant to Rule 12-30. Fed. Bankr. R. 12-37(a). See text accompanying notes 85-92 infra.
88 Acceptance of a plan may be obtained before or after the Chapter XII petition is filed. Bankruptcy Act § 436(4), 11 U.S.C. § 836(4) (1970). The section contemplates that acceptances for a creditor's plan for arrangement may be obtained before or after the Chapter XII petition is filed. 9 Collier, supra note 18, at ¶ 5.10. Under Chapter XI acceptances may be obtained only by a debtor before or after a petition is filed. Bankruptcy Act § 336(4), 11 U.S.C. § 7346(4) (1970).
90 Acceptance by all or some number of creditors affected by a plan is a requisite for confirmation. See Bankruptcy Act §§ 467, 468, 11 U.S.C. §§ 867, 868 (1970). The statute provides that a creditor is affected by a plan when his interest will be materially and adversely affected by the plan. Bankruptcy Act § 407, 11 U.S.C. § 807 (1970). Likewise, where the terms and provisions of the obligation owed will be altered, the creditor is affected by the plan. Kyser v. MacAdam, 117 F.2d 232, 238 (2d Cir. 1941). Where, however, the value of the property dealt with by the plan is less than the amount owed under a senior mortgage, subordinate lienors are not affected by a plan which merely provides for the real property of the debtor. In re Hamburger, 117 F.2d 932, 935 (6th Cir. 1941).
91 9 Collier, supra note 18, ¶ 5.10, at 920-21.
This determination is crucial in deciding whether a proposed arrangement should be confirmed. Second, because separate plans can be proposed and subsequently modified by the debtor or creditors, the court must determine which acceptances pertain to which plans if more than one plan has been submitted.

As part of the process of determining the validity of acceptances the court may also direct division of the creditors into classes if such a division is proposed in a plan for arrangement. The division should be made according to the legal nature of the creditor’s claims and the nature of the property standing as security for the claims, with claims of the same character classified together. Thus, two lenders holding first mortgages with identical terms but which cover different properties could be placed in different classes because their securities differ. Concordantly, a lender holding a first mortgage on a particular property, and a second mortgage on the same property, could be placed in a different class for each of his claims because the two claims are of different legal character.

If no appraiser has been appointed the court may find it beneficial for classification purposes to hold a hearing for determination of the value of the property securing the claim. 

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9 Some requisite number of creditors must accept a plan before it can be confirmed. See text accompanying notes 127-30 infra.


92 9 COLLIER, supra note 18, ¶ 5.10, at 921-22.


94 The court may divide creditors into classes for the purposes of the plan and its acceptance. FED. BANKR. R. 12-31(a). Thus, the court may divide creditors into classes only if the plan so provides. 9 COLLIER, supra note 18, ¶ 7.02, at 1006.

95 Bankruptcy Act § 52, 11 U.S.C. § 852 (1970); FED. BANKR. R. 12-31(a). See Kyser v. MacAdam, 117 F.2d 232, 237 (2d Cir. 1941) (mortgage prior to or subordinate to materialmen’s liens should not be placed in same class with liens).

96 9 COLLIER, supra note 18, ¶ 7.06, at 1006.

97 See In re Nob Hill Apts., 2 Bankr. Ct. Dec. 1463 (N.D. Ga. 1976). Nob Hill provides an excellent example of the division of creditors into classes. In Nob Hill the partnership owned two properties, designated Phase I and Phase II. Creditors were divided into six classes for purposes of securing acceptance of the plan and for providing for the creditors under the plan. The holder of a first mortgage on Phase II was placed alone in class 2 with respect to that mortgage, and was also placed alone in class 3 with respect to his second mortgage covering both Phase I and Phase II. The holder of the first mortgage on Phase I was placed alone in class 1. The unsecured creditors were placed in three classes consisting of creditors whose claims arose prior to filing of the Chapter XII petition, creditors whose claims arose after the filing, and creditors whose claims were to be paid in case under the plan. Id. at 1464.
value of the debtor’s property. If the amount of a secured creditor’s claim exceeds the value of the property securing the claim, the creditor becomes an unsecured creditor for the amount by which his claim exceeds the value. Therefore, the creditor, to the extent of the excess, might be placed and provided for in a class alone or with other unsecured creditors.

If a proposed arrangement is accepted, the judge will appoint an agent to receive and disburse any deposits required of the debtor, and will fix the time period within which the deposits must be made. Deposits include any consideration that will be distributed to creditors under the arrangement, and money necessary for payment of costs, expenses of administration of the estate, and any compensation allowed by the court. The court will also fix the times for filing of an application for confirmation of the plan and for a hearing on confirmation.

IV. The Plan for Arrangement and Its Confirmation

Section 461 of the Bankruptcy Act enumerates the various provisions either permitted or required to be included in a proposed plan for arrangement. Among the provisions that may be included in the plan are those for treatment of unsecured creditors in one or more classes, for rejection of executory contracts not earlier rejected by

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90 See Kysur v. MacAdam, 117 F.2d 232, 238 (2d Cir. 1941); 9 Collier, supra note 18, ¶ 7.03, at 1008.
91 See 9 Collier, supra note 18, ¶ 7.03, at 1007.
92 See text accompanying notes 119-23, and 127-30 infra.
96 Bankruptcy Act § 437(2), 11 U.S.C. § 837(2) (1970). The making of such a deposit is required by the court as a condition precedent to confirmation of an arrangement. Bankruptcy Act §§ 467, 468(2), 11 U.S.C. §§ 867, 868(2) (1970). The required deposit does not necessarily include all the consideration which is required by the plan for arrangement. Rather, the deposit must include only that part of consideration that will be distributed immediately upon confirmation of the plan. 9 Collier, supra note 18, ¶ 5.12(3), at 928.
99 Bankruptcy Act § 461(3), 11 U.S.C. § 861(3) (1970). The purpose of the section is to allow plans to provide for unsecured creditors equally or in classes, thus permit-
the bankruptcy court,\footnote{Bankruptcy Act § 461(1), 11 U.S.C. § 861(1) (1970). This requirement reinforces the concept that an arrangement must have for its primary purpose the adjustment of the rights of secured creditors. See note 17 supra. The requirement is satisfied if the property that is subject to the plan is owned subject to a mortgage securing an obligation not assumed personally by the debtor. In re Hamburger, 117 F.2d 932, 936 (6th Cir. 1971).} and for continued operation of the debtor's business.\footnote{Bankruptcy Act § 461(2), 11 U.S.C. § 861(2) (1970). See note 87 supra. If the value of the property is insufficient to satisfy a first mortgage, junior lienors are not affected by a plan dealing solely with the debtor's property, and thus need not be protected by the plan. Darvilla Housing Corp. v. Accousti, 2 Bankr. Ct. Dec. 1093, 1094 (D. Conn. 1976).} The proposed arrangement must include provisions adjusting the rights of creditors possessing debts secured by real property or chattels real,\footnote{Bankruptcy Act § 461(8), 11 U.S.C. § 861(8) (1970). See generally 9 COLLIER, supra note 18, ¶ 8.09, at 1075.} enumerating the rights of all creditors affected by the plan,\footnote{Bankruptcy Act § 461(9), 11 U.S.C. § 861(9) (1970). See generally 9 COLLIER, supra note 18, ¶ 8.10, at 1076.} prescribing payment of expenses incurred in administering the debtor's estate,\footnote{Bankruptcy Act § 461(10), 11 U.S.C. § 861(10) (1970).} denoting which debts will be fully paid in cash,\footnote{Bankruptcy Act § 461(11), 11 U.S.C. § 861(11) (1970).} specifying which creditors will be unaffected by the plan, and for continued operation of the debtor's business.\footnote{Bankruptcy Act § 461(12), 11 U.S.C. § 861(12) (1970).}
and which provisions might concern those creditors,\textsuperscript{115} establishing adequate means of executing the plan,\textsuperscript{116} and assuring adequate protection of non-accepting creditors so that they will realize the value of their debts secured by their real property subject to the arrangement.\textsuperscript{117} The requirement that an arrangement must modify or alter the rights of secured creditors is the principal characteristic that distinguishes a Chapter XII arrangement from one under Chapter XI. A plan for arrangement under Chapter XI can modify or alter only the rights of unsecured creditors.\textsuperscript{118} The Chapter XII arrangement can affect the rights of both secured and unsecured creditors, but must have for its primary purpose adjustment of the rights of secured creditors.\textsuperscript{119}

If a proposed plan for arrangement is unanimously accepted by the creditors, confirmation of the plan by the court depends upon satisfaction of several prerequisites. First, the debtor must make any deposits required by the court.\textsuperscript{120} Second, the court must be convinced that proposal and acceptance of the arrangement have been made in good faith and were not induced through any activities forbidden by the Bankruptcy Act.\textsuperscript{121} Third, the court must determine that the

\begin{footnotes}

Several methods of providing adequate means for the execution of the plan are suggested in Bankruptcy Act § 461(12), 11 U.S.C. § 861(12) (1970). These include retention of possession of all or part of his property by the debtor; transfer of property in trust to a corporation already organized or to be organized; sale of property free from or subject to a lien, with the proceeds distributed to creditors having an interest therein; satisfaction or modification of liens; extension and modification of the terms of securities and secured obligations; and issuance of securities in exchange for money, property, existing securities, cancellation of debts, or other appropriate purposes. \textit{See generally} 9 Collier, \textit{supra} note 18, ¶ 8.13, at 1081.}
\footnote{119}{See text accompanying note 17 \textit{supra}.}
requirements of Chapter XII have been met,122 and that the plan is in the best interests of the creditors and is feasible.123 Finally, the court must insure that all payments made or proposed by the debtor are reasonable and have been disclosed to the court.124

When the arrangement is confirmed the plan and its provisions become binding upon the debtor and all his affected and unaffected creditors.125 Confirmation operates as a discharge of all debts and liabilities that are subjects of the arrangement, except to the extent they are provided for in the arrangement.126

The primary controversy engendered by Chapter XII does not concern confirmation of unanimously accepted arrangements, but rather is provoked by the interrelation of sections 461(11), 468, and 472 of the Bankruptcy Act. These are the principal sections that govern a court’s decision whether to confirm an arrangement over the objections of non-assenting creditors. The controversy is provoked by an interpretation that the statutory language permits broad discretion in confirming arrangements, empowering courts to confirm arrangements over the objections of creditors in derogation of their rights not to be deprived of property without due process of law.127 Any such power is circumscribed, however, by judicial decisions that prescribe the due process requirements for compensation of creditors deprived of property in bankruptcy cases.128 Confirmation of a Chap-

125 Bankruptcy Act § 473(1), 11 U.S.C. § 873(1) (1970). The binding effect given a confirmed plan means that the rights and liabilities provided for in the plan are fixed and deemed adjudicated, thus insulating them from collateral attack. 9 COLLIER, supra note 18, ¶ 9.08, at 1148. See, e.g., Stoll v. Gottlieb, 305 U.S. 165 (1938) (lack of bankruptcy court jurisdiction over obligation cannot be contested in subsequent state court proceeding for enforcement of discharged obligations; bankruptcy court determination of jurisdiction is res judicata for redetermination of jurisdictional issue).

A debt is provided for under the plan if the plan grants consideration for the debt. 9 COLLIER, supra note 18, ¶ 9.13, at 1156. See generally id., at ¶ 9.13; 9 REMINGTON, supra note 21, at § 3737.
127 See text accompanying notes 145-51 infra.
128 See Lifton, supra note 7, at 1966-69. The creditor’s right to realize the value of
ter XII arrangement would violate due process only when these requirements are not met.

Section 468 indicates how many creditors must accept before an arrangement not unanimously accepted by creditors can be confirmed. The section states that a plan may be confirmed if accepted by "the creditors of each class holding two-thirds in amount of the debts in such class . . . exclusive of creditors or of any class of them" provided for under Section 461(11). The purpose of the provision is to permit confirmation of a plan when creditors holding two-thirds of the amount of debts in some but not all classes accept the arrangement. Although there may be instances where acceptances by very few creditors are sufficient to support confirmation of a plan, a court cannot confirm a plan that is unanimously opposed by creditors.

Section 461(11), which is frequently referred to as the "cram-down" provision, designates the methods through which a plan may be confirmed if accepted by creditors holding two-thirds of the amount of debts in each class, exclusive of creditors and classes provided for in the plan for reorganization. See 11 U.S.C. § 579 (1970). The equivalent section under Chapter XI requires acceptances by a mere majority of creditors in both number and amount, but makes no provision for excluding from consideration non-assenting creditors provided for under the Chapter XI plan. Bankruptcy Act § 362, 11 U.S.C. § 762 (1970). See generally 9 COLLIER, supra note 18, § 9.03, at 1117.


guarantee non-asserting creditors adequate protection for realizing the value of their debts. The first method listed for protecting creditors is by sale, transfer, or retention of the property by the debtor, with the property remaining as security for the debt. 133 If this method is selected as the sole means for protecting all creditors with debts secured by real property, the arrangement must fail because it does not have for its primary purpose alteration or modification of the rights of secured creditors as Chapter XII requires. 136 The second method provides that the debtor may sell his real property for at least a fair upset price 137 and apply the proceeds from the sale to the debts secured by that property. 138 This method, however, is of doubtful utility because the majority of Chapter XII debtors seek to retain possession of their property. 139

The third and fourth methods designated by section 461(11) provoke the most controversy. Under the third method adequate protection for realization of the value of the debts may be provided by appraisal and cash payment of the value of the debts; 140 under the fourth method creditors may be protected by any other method which equitably and fairly provides such protection. 141 Confirmation of a plan utilizing either method for protection of a creditor denies the creditor his mortgage right to recover the value of his debt through sale under a mortgage of the property standing as collateral for the debt. 142 The focus of the controversy concerning Chapter XII is the issue whether such denial violates creditors' rights under the fifth amendment not to be deprived of property for a public purpose. 143

134 See 9 COLLIER, supra note 18, at ¶ 8.12; text accompanying note 17 supra.
135 "Upset price" is a minimum price set by the bankruptcy court that must be met or exceeded before the property may be sold. 6A COLLIER, supra note 18, ¶ 10.15, at 479 n.2. To be fair, the upset price must be high enough to provide just compensation for creditors' claims; otherwise, creditors' due process rights would be violated. See text accompanying notes 141-50 infra. Cf. 6A COLLIER, supra note 18, at ¶ 10.15, at 480-81 (discussion of requisites for fair upset price under Chapter X).
142 See text accompanying notes 144-45 infra.
143 The public purpose of Chapter XII is to permit rehabilitation of the debtor by providing for modification and alteration of the terms of his obligations while permit-
without due process of law and just compensation.\textsuperscript{144}

A mortgage grants a mortgagee a variety of rights in the mortgagor's real property. In \textit{Louisville Joint Stock Land Bank v. Radford},\textsuperscript{145} a 1935 bankruptcy case involving a mortgage on a farm, the Supreme Court found that under Kentucky law a mortgagee's property rights included the right to retain a lien on property until the debt it secures is paid, to realize on the property at a judicial sale, to determine the date of such sale, to protect his interest by bidding at the sale, and to control the property during the period of default.\textsuperscript{146} The Court indicated that denial of any of these rights without just compensation would be unconstitutional.\textsuperscript{147}

The question whether payment of an appraised value of the property may constitute just compensation for denial of the mortgagee's right to realize the value of his debt at a sale was considered in \textit{Wright v. Union Central Life Insurance Co.}\textsuperscript{148} There, the Supreme Court emphasized that secured creditors have no constitutional claim to any protection beyond the "extent of the value of the property."\textsuperscript{149} If the creditor receives assurance that the value of the property, whether or not equal to the amount of his claim, will be applied in payment of his claim, the creditor is adequately protected.\textsuperscript{150} Because valuation by sale is not inherently more accurate than valuation by appraisal, provision for payment of an appraised value challengeable by the creditor insures protection for the creditor's rights commensurating him to retain ownership of his property. \textit{See} \textit{Bass v. Dick}, 296 F.2d 912, 914 (7th Cir. 1961). The federal bankruptcy acts are generally construed as having a public purpose. \textit{See} \textit{Ashton v. Cameron County Water Improvement Dist. No. One}, 298 U.S. 513, 530 (1936); \textit{Louisville Joint Stock Land Bank v. Radford}, 295 U.S. 555, 581-82 (1935).

\textsuperscript{144} \textit{Lifton}, supra note 7, at 1968. \textit{See} materials cited in note 4 supra. \textit{Cf.} 6A \textit{Collier}, supra note 18, at \textsection\textsection 10.16, 10.17 (discussion of similar provisions under Chapter X).

\textsuperscript{145} 295 U.S. 555 (1935). \textit{Radford} concerned former \textsection 75 of the Bankruptcy Act, which provided that if their mortgagees refused to consent to time extensions for payment of debts, farmers could require a bankruptcy court to stay foreclosure proceedings for five years. \textit{Id.} at 575-76. The section was held unconstitutional because creditors received no compensation thereunder for deprivation of their right to realize the value of their debts through sale of the collateral. \textit{Id.} at 601-07.

\textsuperscript{146} \textit{Id.} at 594-95.

\textsuperscript{147} \textit{See} \textit{id.} at 595.

\textsuperscript{148} 311 U.S. 273 (1940). \textit{Wright} involved amended \textsection 75 of the Bankruptcy Act, 11 U.S.C. \textsection 203 (1940), whereby the debtor could redeem his property at an appraised value prior to a public sale of the property. \textit{Id.} at 277.

\textsuperscript{149} \textit{Id.} at 278.

\textsuperscript{150} \textit{Id.} at 278-80.
ate with due process requirements.\textsuperscript{151} Thus, payment of an appraised value provides just compensation for the deprivation of the creditor's rights.

Included under the fourth method prescribed by section 461(11) concerning protection for non-assenting secured creditors are plans that alter or modify the terms of debts held by such creditors. Applying the analysis derived from discussion of the appraisal provision, an adjustment in the terms of a debt meets due process requirements if the value of the debt is preserved.\textsuperscript{152} The determination whether the value of the debt is protected requires investigation into the character of that debt. If the plan proposes substantial changes in the terms or nature of the obligation, the value of the debt might not be preserved.\textsuperscript{153} For example, if the plan would transform a construction loan into a permanent loan maturing in twelve years and bearing an interest rate significantly below the original contract rate and current market rate, the plan might not preserve the value of the debt.\textsuperscript{154}

Section 472(2) provides that a plan shall be confirmed if the court


If the creditor objects to the valuation of the property by an appraiser such objection may be raised at the hearing on confirmation. \textit{See} \textit{Fed. Bankr. R.} 12-38(c),(d). If the debtor objects to the decision of the bankruptcy court, the case may be appealed to the district court. \textit{See generally} \textit{Fed. Bankr. R.} 801-814.


\textsuperscript{153} A plan proposing a substantially extended time for payment of debts may, in effect, merely grant the debtor the opportunity to speculate with his creditors' money and thus not preserve the value of the debts. \textit{In re Huntley Square Assoc.}, 2 Bankr. Ct. Dec. 1417, 1418 (D. Md. 1976).

is satisfied that the plan is for the "best interests of creditors." Formerly, section 472(3) contained an additional test requiring that the court confirm a plan only if satisfied the plan was "fair and equitable." "Fair and equitable" is another term of art requiring an inquiry distinctly different from that involved in determining whether a plan is in the best interests of creditors.

The "fair and equitable" test evolved in corporate reorganization proceedings and was codified in Chapter X of the Bankruptcy Act. The test there essentially requires that all secured and unsecured creditors are entitled in reorganization to priority to the full amounts of their debts in preference to stockholders of the corporation. For stockholders to retain interest the reorganized corporation, the value of the new corporation as a going concern must exceed the value necessary to compensate fully the claims of every creditor of the former corporation. Applied under Chapter XII, the test would require that before a debtor may retain possession and ownership of his property, value must remain in the property after all his secured creditors are compensated for the loss of their rights to the full extent of their claims. Because application of the "fair and equitable" test tended to frustrate the intent of Chapter XII that the debtor be allowed to retain his possessory interest in the property, the "fair and equitable" test was eliminated from section 472.

The practical effect of the deletion of the "fair and equitable" language from section 472 is that debtors are permitted to retain ownership of real property under an arrangement even though the amount of debts secured by the property exceeds the value of the

156 Harvey, supra note 4, at 220. See 9 COLLIER, supra note 18, ¶ 9.07 [3], at 1138.
157 See generally 9 COLLIER, supra note 18, ¶ 9.07 [4], at 1141; Lifton, supra note 7, at 1964-69.
161 9 COLLIER, supra note 18, ¶ 9.07 [4], at 1143.
property. One court has correlated the fact of deletion with the fact that, in contrast to Chapter X, no initial determination must be made under Chapter XII whether the petition was filed in good faith, and has determined that the absence of such provisions indicates courts should be more liberal in confirming plans for arrangements under Chapter XII than they would be in approving plans for reorganization under Chapter X. Even if such license is indicated, however, the courts should carefully scrutinize proposed plans for arrangement to determine whether creditors receive just compensation for their claims.

V. Advantages and Disadvantages of Chapter XII

Chapter XII offers several advantages to real estate debtors. Limited partnerships, which are popular vehicles for real estate investment, are eligible to petition under Chapter XII as entities apart from their partners. This aspect is particularly attractive where the limited partners are but investors taking no active part in operation of the business. Additionally, the partnership may file a petition if it is

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183 Although the "fair and equitable" test was deleted from Chapter XII, the test continues to influence decisions under the Chapter. In Reliance Standard Life Ins. Co. v. Pembroke Manor Apts., 547 F.2d 805 (4th Cir. 1977), the liquidation value of the debtor's property was determined at a hearing under § 453 of the Bankruptcy Act, 11 U.S.C. § 853 (1970), for the purpose of dividing creditors into classes. See text accompanying notes 76-79 supra. On appeal from the bankruptcy judge's order refusing to lift the automatic stay on proceedings to enforce liens against real property, the district court dismissed the stay on the grounds that because the outstanding debt was in excess of the determined property value, the debtor had no equity in the property and thus no arrangement could ultimately be confirmed. 547 F.2d at 807. The Fourth Circuit reversed and remanded, holding that "going concern" value, not liquidation value, should be considered in determining whether to dismiss an automatic stay. Id. at 807-08. Deletion of the "fair and equitable" test, however, indicates that whether the amount of debts secured by real property exceeds the value of the property is but a factor to be considered in the decision on confirmation of a plan; a court should neither automatically dismiss a stay nor refuse to confirm a plan merely because the amount of debts secured by real property exceeds the value of that property. See 9 Collier, supra note 18, ¶ 9.07 [4], at 1141.

184 In re Pine Gate Assoc., 2 Bankr. Ct. Dec. 1478, 1482 (N.D. Ga. 1976), cert. denied, 45 U.S.L.W. 3501 (U.S. Jan. 25, 1977) (No. 76-742). Although no initial finding must be made whether a Chapter XII petition was filed in good faith, the court must be satisfied that proposal and acceptance of a plan for arrangement were made in good faith before the plan may be confirmed. Bankruptcy Act § 472(4), 11 U.S.C. § 872(4) (1970).


186 Watkins, supra note 6, at 244. Chapter X is not available to partnerships, but is restricted to corporations. See Bankruptcy Act § 126, 11 U.S.C. § 526 (1970).
insolvent or unable to pay its debts as they accrue. Thus, if a partnership suffers from diminishing cash-flow from its property and is unable to pay accruing obligations, it may avert sale of its property under a mortgage by petitioning for an arrangement under Chapter XII. Furthermore, the Chapter provides partnerships with the sole means through which they can adjust both unsecured obligations and obligations secured by real property. The most attractive feature of Chapter XII, however, is that it affords the debtor the opportunities to retain ownership and control of his real property while circumventing foreclosure and sale by his mortgagees, and to free himself from or to adjust the terms of his mortgages. Thus, the debtor is accorded an opportunity to rehabilitate himself through better management of his property and affairs without the burden of paying his mortgage obligations on their original terms.

Chapter XII is also available to the individual owning real property that stands as security for debts, and offers him a distinct advantage unavailable under the straight bankruptcy provisions of Chapter I - VII of the Bankruptcy Act. Under straight bankruptcy the creditor's estate, including his real property, is liquidated and the proceeds are distributed to the creditors before the bankrupt is discharged from his obligations. The bankrupt cannot retain ownership of his property. Chapter XII, however, provides the individual with the means through which he may be discharged from his obliga-

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168 In re Potts, 47 F. Supp. 990, 991 (E.D. Ky. 1942), aff’d in part, rev’d in part, 142 F.2d 883 (6th Cir. 1944).

Chapter XII was devised to grant individuals the same rights as corporations under Chapter X to seek rehabilitation through adjustments in their obligations secured by real property. Although not expressly stated in any of the congressional reports, concern for individual homeowners was a primary motivating force behind enactment of Chapter XII. Cohen, Chapter XII—Real Property Arrangements, 14 Ref. J. 28 (Oct. 1939).

tions, but retain ownership of his real property.

There are two principal disadvantages, however, for persons eligible to petition under Chapter XII. First, although a Chapter XII arrangement may adjust the terms of debts secured by real property or chattels real and unsecured debts, no provision is made in Chapter XII for dealing with debts secured other than by real property.\footnote{Watkins, supra note 6, at 252.} Second, the minimum number of acceptances necessary before a plan not unanimously accepted can be confirmed is unclear.\footnote{See text accompanying notes 127-130 supra.} Thus, confirmation of a plan on the basis of a small number of acceptances might engender litigation on the issue whether a requisite number of acceptances were obtained.

The most controversial issue under Chapter XII concerns the power of a bankruptcy court to force upon non-assenting creditors an arrangement that adjusts their rights in the debtor's property.\footnote{See text accompanying notes 138-149 supra.} The controversy has arisen because, in comparison with other chapters of the Bankruptcy Act, Chapter XII is virtually untested. An understanding, however, of the extent of the court's power to confirm such a plan can be derived from analysis of the few sources of authority on Chapter XII in comparison with authority on analogous provisions of the Bankruptcy Act. These sources indicate that the power of the court to confirm a plan is not so broad as it first appears, but is circumscribed by fundamental if rather indefinite limitations, since no plan may be confirmed if it does not protect creditors to the full extent of the value of their debts.\footnote{See text accompanying notes 146-149 supra.} Any plan protecting the value of the debts protects the creditor to the full extent of his property rights.

Courts, however, should be prepared to engage in a two-pronged analysis to determine whether proposed Chapter XII arrangements actually provide adequate protection, because a number of policy issues are ultimately involved. Interrelated with the rehabilitative purposes of the chapter and the interests of financially troubled partnerships and individuals owning real property are the interests of creditors. If courts become too lenient in approving Chapter XII arrangements, increasing amounts of capital that initially would be recoverable through foreclosure might become embalmed in real estate investments under arrangements having little chance for success.\footnote{See Draper, Stays of Mortgage Foreclosure—A Proposal for Reform, 93 Banking L.J. 133, 136-38 (1976).} Concomitant with this increased risk for lenders, interest rates
on loans for real estate investment may increase, resulting in depressed real estate investment markets. Such a situation would benefit neither lenders nor investors. Consequently, in determining whether to confirm proposed arrangements, courts should consider not only whether just compensation is provided by the plan, but also whether the debtor enjoys a genuine probability of rehabilitation under the plan. Only if such a probability exists will confirmation of an arrangement result in realization of the broad rehabilitative purposes of Chapter XII.

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177 Id. See Minard, Numbers Game: The Chapter 12 Cloud, Forbes, April 15, 1977, at 74, 76.