AMERICAN
BANKRUPTCY
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2018 Annual Spring Meeting

PLENARY SESSION

The Most Important Bankruptcy Cases Ever

Richard B. Levin, Moderator
Jenner & Block; New York

Maria J. DiConza
Greenberg Traurig LLP; New York

Jeremy R. Fischer
Drummond Woodsum; Portland, Maine

Whitman L. Holt
Klee, Tuchin, Bogdanoff & Stern LLP; Los Angeles

Stephen D. Lerner
Squire Patton Boggs; Cincinnati

Claire Ann Resop
Steinhilber Swanson, LLP; Madison, Wis.

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AMERICAN BANKRUPTCY INSTITUTE
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Maria J. DiConza
Greenberg Traurig, LLP
New York, NY

Jeremy Fischer
Drummond Woodsum
Portland, ME

Claire Ann Resop
Steinhilber Swanson, LLP
Madison, WI

Whitman Holt
Klee, Tuchin, Bogdanoff & Stern LLP
Los Angeles, CA

Stephen D. Lerner
Squire Patton Boggs (US) LLP
Cincinnati, OH

Richard Levin, Moderator
Jenner & Block LLP
New York, NY

Husky Int'l Elecs., Inc. v. Ritz, 136 S. Ct. 1581 (2016)

Claire Ann Resop
Steinhilber Swanson LLP
Madison, WI

I. Issue

Whether prohibition of a bankruptcy discharge for "actual fraud" under 11 U.S.C. § 523(a)(2)(A) encompasses fraudulent conveyance schemes, even when those schemes do not involve a false representation.

II. Statutory Context

An individual debtor is not discharged from any debt "for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by … false pretenses, a false representation, or actual fraud …." § 523(a)(2)(A). The words "actual fraud" were added by the Bankruptcy Reform Act of 1978. Circuits were split as to whether the added option of "actual fraud" required an affirmative misrepresentation, or whether "actual fraud" encompassed a broader range of behaviors.

III. Facts

Husky International Electronics, Inc. ("**Husky**") sold its products to Chrysalis Manufacturing Corp. ("Chrysalis"), with Chrysalis incurring a debt of $163,999.38 to Husky. During the business relationship, Chrysalis' director, Daniel Lee Ritz, Jr. ("**Ritz**"), drained Chrysalis of assets by transferring funds to other entities Ritz controlled. Husky filed a lawsuit against Ritz to hold him personally liable for the debt under a Texas law that allows creditors to hold a shareholder responsible for corporate debt. Ritz filed a chapter 7 bankruptcy in the Southern District of Texas. Husky initiated an adversary proceeding seeking to hold Ritz personally liable for Chrysalis' debt and for an order that the debt was not dischargeable in bankruptcy because the intercompany-transfer scheme constituted "actual fraud" under section 523(a)(2)(A).

The District Court held that Ritz was personally liable for the debt under Texas law, but the debt could be discharged as it was not "obtained by actual fraud". The Fifth Circuit affirmed, agreeing with the District Court that Ritz did not commit "actual fraud" under section 523(a)(2)(A). The Fifth Circuit held that a necessary element of "actual fraud" is a misrepresentation from the debtor to the creditor. Although Ritz may have hindered Husky's ability to collect its debt, Ritz did not make false representations to Husky, and

therefore did not commit "actual fraud." Husky argued that a series of fraudulent conveyances intended to obstruct the collection of debt are "actual fraud". Husky appealed to the Supreme Court.

IV. Holding

In a 7-1 decision reversing the Fifth Circuit, the Supreme Court held that "actual fraud" in § 523(a)(2)(A) includes fraudulent conveyances schemes; "actual fraud" does not require a misrepresentation from a debtor to a creditor. The Court considered the legislative intent of the addition of "actual fraud" to the statute, meant something different than the prior statute, as well as the historical meaning of "actual fraud." "Actual fraud" consists of both "actual" and "fraud". The common law includes anything that counts as "fraud" to be "actual fraud" if done with wrongful intent. Since the beginning of English bankruptcy, "fraud" has included a debtor's transfer of assets to hide them from creditors. Fraudulent conveyances are a fraud, even without a misrepresentation. Fraudulent conveyances are acts of concealment and hindrance, and thus are "actual fraud", and thus not dischargeable. The Court also discussed that it understood the debtor did not "obtain" debts in a fraudulent transfer, but reasoned that the transferee obtains the transferred assets by fraud if intent exists, and any debt traceable to that transfer would be nondischargeable under section 523(a)(2)(A). Therefore, the Court reasoned that it is "clear that fraudulent conveyances are not wholly incompatible with the 'obtained by' requirement."

The Court disagreed with Justice Thomas' dissenting opinion that the fraud should result from the inception of the credit transaction, reasoning that nothing in section 523(a)(2)(A) requires that. The Court also disagreed with the dissent and found that the addition of "actual fraud" was meant to expand the exception to discharge, not limit it.

V. Significance

Perhaps the most important goal of the Bankruptcy Code is to provide the debtor with a fresh start obtained by the discharge of prepetition debts. By broadening an exception to discharge in *Husky Int'l Elecs., Inc. v. Ritz*, the Supreme Court made it more difficult for debtors to obtain a fresh start. Noting that "there is no need to adopt a definition for all times and all circumstances," the Supreme Court left the door open to further broaden the definition of "actual fraud" and make broader exceptions to a discharge.

Now, the challenge for lower courts is to decide whether there are limits to the *Husky* doctrine, and if so, where. In *Hatfield v. Thompson (In re Thompson)*, 555 B.R. 1 (10th Cir. B.A.P. 2016), the debtor had applied for an Oklahoma nursing home license and

represented that he would be actively involved in operations and physically present at least eight hours a month. When a patient died in the nursing home, allegedly because of substandard care, the surviving spouse sued the nursing home and the debtor. On the eve of trial, the owner filed personal bankruptcy. The trial went ahead only against the nursing home, which defaulted, resulting in a $1 million judgment. In bankruptcy court, the spouse filed a non-dischargeability complaint against the owner, alleging that he was liable for the judgment under Oklahoma law that permits veil piercing "under the legal doctrine of fraud." The spouse alleged that numerous representations made to the state in the license application were false. The owner responded by filing a motion for summary judgment, relying on the fact that the judgment was based on negligence, not fraud. Before the Supreme Court handed down *Husky*, the bankruptcy court granted the summary judgment motion and dismissed the non-dischargeability complaint, because the judgment was for nothing that the owner obtained from the spouse. The surviving spouse appealed and won in a decision that relies heavily on *Husky*. The B.A.P. held that if the debtor obtains money by "actual fraud," "any liability of the debtor arising from the false pretenses, fraud, representations, or actual fraud is excepted from discharge." Non-dischargeable liability is not even limited by the value of the property obtained by fraud. In *Hatfield*, like *Husky*, the alleged fraud was not peculiar to the creditor who that raised the claim, yet that creditor's debt survives, while others who did not file a section 523 action do not. The B.A.P.'s decision remanded, but the B.A.P.'s decision highlights the significant impact *Husky* has had on fraudulent transfer case law and dischargeability.

After *Husky,* can anyone who commits any kind of fraud, even without misrepresentation, on behalf of a corporation have non-dischargeable liability for debts owed by the corporation? What has happened to the Debtor's fresh start?

Committee of Equity Security Holders v. Lionel Corp. (In re Lionel Corp.) 722 F.2d 1063 (2d Cir. 1983)

Maria J. DiConza
Greenberg Traurig, LLP
New York, NY

I. Issue

To what extent chapter 11 permits a bankruptcy court to authorize the sale of an important asset of the debtor's estate out of the ordinary course of business and outside of a plan of reorganization.

II. Statutory Context

Section 363(b) of the Bankruptcy Code.

III. Facts

In 1982, Lionel Corporation ("**Lionel**") and its two subsidiaries filed for chapter 11 bankruptcy protection in the United States Bankruptcy Court for the Southern District of New York (the "**Bankruptcy Court**"). Historically a manufacturer of toy trains, at the time of the filing, Lionel's business primarily related to its operation of retail stores owned and operated through its debtor subsidiaries. In addition, at the time of the filing Lionel's most important asset was its ownership of 82% of the common stock of Dale Electronics, Inc. ("Dale"), a non-debtor engaged in the manufacture of electronic components. The remaining 18% of Dale's common stock was publically traded. Unlike Lionel's retail operations which incurred substantial losses prior to the filing, Dale was profitable. As a result, Lionel's interest in Dale was Lionel's most valuable asset, representing approximately 34% of Lionel's consolidated assets.

On June 14, 1983, Lionel filed an application under section 363(b) of the United States Bankruptcy Code for court authorization to sell its 82% interest in Dale to Acme-Cleveland Corp. for $43 million. Four days later, Lionel also filed a plan of reorganization conditioned upon a sale of Dale, with the proceeds to be distributed to creditors.

On September 7, 1983, the Bankruptcy Court conducted a sale hearing. At the hearing, Peabody International Corp. emerged as the successful bidder with a $50 million offer. At the time of the sale hearing, the plan process had not yet progressed to solicitation and issues remained unresolved.

Lionel's Chief Executive Officer and a Salomon Brothers Vice President testified at the sale hearing. Although their testimony established that the $50 million offer for Dale stock was fair, their testimony also established that the asset was not "wasting away." Additionally, Lionel's CEO testified that that there was no reason that the sale could not be accomplished through a plan, as the Creditors' Committee's insistence was the sole reason Lionel pursued the 363 process, prior to and outside of, the plan process.

The Bankruptcy Court approved the sale, without making any formal findings of fact. The Bankruptcy Court noted that cause was sufficiently shown by the Creditors' Committee's insistence on the 363 process. The Bankruptcy Court found that a present failure to confirm the sale motion would set Lionel's reorganization process back a year or longer while the parties attempted to restructure.

The Equity Committee appealed the sale order, claiming that a sale prior to approval of a plan deprived Lionel's equity holders of the chapter 11 plan safeguards of disclosure, solicitation and acceptance of the plan and divested the debtor of a profitable asset that could serve as a cornerstone of a plan. The Equity Committee argued that pre-confirmation sales should be approved only in emergency situations. The Securities and Exchange Commission supported the Equity Committee's appeal.

The Creditors' Committee countered the appeal, arguing that section 363 expressly authorizes a sale outside of a plan process and the plain language of section 363 did not impose any restraints on a debtor's ability to sell its assets.

IV. Holding

The United States Court of Appeals for the Second Circuit (the "Second Circuit") reversed and remanded the Bankruptcy Court's decision, holding that a bankruptcy court must find good business justifications to sell, use, or lease assets outside of a plan of reorganization. The Second Circuit found that creditor committee insistence was insufficient cause to approve a sale outside of a plan, but rejected both the extreme advocated by the Equity Committee – that sales under section 363 are permitted only in emergencies – and the extreme advocated by the Creditors' Committee—that the bankruptcy court has unfettered freedom to do what it thinks best. *See Lionel*, 722 F.2d at 1066.

In reaching this decision, the Second Circuit reviewed the both the prior Bankruptcy Act of 1867 and Chandler Act of 1938, and surveyed cases decided thereunder. Both Acts permitted sales of a debtor's assets outside of the debtor's ordinary course of business, but looked at such sales as the exception not the norm. In such instances, courts sought to

determine whether cause existed; and looked to whether the debtor's assets were of a "perishable nature" or "deteriorating," if there was an "emergency," or if there was a good business reason to sell the assets that was in the best interests of the estate. *See id.* at 1066-71.

Turning to the recently adopted Bankruptcy Reform Act of 1978, the Second Circuit acknowledged that, on its face, section 363(b) of the Bankruptcy Code provided a bankruptcy court virtually unfettered discretion to approve sale motions. However, the Second Circuit rejected this broad interpretation (which the Creditors' Committee had urged the Court to adopt) for several reasons. First, the Second Circuit found that the statute required notice and a hearing – procedural safeguards that would be meaningless absent a further requirement that reasons be given for whatever determination is made. Second, the Second Circuit found that appellate review would effectively be precluded if a bankruptcy court is not required to make any findings. Finally, the court found that the legislative history surrounding the Bankruptcy Reform Act of 1978 illustrated a legislative intent to protect creditors and investors through a transparent chapter 11 plan process. *See id.* at 1069.

The *Lionel* Court also rejected the Equity Committee's narrow interpretation of section 363. It found that not every 363 sale short-circuits or side-steps the chapter 11 process. The Second Circuit also found that a bankruptcy court needs a certain amount of flexibility to further the purpose of chapter 11. As such, in certain circumstances, a sale may be justified as a good business opportunity. *Id.*

Rejecting both the committees' all-or-nothing approach, the *Lionel* Court concluded that a bankruptcy judge may approve a pre-confirmation sale, lease, or use of the debtor's assets if there is "some articulated business justification, other than appeasement of major creditors." *Id* at 1070. The Second Circuit found that in determining whether there is an appropriate business justification, bankruptcy courts must consider all relevant factors related to the case and act to further the diverse interests of the debtor, creditor and equity holders. The Second Circuit further suggested a number of non-exclusive factors that a bankruptcy court could consider in making such a finding, including: (i) the proportionate value of the asset to the estate as a whole; (ii) the amount of elapsed time since the bankruptcy filing; (iii) the likelihood that a plan of reorganization will be proposed and confirmed in the near future; (iv) effect of the proposed disposition on future plans of reorganization; (v) the proceeds to be obtained from the disposition vis-a-vis any appraisals of the property; (vi) which of the alternatives of use, sale or lease the proposal envisions; and (vii) whether the asset is increasing or decreasing in value. *See id.* at 1070-71.

Applying this articulated standard to the facts, the Second Circuit found that the Bankruptcy Court's findings were insufficient to establish that the business justification standard had been met, as the only reason advanced for the sale was the Creditors' Committee's insistence that the sale occur prior to a plan. The Second Circuit found that such appeasement "is insufficient as a matter of fact because it is not a sound business reason and insufficient as a matter of law because it ignores the equity interests required to be weighed and considered under chapter 11." *Id.* at 1071. The court went on to find that a delay in Lionel's bankruptcy cases, alone, was not a sufficient reason to approve a pre-confirmation sale of the Dale stock. The Second Circuit therefore reversed the sale order and remanded the case for further proceedings.

V. Significance

In a somewhat ironic twist, although the court in *Lionel* refused to uphold the sale, the decision has become the bedrock for approval of sales of assets outside of a plan. Broadly read, *Lionel* permits debtors to use, sell or lease their property if they demonstrate *some* "business justification." But *Lionel* rejected such a simplistic approach and overturned the sale order because it found the purported justification lacking. *Lionel* instead required courts to scrutinize carefully the proposed transaction before making a business justification finding and provided a non-exhaustive list of factors that courts should consider.

Following the *Lionel* decision, courts have sought to limit a broad reading of *Lionel*. For example, in *In re Continental Air Lines, Inc.*, the Fifth Circuit harmonized *Lionel* with its decision in *In re Braniff Airways, Inc.*, 700 F.2d 935 (5th Cir. 1983) and held that bankruptcy courts must find both that there is an appropriate justification for the sale and that the sale does not dictate the terms of a future plan of reorganization. *See Institutional Creditors of Cont'l Air Lines, Inc. v. Cont'l Air Lines, Inc. (In re Cont'l Air Lines, Inc.),* 780 F.2d 1223, 1226 (5th Cir. 1986). In *In re Abbott Dairies of Pennsylvania, Inc.*, the Third Circuit held "when a bankruptcy court authorizes a sale of assets pursuant to section 363(b)(1), it is required to make a finding with respect to the 'good faith' of the purchaser." *Abbott Dairies*, 788 F.2d 143, 149-50 (3d Cir. 1986). These courts aim to strike the appropriate balance between a transparent chapter 11 plan process and a debtor's need to sell assets to maximize returns for its stakeholders.

In practice, *Lionel* continues to play an important role in bankruptcy cases today. Section 363 sales have become the rule rather than the exception in the vast majority of chapter 11 cases. *Lionel* and its progeny have also allowed debtors to file motions under section 363 early in cases and even as "first day" pleadings. For example, a Westlaw search shows that

almost 7,000 trial pleadings cited *Lionel*, many of which were in connection with a proposed section 363 sale. In these cases, debtors are selling their assets in the first three months (or sooner) in order to maximize value for their stakeholders, only to worry later about how to allocate sale proceeds through a plan of liquidation. These debtors often cite *Lionel* and the business justification standard when making such applications to the court.

Nowhere is that more evident than in cases such as *General Motors*, *Lehman Brothers*, and *Chrysler*, where multi-billion dollar companies were sold through quick section 363 sales. *Lionel* provided these courts the framework in approving the sales. *See, e.g.*, *In re Gen. Motors Corp.*, 407 B.R. 463, 487-88 (Bankr. S.D.N.Y. 2009) ("[T]his Court . . . has the benefit of the Second Circuit's decision[] in *Lionel … ,* which confirm[s] that section 363 sales of major assets may be effected before confirmation [of plan] …."); *In re Chrysler LLC*, 405 B.R. 84, 94-95 (Bankr. S.D.N.Y. 2009) (discussing *Lionel* factors before approving sale); Sale Motion ¶¶ 23, 25 filed in *In re Lehman Bros. Holdings Inc.*, Ch. 11 Case No. 08-13555 (JMP) (Bankr. S.D.N.Y. Sept. 17, 2008) [D.I. 60] (citing *Lionel* in support of a $1.7 billion sale of the debtors' assets within the first week of the bankruptcy filings).

Ultimately, *Lionel* provides debtors with a framework in which they can sell assets before a plan is confirmed and, perhaps more importantly, provides bankruptcy courts with the necessary amount of flexibility to determine if such a pre-plan sale is justified. As a result, *Lionel* has become the foundation upon which modern chapter 11 practices is based.

Chem. Bank v. Am. Kitchen Foods, Inc. (In re Am. Kitchen Foods, Inc.)
9 C.B.C. 537, 2 B.C.D. 715, 1976 WL 23699, 20 UCC Rep. Serv. 238 (Bankr. D. Me. 1976)

Jeremy R. Fischer
Drummond Woodsum
Portland, ME & Manchester, NH

I. Issue

What is the appropriate standard for valuing a secured creditor's collateral in bankruptcy reorganization proceedings?

II. Statutory Context

This case was decided under the Bankruptcy Act of 1898.

III. Facts

American Kitchen Foods and its affiliates filed for relief under Chapter XI of the Bankruptcy Act on October 17, 1975. The debtors were engaged in the business of growing and processing potatoes and other vegetables in Maine, Minnesota, and North Dakota. Its senior lenders were owed approximately $11.4 million, secured by first liens on the debtors' receivables, inventory, and equipment, as well as junior liens on real estate.[1]

The lenders filed a complaint for relief from stay. They contended that the collateral was worth far less than their debt at liquidation value, and that the debtors' retention of the collateral constituted an unconstitutional taking because it impermissibly impaired their interests.[2] Additionally, they argued that "the court is without power to authorize the retention and use of collateral for the purpose of facilitating continuing business operations under Chapter XI" and that "such power is restricted to use in proceedings under . . . Chapters X and XII."[3]

The debtors, on the other hand, sought to retain and use the lender's collateral as part of their effort to reorganize. They argued that, applying a going concern valuation standard, the collateral was worth far more than the secured debt. In the debtors' view, the going

[1] *See Am. Kitchen Foods, Inc.*, 20 UCC Rep. Serv. at 241.
[2] *Id.* at 242, 248
[3] *Id.* at 243.

concern valuation was appropriate because, through continued operations, they would maximize the value of the collateral.[4]

Judge Conrad Cyr presented the dispute in the starkest terms: "The power of the bankruptcy court to authorize retention and use of collateral and proceeds to fund continuing Chapter XI business operations is under direct challenge."[5] The court succinctly rejected the lenders' argument that the requested relief was barred in Chapter XI, noting that the automatic stay:

> [E]xpressly confer[s] such jurisdiction and power upon the court.... Were it not for the interposition of legal constraints upon lien enforcement the ubiquitous floating lien could conceivably preempt virtually every attempt at arrangement proceedings. Continued business operations would be rendered impractical, just as in the instant case, due to dispossessions of indispensable collateral, leaving no alternative but liquidation with its attendant waste and disruption.[6]

Finally, the court framed the central valuation question:

> At this stage in the discussion it becomes apparent that the principal judgmental problems involved in lien impairment litigation in Chapter XI proceedings ultimately relate to the valuation of the collateral .... It is a rare Chapter XI proceeding in which the rub does not come over exactly such valuation issues.[7]

IV. Holding

The court's valuation analysis began by noting that, "The customary practice in bankruptcy courts has been to use forced sale valuations for all appraisals, without sufficient regard to the nature of the proceedings."[8] The court rejected this custom in favor of a valuation derived from "the most commercially reasonable disposition practicable in the circumstances ... in all cases and at every phase of each case"—a standard lifted from Article 9 of the Uniform Commercial Code.[9]

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[4] *Id.* at 241-42.
[5] *Id.* at 243.
[6] *Id.* at 247.
[7] *Id.* at 249.
[8] *Id.* at 253.
[9] *Id.*at 255.

At state law, the court explained, the commercial reasonableness standard "provides significant safeguards for ensuring improved recoveries from collateral dispositions."[10] In bankruptcy, "[a] standard importing commercial reasonableness clearly conforms, in both theory and practice, with the dominant theme of Chapter XI, the rehabilitation of businesses weakened by economic reversals, thereby minimizing disastrous losses, waste, and disruption entailed in liquidation proceedings."[11] Thus, the commercial reasonableness standard properly protected lenders' Fifth Amendment rights, while restraining them from collecting in a manner unfairly detrimental to the obligors on the debt or other creditors.[12]

The court then analyzed alternatives for valuing the collateral through the lens of commercial reasonableness. "Forced-sale valuations," the court determined, "should be confined to use in cases where the circumstances of the debtor and the nature and condition of the collateral and its marketplace leave no commercially reasonable alternative."[13] By contrast, "[w]here collateral is being used or produced under Chapter XI by a going business which offers reasonable prospects that it can continue, the value of the collateral is equatable with the net recovery realizable from its disposition as near as may be in the ordinary course of business."[14]

Based on the facts of the case before it, the court then held that a forced sale valuation "would constitute a clear repudiation of the commercial realities" because "the debtor continues to operate as a going concern, [] the collateral is being preserved, and [] active retail and institutional markets continue to support an average markup for the debtors' products approximating one-third over cost" and the collateral "can be converted into cash in the orderly course of business at prices ranging from 30% to 80% above forced sale recovery levels."[15] "A forced sale in these circumstances could not be considered commercially reasonable."[16] Rather, "[i]t is little more than the articulation of an unexceptional business judgment to hold that, whenever practicable, conversion in the ordinary course of business should be considered the most commercially reasonable collateral disposition, simply because and to the extent it is more productive. . . . . It would

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[10] *Id.* at 252.
[11] *Id.* (citing *In re Blazon Flexible Flyer, Inc.*, 407 F. Supp. 861, 865 (N.D. Ohio 1976)).
[12] *See id.*at 253 (court "neither constitutionally nor otherwise required to reject more commercially reasonable collateral conversion methods in preference for forced sales at levels which substantially worsen the losses of all parties to the proceedings, including the secured party.").
[13] *Id.* at 253.
[14] *Id.* at 254.
[15] *Id.* at 253.
[16] *Id.* at 254.

be inept to ignore and prodigal to decline that collateral margin in the rehabilitation process."[17]

The court concluded with a cautionary note for reorganizing debtors:

> Debtors in possession, receivers or trustees should not be facilitated in their efforts to foist upon the secured party the risk of collateral depletion or diminution ...where the collateral was retained at the instance and for the benefit of the debtor, rather than the secured party. The controlling concept is one of fundamental fair play. The risk of loss should pass from the party in jeopardy to the one who placed him there.[18]

V. Significance

On one hand, *American Kitchen Foods* is merely an unreported bankruptcy court decision from a small, rural state decided before adoption of the modern Bankruptcy Code. On the other hand, it remains a seminal case on the issue of collateral valuation in bankruptcy reorganization proceedings.[19] Moreover, given its author and his "very strong" influence on the legislative process that led to enactment of the Bankruptcy Code – including section 506(a) – understanding the decision's expressive and nuanced analysis of the intersection between constitutional property rights, business reorganization, and collateral valuation is essential to today's bankruptcy practitioner.[20]

As part of the Bankruptcy Reform Act of 1978, Congress enacted section 506(a), which closely tracks the rationale of *American Kitchen Foods*. Under the statute, a creditor's secured claim is equal to the value of its collateral, and "[s]uch value shall be determined

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[17] *Id.* at 254.
[18] *Id.* at 255 (citing *In re Pittsburgh-Duquesne Dev. Co.*, 482 F.2d 243, 245-46 (3d Cir. 1973)).
[19] *American Kitchen Foods* also remains a seminal case on adequate protection issues related to cash collateral. When it was decided, "few cases dealt with the power of a Chapter XI court to permit continued use of 'soft' collateral, such as accounts receivable and inventory." 3 Alan Resnick & Henry Sommer, COLLIER ON BANKRUPTCY ¶ 363.LH[2] (16th ed. rev. 2018). Additionally, Judge Cyr's discussion of a debtor's right to "mak[e] use of the collateral margin" made *American Kitchen Foods* among "[t]he first cases formulating and applying the equity cushion concept …." Robert James & J. David Kirkland, Jr., *Adequate Protection Through Augmented Interests in Reorganization Plans*, 58 AM. BANKR. L.J. 69, 79 n.60 (1984).
[20] Matt Chiappardi, *Architect of Modern Bankruptcy Left Mark That Shaped Ch. 11*, LAW 360 (Aug. 8, 2016) ("'The bankruptcy judges were among the ones who had the strongest voices in the legislation,' said Richard Levin, a partner at Jenner & Block LLP and one of the authors of the reforms when he was assistant counsel to the U.S. House of Representatives Judiciary Committee. '[Judge Cyr's] influence was very strong. There weren't many judges of his sophistication at the time, although he would stand out even among today's strong bench.'").

in light of the purpose of the valuation and of the proposed disposition or use of such property ....”

In *Associates Commercial Corp. v. Rash*,[21] the U.S. Supreme Court construed section 506(a) in the context of a chapter 13 cram-down related to a creditor’s claim secured by a vehicle. The debtors proposed to retain the vehicle for use in their business and to pay the creditor the present value of its claim through the plan. The debtors valued the vehicle using foreclosure value at approximately $31,000; the secured creditor objected and argued that the vehicle should be ascribed a replacement value of approximately $45,000. The Court determined that valuation under section 506(a) turned on the debtors’ choice to retain, rather than surrender, the collateral. By doing so, the plan “exposed [the creditor] to double risks: The debtor may again default and the property may deteriorate from extended use,” and merely adding a “risk premium” to the cram-down interest rate “do[es] not fully offset the[] risk[].”[22] Thus, applying the higher replacement value standard provides additional protection against the double risks.

A full understanding of both section 506(a) and *Rash* is enhanced through an appreciation of Judge Cyr’s valuation analysis in *American Kitchen Foods*. Failing to grasp the decision’s nuanced lessons, however, leads to oddities like the Ninth Circuit’s recent decision in *First Southern National Bank v. Sunnyslope Housing Limited Partnership*.[23] In that case—as in *Rash* and *American Kitchen Foods*—the debtor proposed to retain a creditor’s collateral (a housing complex) as part of its reorganization. Unlike in those earlier cases, however, the forced sale valuation of the collateral was much higher than the going concern value because the debtor proposed to continue to use the collateral as restricted affordable housing; in a foreclosure, the restrictions would have been removed, unlocking a higher value. Thus, in *Sunnyslope*, the debtor sought to apply the lower going concern valuation at the expense of the secured party, which argued that it could never be paid less than the foreclosure value of its collateral. The bankruptcy court, district court, and Ninth Circuit all determined that section 506(a) and *Rash* mandated valuing the collateral at the lower value derived from the debtor’s proposed use of the collateral as restricted affordable housing.

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[21] 520 U.S. 953 (1997).
[22] *Id.* at 962-63.
[23] 859 F.3d 637 (9th Cir. 2017) (*en banc*).

The secured party in *Sunnyslope* did not discuss *American Kitchen Foods* in any of its briefing. However, it could have used Judge Cyr's analysis to support a different result. Underlying the *American Kitchen Foods* decision – and later section 506(a) and *Rash* – is the fundamental principle that the decision to retain and use collateral in a reorganization is motivated by the goal of maximizing and preserving value for the benefit of the estate. Maximizing and preserving value is the very essence of commercial reasonableness, and it applies to secured parties under Article 9 and to trustees as a common law fiduciary duty. To Judge Cyr, it would have constituted a repudiation of commercial realities, and a contravention of business judgment, to value collateral for a less productive purpose – as he held in *American Kitchen Foods*, converting collateral in the ordinary course of business is commercially reasonable "simply because and to the extent that it is more productive."[24]

At bottom, the decision in *Sunnyslope* runs afoul of Judge Cyr's parting admonition in *American Kitchen Foods*: "Debtors ... should not be facilitated in their efforts to foist upon a secured party the risk of collateral depletion or diminution.... The controlling concept is one of fundamental fair play. The risk of loss should pass from the party in jeopardy to the one who placed him there." And yet that is exactly what the debtor was allowed to do in *Sunnyslope*. The fundamental lesson of *American Kitchen Foods* for today's practitioner is that bankruptcy valuations are not intended to transfer the risk of the debtor's decision to retain collateral to the secured party; rather, where a debtor retains and uses property in aid of its own rehabilitation, it is bound by the principle of commercial reasonableness to put its property to the most productive use and to maximize reorganization value for the estate.

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[24] Notably, nothing in section 506(a) or *Rash* requires a bankruptcy court to value collateral in light of the *particular* use proposed by the debtor. Rather, section 506(a) merely distinguishes between disposition (i.e., surrender) and use (i.e., retention). The only statutory requirement is that the valuation occur in light of the debtor's retention of the collateral, not *how* the debtor proposes to use the collateral while retaining it.

Local Loan Co. v. Hunt
292 U.S. 234 (1934)

Whitman L. Holt
Klee, Tuchin, Bogdanoff & Stern LLP
Los Angeles, CA

I. Issue

Whether a bankruptcy court had jurisdiction regarding a proceeding to enjoin the prosecution of a wage garnishment action in Illinois municipal court and whether the underlying assignment of future wages constituted an enforceable lien that survived a consumer debtor's discharge in bankruptcy.

II. Statutory Context

This case was decided under the Bankruptcy Act of 1898 (the pre-Chandler-Act version).

In 1934, section 67(d) of the 1898 Act provided that "[l]iens given or accepted in good faith and not in contemplation of or in fraud upon this Act, and for a present consideration, which have been recorded according to law, if record thereof was necessary in order to impart notice, shall, to the extent of such present consideration only, not be affected by this Act." 11 U.S.C. § 107(d) (repealed 1978).

III. Facts

In September 1930, William Hunt borrowed $300 from Local Loan Co. and as security executed an assignment of a portion of his future wages.

Hunt filed for bankruptcy in March 1931, scheduled the Local Loan Co. loan among his debts, and obtained a discharge on October 10, 1932.

On October 18, 1932, Local Loan Co. sued Hunt's employer in the municipal court of Chicago to enforce the assignment as to Hunt's post-bankruptcy wages. Hunt responded by seeking injunctive relief in the bankruptcy court to bar Local Loan Co. from continuing its state court action or otherwise seeking to enforce the wage assignment. The bankruptcy court granted Hunt's requested relief and the Seventh Circuit Court of Appeals affirmed. *See In re Hunt*, 67 F.2d 998 (7th Cir. 1933).

On certiorari to the Supreme Court, Local Loan Co. argued that (1) the bankruptcy court lacked jurisdiction to enjoin prosecution of the municipal court action; (2) assuming such

jurisdiction, Hunt's assignment of future wages constitutes an enforceable lien; and (3) in any event, the highest court of the State of Illinois has enforced similar wage assignments as a lien, and the Supreme Court is bound by that decision. *See* 292 U.S. at 238-39.

IV. Holding

Writing for a unanimous Court, Justice George Sutherland affirmed the Seventh Circuit Court of Appeals and rejected each of Local Loan Co.'s arguments.

As to the jurisdictional question, the Court noted that "proceedings in bankruptcy are in the nature of proceedings *in rem*, adjudications of bankruptcy and orders of discharge being … in every essential particular decrees in equity determining a *status*." 292 U.S. at 241. And because bankruptcy courts "are essentially courts of equity, and their proceedings inherently proceedings in equity," those courts retain continuing jurisdiction regarding their own orders if necessary "to secure or preserve the fruits and advantages of a judgment or decree rendered therein." *See id.* at 239-40. As a result, the bankruptcy court had jurisdiction and power regarding Hunt's request and could properly enjoin Local Loan Co.'s state court lawsuit if necessary to give effect to Hunt's discharge. *See id.* at 241.[25]

As to the lien question, the Court followed a line of cases holding that the after-acquired wages are too inchoate a property interest to support a "lien" under section 67(d). As the Court explained:

> The earning power of an individual is the power to create property; but it is not translated into property within the meaning of the bankruptcy act until it has brought earnings into existence. An adjudication of bankruptcy, followed by a discharge, releases a debtor from all previously incurred debts, with certain exceptions not pertinent here; and it logically cannot be supposed that the act nevertheless intended to keep such debts alive for the purpose of permitting the creation of an enforceable lien upon a subject not existent when the bankruptcy became effective or even arising from, or connected with, preexisting property, but brought into being solely as the fruit of the subsequent labor of the bankrupt.

Id. at 243.

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[25] The Court did observe that such jurisdiction was not exclusive, which meant the bankruptcy court was not "bound to exercise its authority" and "probably would not and should not have done so except under unusual circumstances such as here exist." *Id.*

Finally, the Court determined that contrary opinions by the Supreme Court of Illinois were "precluded here by the clear and unmistakable policy of the bankruptcy act." *Id.* at 244. In grounding this conclusion, the Court emphasized the "fresh start" policy of federal bankruptcy law, one that "has been again and again emphasized by the courts as being of public as well as private interest" by giving "the honest but unfortunate debtor who surrenders for distribution the property which he owns *at the time of bankruptcy*, a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt." *Id.* All of the provisions of the Bankruptcy Act, including those regarding the continued enforcement of liens, "were adopted in the light of that view and are to be construed when reasonably possible in harmony with it so as to effectuate the general purpose and policy" at the foundation of federal bankruptcy law. *See id.* at 245. As a result, state court rules and decisions "subversive of that result cannot be accepted as controlling the action of a federal court." *Id.*

The opinion concludes with a striking discussion of how the enforcement of a wage assignment would gut a consumer debtor's discharge, which discussion is well worth quoting in its entirety:

> When a person assigns future wages, he, in effect, pledges his future earning power. The power of the individual to earn a living for himself and those dependent upon him is in the nature of a personal liberty quite as much as, if not more than, it is a property right. To preserve its free exercise is of the utmost importance, not only because it is a fundamental private necessity, but because it is a matter of great public concern. From the viewpoint of the wage earner there is little difference between not earning at all and earning wholly for a creditor. Pauperism may be the necessary result of either. The amount of the indebtedness, or the proportion of wages assigned, may here be small, but the principle, once established, will equally apply where both are very great. The new opportunity in life and the clear field for future effort, which it is the purpose of the bankruptcy act to afford the emancipated debtor, would be of little value to the wage earner if he were obliged to face the necessity of devoting the whole or a considerable portion of his earnings for an indefinite time in the future to the payment of indebtedness incurred prior to his bankruptcy.

Id. Accordingly, because enforcement of the Illinois wage assignment as to Hunt's post-bankruptcy wages would be "destructive of the purpose and spirit of the bankruptcy act," it was properly invalidated by the Illinois bankruptcy court. *See id.*

V. Significance

Local Loan Co. v. Hunt supports several propositions that are of enormous and continuing significance to the formulation, interpretation, and application of United States bankruptcy law.

First, *Local Loan Co. v. Hunt* is one of several Supreme Court cases establishing that bankruptcy courts retain jurisdiction to interpret and enforce their own orders. The scope of a bankruptcy court's post-sale, post-confirmation, or post-discharge jurisdiction remains an issue that is litigated today, and *Local Loan Co. v. Hunt* often is cited to support continuing jurisdiction. *See, e.g.*, *Travelers Indem. Co. v. Bailey*, 557 U.S. 137, 151 (2009); *Angel v. Tauch (In re Chiron Equities, LLC)*, 552 B.R. 674, 684 (Bankr. S.D. Tex. 2016); *In re Patriot Coal Corp*., 539 B.R. 812, 819 (Bankr. E.D. Mo. 2015).

Second, *Local Loan Co. v. Hunt* also is one of several Supreme Court cases regularly cited for the proposition that bankruptcy courts are courts of equity acting in equitable proceedings. *See, e.g.*, *Official Comm. of Unsecured Creditors of Cybergenics Corp. ex rel. Cybergenics Corp. v. Chinery*, 330 F.3d 548, 567 (3d Cir. 2003) (en banc); *In re Fabricators, Inc*., 926 F.2d 1458, 1464 (5th Cir. 1991); H.R. Rep. No. 95-595, at 359 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6315. *But see generally* Alan M. Ahart, *The Limited Scope of Implied Powers of a Bankruptcy Judge: A Statutory Court of Bankruptcy, Not a Court of Equity*, 79 AM. BANKR. L.J. 1 (2005). This broad principle supports the assorted "equitable powers" of bankruptcy courts.

Third, *Local Loan Co. v. Hunt* underscores the importance of segregating value "brought into being solely as the fruit of" post-bankruptcy efforts from pre-bankruptcy liens. This same policy undergirds Bankruptcy Code section 552, which applies across consumer, corporate, and municipal cases. *See, e.g.*, *Johnson v. RFF Family P'ship, LP (In re Johnson)*, 554 B.R. 448, 462-63 (Bankr. S.D. Ohio 2016); *Official Comm. of Unsecured Creditors v. UMB Bank, N.A. (In re Residential Capital, LLC)*, 501 B.R. 549, 612 (Bankr. S.D.N.Y. 2013); *In re Cafeteria Operators, L.P.*, 299 B.R. 400, 403-05 (Bankr. N.D. Tex. 2003); *In re Patio & Porch Sys.*, 194 B.R. 569, 573 (Bankr. D. Md. 1996).

Fourth, *Local Loan Co. v. Hunt* contains an extremely powerful articulation of the value of a "fresh start" to consumer debtors, including by grounding the bankruptcy discharge in both personal human liberty and broad public policy. The potent language used by the Supreme Court has served as an inspiration for generations of consumer bankruptcy attorneys, as well as policy advocates seeking to preserve the scope and viability of a broad bankruptcy discharge for individual debtors. *See, e.g.*, Kenneth N. Klee & Whitman L.

Holt, BANKRUPTCY AND THE SUPREME COURT: 1801-2014 at 318 (West Academic 2015) (describing how "the Court made a powerful statement that would serve as the backbone of American consumer bankruptcy law for the next 70 years"); Lee Dembart & Bruce A. Markell, *Alive at 25? A Short Review of the Supreme Court's Bankruptcy Jurisprudence, 1979-2004*, 78 AM. BANKR. L.J. 373, 376 (2004) (observing how the Supreme Court "has recognized the salutary aspect of the discharge in many ways, but none more concise and eloquent than in *Local Loan Co. v. Hunt*").

Northern Pacific Railway Co. v. Boyd
228 U.S. 482 (1912)

Case v. Los Angeles Lumber Products Co.
308 U.S. 106 (1939)

Stephen D. Lerner
Squire Patton Boggs (US) LLP
Cincinnati, Ohio

These two Supreme Court decisions from the early 20th century created the absolute priority rule largely as we still know it today—codified in section 1129(b)(2)(B) of the Bankruptcy Code. Together, they stand for the principle that holders of a junior class of claims may not recover any value on account of such claims unless senior claims are paid in full or holders consent. Following the case summaries, there is a more complete discussion of their enduring significance.

I. Issue

Can a contract for reorganization made between bondholders and stockholders of an insolvent corporation, which involves the transfer of property to a new corporation owned by the same stockholders, defeat the claims of intermediate non-assenting creditors?

II. Statutory Context

Not applicable.

III. Facts

In 1887, Spaulding sued the Coeur D'Alene Railway & Navigation Company ("**Coeur D'Alene**") for approximately $24,000 for services and materials provided in connection with construction of a portion of the railroad line. He received a judgment in 1896 and was succeeded in the judgment by Boyd. Boyd revived the judgment in 1906 for $71,278 (the original amount plus interest) and sought to execute the judgment. However, in the intervening years, Coeur D'Alene had become insolvent and it became part of the Northern Pacific Railroad. Later the Northern Pacific *Railroad* went through an equity receivership and its assets were acquired by the Northern Pacific *Railway* Company. The case, thus, involves Boyd's effort to pursue the judgment first obtained against Coeur D'Alene against the Northern Pacific Railway Company.

Previously, the president of Coeur D'Alene entered into a contract with Northern Pacific Railroad in which he sold 5,100 shares (representing 51% of Coeur D'Alene) to secure for Northern Pacific Railroad a lease of the Coeur D'Alene's property for 999 years and the authority to issue $825,000 of mortgage bonds. Of this amount, $360,000 was to be retained to redeem the outstanding bonds for that amount, but the agreement was silent on what should be done with the remaining $465,000 of bonds. There was a disagreement on this issue, with Boyd claiming that the bonds, or their proceeds, were used to pay the President of Coeur D'Alene for the 5,100 shares of stock. Northern Pacific, however, maintained that the consideration for the transfer was the railroad guaranteeing the principal and interest of the bonds and taking a lease of the property for 999 years, which provided for rental to be paid out of Coeur D'Alene's net earnings.

In 1889, Northern Pacific Railroad acquired the balance of Corbin's stock in Coeur D'Alene. As Coeur D'Alene's earnings rapidly decreased, Northern Pacific Railroad's source for repayment of the bonds evaporated and it ultimately defaulted on its bonds. An equity receivership was commenced and foreclosure of the mortgages on the Coeur D'Alene property was sought. Ultimately, the bondholders and shareholders agreed on a plan to avoid foreclosure. Under the plan, a newly formed company – Northern Pacific Railway – would acquire the assets of Northern Pacific Railroad, the bonds would be paid in full and the shareholders would ride through and own the equity of the Railway. No recovery was provided to holders of unsecured creditors such as Boyd. Notably, Boyd did not participate in any of these proceedings.

Boyd sued both the Railroad and the Railway claiming that the Railroad had become liable directly for the Coeur D'Alene's debt and that through the equity receivership the Railway also was liable. Boyd's argument relied upon the common law doctrine that a real property owner who acquires his own property through a foreclosure takes subject to the claims of junior creditors. In essence, he claimed the sale was invalid because the plan of reorganization between the bondholders and the stockholders made no provision for the payment of unsecured creditors, although the stockholders retained their interest by receiving shares in the new company.

Both lower courts found in favor of Boyd and the case landed in the Supreme Court.

IV. Holding

The Supreme Court held that the common law principle argued by Boyd was applicable in the context of corporate reorganizations.

The Court held that contracts for reorganization made between bondholders and stockholders of insolvent corporations which involve the transfer of corporate property to a new corporation cannot defeat the claims of non-assenting creditors. In that regard, even when the agreement is made in good faith, the rights of such creditors must be taken into account. Moreover, the rights of junior non-assenting creditors do not depend upon whether their claims were "in the money."

The property of a corporation, in the hands of the former owners under a new charter, is as much subject to existing liabilities as that of a defendant who buys his own property at a foreclosure sale. Thus, the decree in a proceeding brought by one of a class to permit that class to participate in a reorganization is not res judicata as against another of the same class who was not a party thereto and had no notice of the proceeding. A fair and equitable provision was required to have been made for the unsecured debts, which would recognize their priority over the interests of the stockholders. On the strength of this reasoning, the Supreme Court held that Boyd could recover his judgment against the new Northern Pacific Railway entity:

> Though the Northern Pacific Railroad was divested of the legal title, the old stockholders were still owners of the same railroad, encumbered by the same debts….The property in the hands of the former owners, under the new charter, was as much subject to any existing liability as that of a defendant who buys his own property at a tax sale.

Finally, the Supreme Court clarified that its conclusion does not "require the impossible" by making it necessary to pay an unsecured creditor in cash as a condition of stockholders retaining an interest in the reorganized company. Other options to preserve its interest exist, including issuing income bonds or preferred stock. As long as a tender is made and the unsecured creditor declines a fair offer, he cannot thereafter be heard in a court of equity to attack it.

Case v. Los Angeles Lumber Products Co.
308 U.S. 106 (1939)

I. Issue

Is it "fair and equitable" under Section 77B of the Bankruptcy Act for stockholders to receive a recovery on account of their stock when creditors are not paid in full?

II. Statutory Context

This case was decided under Section 77B of the Bankruptcy Act.

III. Facts

Respondent debtor Los Angeles Lumber Products Company was a holding company owning all of the outstanding shares of the capital stock of six subsidiaries. Five of the subsidiaries had little or no value. The principal asset of the debtor consisted of stock of a shipbuilding subsidiary. This subsidiary had fixed assets of $430,000 and current assets of approximately $400,000. The debtor's liabilities consisted of $3.8 million of first lien mortgage bonds issued in 1924 and maturing in 1944, secured by a trust indenture covering the fixed assets of the shipbuilding subsidiary and the capital stock of all of the subsidiaries.

The debtor ceased paying interest in early1929, and in 1930, a voluntary out of court reorganization was undertaken. As part of the voluntary reorganization, a supplement to the trust indenture was executed whereby: (1) interest was reduced from 7.5% to 6% and interest became payable only if earned; (2) the old stock of the debtor was wiped out by assessment and new stock was issued, divided into Class A and Class B, with equal voting rights; (3) Class A stock was issued to some of the old stockholders who contributed $400,000 in new money which was turned over to the subsidiary to be used as working capital; (4) the bondholders released the stockholders' liability under California law in favor of these contributors; and (5) some Class B stock was issued to bondholders in payment of unpaid interest coupons.

Notwithstanding the 1930 reorganization, the debtor struggled and in 1938, it filed a petition for reorganization under Section 77B of the Bankruptcy Act. With an overwhelming majority of bondholders and shareholders supporting the reorganization effort, the parties agreed on a plan of reorganization. The plan provided for the formation of a new corporation that would acquire the assets of the shipbuilding subsidiary. Its capital structure would consist of 1,000,000 shares of authorized $1 par value voting stock divided into preferred and common shares. Of the 811,375 shares of preferred stock, 641,375 were

to be issued to the bondholders, with 250 shares to be exchanged for each $1000 bond. The balance of the preferred shares was reserved for future sale to raise additional capital. All of the common shares were to be issued to the existing Class A shareholders. Class B shareholders would receive nothing.

The petitioners owned bonds in the face amount of $18,500. They did not consent to the 1930 voluntary out of court reorganization and throughout the section 77B proceedings, they objected that the plan was not fair and equitable to bondholders.

The district court found the debtor was insolvent and confirmed the plan despite the fact that the old stockholders, who were out of the money, were given 23% of the value of the assets and voting power in the new company without making any fresh contribution by way of subscription or assessment. The court justified the treatment afforded to the stockholders for several reasons, including (1) the stockholders' familiarity with the business and their financial standing and influence in the community which the court considered "compensating advantages" or "consideration" provided to the bondholders; and (2) the plan maintained the relative priorities of the bondholders and stockholders by virtue of the preferences accorded the stock which the bondholders were to receive and the fact that the stock going to the bondholders carried 77% of the voting power of all the stock presently to be issued under the plan.

The Circuit Court of Appeals, in affirming the decree, stated it was not possible for it to do anything other than accept the district court's findings because of a stipulation providing for an abbreviated record and the dissenting bondholders intended to raise only substantive questions of law.

IV. Holding

Writing for a unanimous Court, Justice Douglas held that the District Court erred in confirming the plan and the Circuit Court of Appeals erred in affirming the decree. As a matter of law, the plan was not fair and equitable.

As a threshold matter, the Court determined that where a plan is not fair and equitable as a matter of law, it cannot be approved by a court even though the percentage of various classes of security holders required by Section 77B(f) for confirmation of the plan has consented. Indeed, the Court found that Congress' intent was for the "required percentages of each class of security holders approve the plan and that the plan be found to be 'fair and equitable.'" Importantly, the "former is not a substitute for the latter" and the court should not merely act as a "ministerial register of the vote of the several classes of security

holders." As such, it was immaterial that 92.81% of the bonds in circulation, 99.75% of the Class A stock, and 90% of the Class B stock approved the plan.

The Court recited the contours of the "fixed principle" enunciated in *Northern Pacific Ry. Co. v. Boyd* and extended it to Section 77B as being functionally equivalent to phrases like "just, fair and equitable." In other words, in equity reorganizations, the court must use its own informed and independent judgment in every important determination in the administration of the proceedings. Under that section, creditors are entitled to absolute priority over stockholders against all the property of an insolvent corporation, relative priority not being sufficient.

As applied to the facts of the case, giving the stockholders 23 percent of the assets and voting power in a new company without requiring a fresh contribution of capital was not "fair and reasonable" where the amount owed bondholders was more than four times the value of its assets. As there were insufficient assets, it was not sufficient to simply maintain the relative priorities of the bondholders and old Class A stockholders. In dicta, the court stated that to accord the creditor its full right of priority against the corporate assets where the debtor is insolvent, the stockholder's participation must be based on a contribution in money or in consideration reasonably equivalent in view of all the circumstances to the participation of the stockholder. In this case, the alleged consideration provided by the stockholders did not comply with those requirements. Even if requisite majorities of security holders agree to a plan of reorganization, it is not a contract binding on the court.

Finally, the Court also found erroneous the district court's holding that the value to the bondholders of maintaining the debtor as a going concern and of avoiding litigation with the old stockholders justified the inclusion of the latter in the plan. The district court is not to be influenced by threats of litigation on the part of stockholders.

V. Significance of *Boyd* and *Case*

The importance of the Supreme Court decisions in *Boyd* and *Case* cannot be overstated. Together they established one of the critical and everlasting cornerstones of current reorganizations—the absolute priority rule. This rule guides virtually all market participants in both out of court and chapter 11 reorganizations and establishes a clear framework for developing a consensual restructuring or achieving a cramdown in chapter 11. Notably, the Supreme Court recognized that, even in the face of overwhelming consensus by holders of debt and equity regarding the terms of a restructuring, the rights of dissenting creditors, who are not treated fairly, must be respected. *Case*, albeit in *dicta*, also created the new value exception to the absolute priority rule.

While current restructuring professionals take the absolute priority rule for granted as consistent with contractual and corporate governance priorities as well as common sense, the railroad reorganizations of the late 19th and early 20th centuries routinely resulted in shareholders retaining value while not all creditors received full or even any recovery. Often shareholders also managed the business and that status was used to justify retaining ownership. In *Boyd* and *Case*, the Court bravely did an about face and protected the rights of minority claimants to be treated fairly and equitable. Thus the enduring absolute priority rule was born.