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Anne Webber Epstein

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FROM DEBTOR'S SHIELD TO CREDITOR'S SWORD:
CRAM DOWN UNDER THE CHANDLER ACT
AND THE BANKRUPTCY REFORM ACT

The first comprehensive revision of bankruptcy law in forty years was completed on November 6, 1978, when President Carter signed the Bankruptcy Reform Act of 1978.\(^1\) As it becomes effective on October 1, 1979, the new act introduces substantive changes that will undoubtedly have a tremendous impact on bankruptcy law.\(^2\) The new act rejuvenates the system, taking into consideration changes in commercial transactions, lending conditions and public policy.\(^3\) Among the adjustments are an expanded jurisdiction for the United States Bankruptcy Court,\(^4\) the creation of an office of United States trustee to perform several administrative functions formerly the responsibility of the bankruptcy court,\(^5\) and alterations necessitated by the adoption of the Uniform Commercial Code.\(^6\) One major change in the new act is the consolidation of the provisions for reorganization in four chapters of the old act\(^7\) into one new chapter, to be known as chapter 11.\(^8\) The new

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chapter embodies many provisions of the old reorganization chapters and embraces several original concepts as well.\(^9\) Combining the business reorganization chapters into one chapter simplifies reorganization procedure, eliminating the most grievous threat to any business reorganization—needlessly wasted time and delay in litigation.\(^{10}\)

The success of every reorganization hinges on the creditors' acceptance of the proposed plan of arrangement.\(^{11}\) Creditors with valid, allowed claims are divided into classes according to the nature of their individual claims.\(^{12}\) The debtor or some or all of the creditors propose a plan of arrangement setting forth the amount and the method of payment of each claim.\(^{13}\) Creditors whose claims are materially and adversely altered by the plan constitute "affected creditors"\(^{14}\) who may vote whether to accept or reject the plan. Recipients of the full amount of their claims are not affected by the plan and are not entitled to vote. A plan is accepted when a two-thirds majority of each affected class assents to it.\(^{15}\) The court confirms the plan subject to the requirements of the particular chapter.\(^{16}\)

An alternative method of acceptance is available to debtors in


\(^{10}\) Corporations often suffer appreciable deterioration if they are caught in a reorganization proceeding for any substantial length of time. The new act seeks to eliminate this delay by permitting a debtor to "affect" creditors and shareholders in the same proceeding. 124 Cong. Rec. H11,102 (daily ed. Sept. 28, 1978).

\(^{11}\) The plan contains the proposed reorganization of the business. Each reorganization chapter describes which parties may propose a plan and what the plan must contain. Parties who may propose a plan under the new act are defined in Pub. L. No. 95-598, 92 Stat. 2631 (1978) (to be codified at 11 U.S.C. § 1121).

\(^{12}\) The court arranges the classes of creditors and interest holders according to the type of interest involved, either a secured or unsecured debt or an equity interest. Having determined the nature of the claim, the court then arranges classes according to the size of the debt. See, e.g., Bankruptcy Act §§ 216, 452, 11 U.S.C. §§ 616, 852 (1976).


\(^{14}\) Affected creditors in chapter XII are those creditors whose contract rights are materially and adversely altered by the debtor's plan. 11 U.S.C. § 807 (1976). Kyser v. MacAdam, 117 F.2d 232 (2d Cir. 1941). The new act has changed the term to "impairment" of claims or interests. Pub. L. No. 95-598, 92 Stat. 2633 (1978) (to be codified at 11 U.S.C. § 1124). A claim or interest is impaired when the plan alters the legal, equitable or contractual rights on which the claim or interest is based. Id.


chapters X and XII of the old act. This device, commonly known as "cram down," may be broadly described as permitting a plan to be accepted despite a negative vote by a majority of each class, provided the plan adequately protects the value of each dissenting creditor's claim. Because all reorganizations have been consolidated into one chapter under the new act, the use of cram down will be expanded to include all creditors and interest holders of the reorganized debtor. Undoubtedly, the new act will promote increased usage of cram down. Courts deciding whether to implement a forced acceptance of a debtor's reorganization under the new act will need to rely upon existing precedent. There has been a substantial amount of litigation dealing with cram down under chapter XII. This has proved to be a source of controversy concerning when cram down should be applied.

Problems of interpretation of cram down arise because the statu-

18. "Cram down" is a term used by some bankruptcy lawyers and bankruptcy commentators to describe the application of [section 861(11)] under Chapter XII and [section 616(7)] under Chapter X of the Act upon a dissenting class of creditors where the proposed plan failed to receive approval of the requisite majority. [It is a self-evident, vivid term of immediate understanding, perhaps requiring no explanation. It creates an instant correct connotation of the involuntary administration of bad medicine upon a recalcitrant victim, the secured creditor who opposes the effects of the reorganization proceedings in the Bankruptcy Court. In re Pine Gate Assocs., Ltd., 10 C.B.C. 581, 591 n.16 (N.D. Ga. 1976).
19. This interpretation of cram down is a hotly disputed issue. See, e.g., Fine, Unjamming the "Cram-Down," 52 AM. BANKR. L.J. 321, 335-39 (1978) [hereinafter referred to as Fine]; Nicholson, Chapter XII: Rehabilitation or Resurrection? The Cram-Down and Other Problems, 26 Emory L.J. 489 (1977) [hereinafter referred to as Nicholson]. Even this general description of cram down would not be acceptable to those courts adhering to the reasoning of In re Herweg, 119 F.2d 941 (7th Cir. 1941). See text accompanying notes 63-75 infra.
20. Chapter 11 of the new act will affect secured and unsecured creditors and all interest holders. The cram down provision will affect these interests as well. Pub. L. No. 95-598, 92 Stat. 2637-38 (1978) (to be codified at 11 U.S.C. § 1129(b)).
21. Moreover, the old act will continue as the applicable law for all cases commenced prior to Oct. 1, 1979, and will continue as applicable law for those cases still pending until April 1, 1984. Bankruptcy Reform Act of 1978, § 403(a), Pub. L. No. 95-598, 92 Stat. 2683 (1978).
23. The chapter XII decisions dealing with cram down provide a better basis for discussion than do the few chapter X cram down cases. See, e.g., Consolidated Rock Prods. Co. v. DuBois,
tory language of the old act is ambiguous with respect to the precise nature of the circumstances under which cram down is available. The courts have attempted to fill this vacuum but have disagreed in their interpretation of what Congress intended. Two divergent lines of reasoning have emerged: One view,\textsuperscript{24} holds that cram down is available only in limited circumstances;\textsuperscript{25} the other view,\textsuperscript{26} asserts that cram down should not be so restrictively construed. The former view applies a one-step analysis:\textsuperscript{27} Unless two-thirds of each class of creditors assents to the plan in the first place, courts subscribing to this analysis summarily deny use of cram down against the dissenting creditors. Cram down is refused irrespective of whether there are several classes of dissenting secured creditors or whether the plan involves only a single mortgagee.\textsuperscript{28}

A two-step approach was developed in response to the inflexibility of the traditional one-step approach.\textsuperscript{29} The number of dissenting affected creditor classes is ascertained. The court then determines whether the plan adequately protects the claims of the individual dissenting creditors in each class. If the court is satisfied as to the adequacy of protection, the dissenting classes are crammed down and the plan is confirmed despite their objections.\textsuperscript{30}

The cram down provision in chapter 11 of the new act\textsuperscript{31} is an at-
tempt to resolve various controversies which have arisen concerning the application of cram down under chapter XII of the old act.\textsuperscript{32} The courts have been given more precise guidelines as to standards of protection for dissenting classes of creditors.\textsuperscript{33} However, it appears that congressional efforts may have transformed a protective mechanism for debtors into an offensive weapon for creditors.

This note will describe the line of cases that developed and preserved the one-step approach to cram down. The two-step approach with its more flexible definition of situations in which cram down is available will then be examined. The necessity for adoption and expansion of this approach will be explained. Projections for the future role of cram down under the Bankruptcy Reform Act of 1978 will be made. Controversies pertaining to the conflict concerning the old provision which have been resolved by the new act and those that continue under the new act will then be discussed. This note will conclude with the proposition that Congress has adopted the wrong approach and has transformed cram down into a creditor's tool as a result.

whether the property subject to such lien is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and

(ii) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;

(i) for the sale, subject to section 363(k) of this title, of any property that is subject to the lien securing such claims, free and clear of such lien, with such lien to attach to the proceeds of such sale, and the treatment of such lien on proceeds under clause (i) or (ii) of this subparagraph; or

(ii) for the realization by such holders of the indubitable equivalent of such claims.

(B) With respect to a class of unsecured claims—

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain on account of such junior claim or interest any property.

(C) With respect to a class of interests—

(i) the plan provides that each holder of an interest of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the greatest of the allowed amount of any fixed liquidation preference to which such holder is entitled, any fixed redemption price to which such holder is entitled, and the value of such interest; or

(ii) the holder of any interest that is junior to the interests of such class will not receive or retain under the plan on account of such junior interest any property.


Subsection (a)(8) details one of the several requirements which must be met in order to permit court confirmation of a debtor's plan. It specifies that, “With respect to each class . . . such class has accepted the plan; or . . . such class is not impaired under the plan.” Pub. L. No. 95-598, 92 Stat. 2636 (1978) (to be codified at 11 U.S.C. § 1129(a)(8)(A), (B)).


33. See text of statute at note 31 supra.
The Traditional One-Step Approach to Determining The Availability of Cram Down

The essential purpose of a reorganization proceeding is to preserve the debtor's business as an ongoing operation in the face of financial setbacks which have rendered the debtor unable to meet completely all its obligations to creditors. The debtor wishes to avoid a liquidation proceeding in which the business is dissolved and its assets sold in order to partially satisfy the debts of the business. To accomplish this, the debtor seeks to reassure creditors that its financial difficulties are temporary, that the business will be restored to health, and most, if not all, debts will be paid. Creditors must be convinced that by accepting less than the face value of a claim or deferring payments over an extended period they will receive a larger portion of the amount owed than they would if the debtor were forced to dissolve the business and settle accounts in a liquidation proceeding. Thus, reorganization is principally a debtor's means to avoid the permanency of straight bankruptcy, restricted only by the financial arrangements which creditors and the court will accept.

Cram down in chapter XII is contained in section 461(11). The provision provides for confirmation, even though the plan has been rejected by a two-thirds majority of each affected class, if each member of the dissenting classes will receive adequate protection by one of four methods: (1) the transfer, sale or debtor's retention of the property subject to the debt, (2) a sale of the property free of debts as long as the price is not less than fair upset price, followed by payment of debts

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39. Each chapter has a confirmation standard by which the court determines whether to confirm a plan that has been proposed to creditors affected by the reorganization. The confirmation standard varies according to the particular chapter. See text accompanying notes 178-205 infra.
41. Fair upset price must be an amount exceeding liquidation value. Relying on appraised
from the proceeds, (3) appraisal and payment in cash of the value of the debts or (4) by any method consistent with the circumstances of the case which fairly protects the creditors. 42

Two cases, decided within months of one another, 43 combined to establish the procedure for the one-step approach to determine the availability of cram down in chapter XII. Kyser v. MacAdam 44 involved a debtor whose family home was encumbered by a mortgage and several materialmen's liens. These debts exceeded the value of the home, the only property included in the reorganization. 45 The debtor proposed a plan that was based on two assumptions. First, the secured creditors could only be secured up to the face value of the security. They would be reclassified as unsecured creditors to the extent that their liens exceeded the value of the house. 46 Second, since the amount of their claims had been scaled down to the value of the security, they were secured to the extent of their claims under the plan. The plan would not offer them any less than the value of the house; thus, these creditors were not affected by the plan and as unaffected creditors, they could not vote on the plan as secured creditors. 47

The specific plan which emerged from this recondite reasoning proposed reducing each secured creditor's lien to one-half its stated amount. 48 The lienors would be reclassified as unsecured creditors for the remaining half of the debt owed them. Two classes of creditors would be formed. One class would consist of claimants secured to the extent of the appraised value of the house; the other class would include the materialmen's lienors for their claims in excess of the home's value and all other unsecured creditors. 49 The debtor contended that because the plan would not deprive the lien creditors of the value of their now scaled-down claims, the lienors were not materially and ad-

valuations, the court determines whether the amount bid constitutes fair upset price. See generally In re Pembroke Manor Apts., 547 F.2d 805 (4th Cir. 1977).

42. The fourth method is the most flexible and consequently, most difficult method for the courts to interpret. See In re Triangle Inn Assocs., 14 C.B.C. 532 (E.D. Va. 1977).

43. Kyser v. MacAdam, 117 F.2d 232 (2d Cir.1941), was decided on January 13, and In re Herweg, 119 F.2d 941 (7th Cir. 1941), was decided on May 1.

44. 117 F.2d 232 (2d Cir. 1941).

45. Id. at 234.

46. Id. at 238.

47. Id. This assertion is based on the theory that if the secured claim is only $4000 and the plan offers to pay the secured creditors $4000 then they are receiving the full value of their claims, i.e., creditors receiving full value unaffected by the plan, and cannot vote to accept or reject the plan. See Bankruptcy Act § 468, 11 U.S.C. § 868 (1976).

48. 117 F.2d at 234.

49. Id.
Creditors not affected by the plan are not entitled to vote. Therefore, an affirmative vote by the unsecured creditor class would be sufficient to allow approval of the debtor's plan.\(^{52}\)

The Kyser court refused to accept the debtor's argument.\(^{53}\) It stated that the secured creditors' claims could not be reduced by a substantial amount\(^{54}\) merely to redesignate these claimants as unsecured creditors for the excess. The plan did not provide for the payment of the full value of the secured creditors' claims; therefore, they were affected by the plan and consequently entitled to vote. An arrangement could not be adopted through the votes of unsecured creditors alone. Similarly, cram down could not be utilized when the only affirmative votes for the plan were those of the unsecured creditors.\(^{55}\)

In *In re Herweg*,\(^{56}\) the debtor's plan proposed that the secured creditor class,\(^{57}\) comprised of first and second mortgagees, accept cash payment of the appraised value of the building which was security for the debt. However, because the appraised value of the collateral was less than the face value of the debt,\(^{58}\) the creditors rejected the plan, preferring to collect their claims upon foreclosure at a judicial sale. Since neither creditor accepted the plan, the court denied the debtor's request to invoke cram down to force acceptance of the plan over the secured creditors' objections. The cram down provision, the court said, did not authorize forcing secured creditors unanimously opposed to the plan to accept a reduced amount of their claims.\(^{59}\)

The Kyser and Herweg courts both denied debtors' requests to ap-
ply cram down in order to salvage plans of arrangement despite secured creditors' rejections of them. The basis for the denial in *Kyser* was the court's statutory interpretation—cram down was held to be unavailable when unsecured creditors were the only classes accepting the debtor's plan.\(^\text{60}\) In *Kyser*, the unsecured creditors would recover a larger portion of their claims if the debtor did not go into liquidation, while the secured creditors would recover more if they foreclosed upon their mortgages and forced the debtor to liquidate all its assets.\(^\text{61}\) The court perceived that it would be unfair to the secured creditors, and contrary to the intent of the statute, to force them to accept a plan via cram down merely because the unsecured creditor classes had accepted the plan.

In contrast, *Herweg* focused on the problem from the perspective of the negative votes of secured creditors,\(^\text{63}\) rather than the insufficiency of affirmative votes from unsecured creditors. The basis for this interpretation was the belief that the statute required that a two-thirds majority of at least one class of secured creditors assent to the plan before a dissenting class could be subjected to cram down.\(^\text{64}\) *Herweg* involved two classes of secured creditors, each comprised of one member. According to this interpretation, at least one secured creditor must assent in order to invoke cram down. Since neither did, the debtor's plan was denied.\(^\text{65}\)

The specific plans proposed in *Kyser* and *Herweg* failed to provide adequate protection for the value of each creditor's claim. Therefore, cram down should have been denied on the inadequacy of the plans, rather than for the reasons expressed in the cases. A cram down in *Kyser* would have forced the creditors to accept drastically reduced amounts in exchange for the right to foreclose immediately on their liens, the collateral for which might continue to diminish in value. The *Herweg* court may have denied cram down because it believed that the appraised value of the property had been substantially underestimated.\(^\text{66}\) Had the appraised value seemed more realistic, the plan

\(^{60}\) 117 F.2d at 238.

\(^{61}\) Id.

\(^{62}\) Id.

\(^{63}\) See 119 F.2d at 943.

\(^{64}\) See Gilbert & Massari, *supra* note 22, at 114-15.

\(^{65}\) 119 F.2d at 943.

\(^{66}\) If the debtor's theory had been successful, the appraised value of the property would have been crucial to the plan. See note 58 *supra*. Therefore, the court may have suspected the debtor of undervaluing the property so it would have to pay less to the secured creditors. See, e.g., *In re Colonial Realty Inv. Co.*, 516 F.2d 154 (1st Cir. 1975); *In re Marietta Cobb Apts. Co.*, 14 C.B.C. 503 (S.D.N.Y. 1977).
might have been held to offer the creditors adequate protection. But the proposed plan certainly did not adequately protect the creditors and did not support a cram down.67

Rather than limiting their holdings to the facts, both Kyser and Herweg articulated unnecessarily sweeping conclusions of law.68 While the Kyser opinion may be excused as an expression of policy, namely, that it would be unfair to bind secured creditors to a plan accepted only by unsecured creditors, the Herweg court committed the more grievous error by articulating a broad, arbitrary statement that cram down was unavailable when secured creditors unanimously opposed the plan. Because the Herweg rule had no foundation in the statute,69 the fact that it has been subsequently adopted without further examination exacerbates the seriousness of the error.70

The Herweg court's confusion should have been evident from the nature of the opinion. Although the holding quite clearly precluded the use of cram down when all classes of secured creditors unanimously opposed the plan, the dictum implied a contradictory result. The court stated that "no arrangement shall be blocked because one group of creditors opposes it, provided that they are adequately protected by the arrangement."71 The court may not have perceived the divergent reasoning embodied in its holding and dictum.72 The language of the dictum closely resembles the language of the statute.73 It emphasizes the adequacy of protection for dissenting groups of creditors. The holding, on the other hand, concentrates on the existence of at least two-thirds of one class of secured creditors who assent to the plan before any consideration can be given to applying cram down. The two approaches

67. The particulars of the debtor's plan substantiate the fact that the creditors were inadequately protected. See notes 56-58 and 66 and accompanying text, supra. 68. See generally In re Pine Gate Assocs., Ltd., 10 C.B.C. 581 (N.D. Ga. 1976). See also Dole, supra note 36. 69. See also In re KRO Assocs., 4 Bankr. Ct. Dec. 462 (S.D.N.Y. 1978). 70. See Taylor v. Wood, 458 F.2d 15 (9th Cir. 1972); Rader v. Boyd, 267 F.2d 911 (10th Cir. 1959); In re Stillbar Const. Co., 4 Bankr. Ct. Dec. 452 (N.D. Ga. 1978); In re Bekare Realty Assocs., 3 Bankr. Ct. Dec. 646 (E.D. Pa. 1977); In re Spicewood Assocs., 445 F. Supp. 564 (N.D. Ill. 1977). 71. 119 F.2d at 943. 72. This apparent contradiction could be reconciled on the theory that the court in Herweg was combining the requirements for cram down with the elements necessary for confirmation of the plan by the court. The confirmation provision required, inter alia, that the plan comply with the "fair and equitable" test. This stipulated that senior creditors must be fully compensated before payments to junior creditors are considered. The court may have approached both holding and dictum on the supposition that since the senior secured creditor would not receive full compensation, the plan could never be confirmed by the court. See text accompanying notes 81-93 infra. 73. See note 31 supra, for text of cram down provision.
are irreconcilable, but the Herweg court explicitly designated the latter to be the rule in the case. Subsequent courts adopted the Herweg rule that cram down could not be used to save a plan unless two-thirds of one class of secured creditors assented to it, however impractical the rule might be when applied to the facts of a particular case.

Meyer v. Rowen\(^7\) established a corollary to the Herweg rule. There, the debtor’s property was subject to a debt owed a single mortgagee. The court held that it was “obviously not the purpose” of the cram down provision to confirm a plan of arrangement when no secured creditor agreed to the plan.\(^7\) Meyer relied on the holding in Herweg to explicitly deny cram down when only one secured creditor is affected by the plan and that creditor rejects it. The court concluded that irrespective of the number of secured creditor classes or the number of secured creditors in each class, the Herweg rule applied. Unless two-thirds of any secured class assented, it was unnecessary even to consider whether the debtor’s plan adequately protected the value of the dissenting creditor’s claim.

The Meyer court’s expansion of the Herweg approach to encompass sole secured creditor situations further restricted the availability of cram down. The ultimate result of Meyer v. Rowen was to give sole secured creditors the final word on whether the reorganization will succeed, or whether the creditor will draw the debtor into a foreclosure proceeding.\(^8\) The court could have avoided setting this precedent. Instead, cram down could have been denied on the rationale that the plan failed to adequately protect the value of the mortgagee’s claim, rather than on the ground that the sole secured creditor dissented to the plan.

**The 1952 Amendment: Deletion of the Absolute Priority Rule and Continued Adherence to Herweg Despite the Change**

Herweg, Kyser and Meyer were all decided subject to the confir-

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74. 119 F.2d at 943.
75. The Herweg rule is particularly impractical where only one secured creditor is affected by the plan. Since the creditor’s vote cannot be divided into thirds, that one interest holder must assent. See generally In re Pine Gate Assocs., Ltd., 10 C.B.C. 581, 599-601 (N.D. Ga. 1976); In re Marietta Cobb Apts. Co., 14 C.B.C. 503 (S.D.N.Y. 1977).
76. 195 F.2d 263 (10th Cir. 1952).
77. Id. at 266.
78. Id.
79. Had the Herweg rule not been adopted for sole secured creditors, the courts might have developed a more flexible approach, similar to that of In re Pine Gate Assocs., Ltd., 10 C.B.C. 581 (N.D. Ga. 1976).
80. 195 F.2d at 265.
Information requirement that a plan be "fair and equitable, and feasible and in the best interest of the creditors." The absolute priority rule requires that a senior class of creditors must receive full compensation before any subordinate class is entitled to payment. A plan might be confirmed by means of a cram down if it adequately protected the value of the dissenting creditors' claims, but the court could not confirm the plan unless the distribution of value complied with the absolute priority rule. The rule created additional barriers for the debtor seeking rehabilitation.

As part of the 1952 omnibus amendments to the Bankruptcy Act, Congress deleted the absolute priority rule as a prerequisite for confirmation of a chapter XII plan. The requirement was eliminated from the confirmation standard because the rule could not be applied in chapter XII "without impairing, if not entirely making valueless, the relief provided by this Chapter." It was thought that after secured creditors were accorded absolute priority to the extent of their claims, the reorganized debtor would be left with insufficient property to reestablish itself. Congress viewed the deletion of the absolute priority rule as increasing the prospects that a chapter XII debtor would emerge from an arrangement proceeding with most of its property intact, although it may be reconstituted in a different form.

The 1952 amendment should have effectively superseded the Herweg interpretation of cram down. The deletion of the absolute priority rule made it possible for a debtor to propose a plan in which it would retain possession of an interest in its property without making full payment of debts owed senior secured creditors. Even if the senior secured creditors rejected the plan, the court was free to consider

84. See, e.g., In re Colonial Realty Inv. Co., 516 F.2d 154, 157-59 (1st Cir. 1975). See also Dole, supra note 36, at 201-03; Fine, supra note 19, at 330-36.
86. The confirmation requirement subsequent to the amendment is that the plan must be in the best interests of the creditors and feasible. Bankruptcy Act § 472, 11 U.S.C. § 872 (1976).
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the possibility of cram down without the prior restraints imposed by the absolute priority rule.90

Nevertheless, the Herweg rule continued to be the predominant interpretation of the cram down provision. This was true even though the outcome in Herweg may have been influenced by the fact that the court did not believe that the absolute priority rule had been complied with and denied cram down on that basis.91 While the amendment may not have explicitly neutralized the Herweg rule because the court did not explain the absolute priority rule's effect on the outcome of the case, it is certain that post-1952 courts were not constrained by the absolute priority rule.92 Therefore, later decisions should have discounted the Herweg interpretation to the extent that it was a consequence of the absolute priority rule.93

Although some courts raised the possibility of different analytical schemes to determine the availability of cram down,94 none directly challenged the one-step approach to cram down. Rader v. Boyd,95 for example, involved a sole secured creditor who rejected the proposed plan of arrangement.96 Instead of an automatic denial of cram down, as Herweg would require, the Rader court asked whether the plan adequately protected the creditor's claim. Concluding that plan was "too speculative,"97 the court rejected it without actually deciding whether to apply the Herweg rule.

In the period prior to 1975, only one case acknowledged the anomalies inherent in Herweg. In Sumida v. Yumen,98 the court admitted that a plan of arrangement conceivably could be formulated to protect adequately unanimously dissenting classes of secured creditors despite the Herweg rule.99 The court acknowledged by implication that the Herweg rule was incorrect or at least incomplete. Despite Sumida's

90. 119 F.2d at 943.
91. See notes 71-75 and accompanying text supra.
92. Merrick, supra note 22, at 246-47.
95. 267 F.2d 911 (10th Cir. 1959).
96. The plan would have allowed the debtor to retain possession of its oil wells. Creditor Boyd would receive stock in a newly formed corporation which would own the property and assume the debt. Id. at 913.
97. Id.
98. 409 F.2d 654 (9th Cir. 1969), cert. denied, 405 U.S. 964 (1972).
99. The court interpreted the cram down provision to require investigation of the adequacy of protection provided by the plan prior to any decision regarding the availability of cram down. Id. at 659.
dalliance with a contrary rule, the court accepted the hegemony of the Herweg approach, and held that it could not apply cram down in the absence of the assent of one secured class to the plan.

**The Traditional One-Step Approach of Herweg Challenged: In re Pine Gate & Associates, Ltd.**

The traditional one-step approach of Herweg severely restricted the availability of cram down to situations where at least two-thirds of one class of secured creditors assented to the plan. This approach prevented bankruptcy courts from considering the adequacy of the protection offered to dissenting creditors, limited judicial discretion, and restricted cram down as an alternative standard in all but a few situations.

The harshness of the Herweg rule became apparent as the number of chapter XII petitions increased during the mid-1970's. Tax reform laws had made it lucrative for limited partnerships to invest in real estate. However, the subsequent real estate recession forced many of these partnerships to seek the shelter of chapter XII in order to avoid foreclosure and a recapture by the Internal Revenue Service of deductions formerly made for depreciation of the value of the property. Although the statutory intent of cram down was clearly to allow the debtor to retain its property despite creditor refusal to accept the plan of arrangement, the Herweg approach had so narrowly defined the debtor's right to cram down as to make it an almost non-existent remedy. In their concern for dissenting creditors, the courts transformed cram down, which was initially developed as a debtor's remedy, into an additional means to protect creditors. This stark result became more pronounced as the number of filings increased in which the debtor's plan faced the dissent of a sole secured creditor, and courts, following Herweg, permitted foreclosure without determining the viability of the proposed plan.

The most vigorous challenge to this traditional approach came in In re Pine Gate Associates, Ltd., the first case to closely review the Herweg interpretation of cram down. Pine Gate involved a limited

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100. The number of filings increased from a low of 1 in 1946 to 525 in 1976. Approximately 43% of all Chapter XII proceedings have been filed since 1974. In re Pine Gate Assocs., Ltd., 10 C.B.C. 581, 587 n.12 (N.D. Ga. 1976). See also Nicholson, supra note 19, at 490.
102. Id. See I.R.C. § 1250.
partnership debtor, whose business was ownership and operation of an apartment complex, its sole asset. The debtor proposed a plan to refinance the existing debt owed on the project in order to pay almost all the remaining principal owed the secured creditors.106 Of the six classes of creditors, tax claimants comprised the first class. The plan proposed payment to them in full; therefore, as unaffected creditors, the tax claimants were not entitled to vote. Creditors in the other five remaining classes were affected by the plan. Four classes of unsecured creditors approved it. Only the secured creditor class rejected the plan, and urged adoption of the Herweg rule to prevent cram down.107

The Pine Gate court refused to adopt the rule, concluding instead that the dissenting creditors were subject to cram down, provided they received the value of their security; further, the secured creditors were not entitled to receive payment of their debts in full.108 The court held that an appraisal of the collateral and payment in full of that amount constituted adequate protection of the dissenting creditors' claims.109 Pine Gate took issue with the Herweg requirement that one class of secured creditors must assent to the plan in order to activate cram down. The procedure prescribed by Herweg110 and its progeny for determining the availability of cram down involved only a one-step analysis, whereas Pine Gate asserted that compliance with the provision required two steps. According to the Herweg approach, it was necessary only to ascertain which classes of secured creditors were affected and non-accepting.111 The Pine Gate court contended that the Herweg approach was incomplete.112 After discerning which classes of secured creditors dissented, Pine Gate reasoned that as the next step, the court must determine whether the plan adequately protected the dissenting secured creditors.113 If the plan adequately protected the value of their claims, the court may order cram down against the dissenting classes and subsequently confirm the plan. Thus, the adequacy of protection, not the number of dissenting secured creditors, was deemed pivotal to the success of the plan.

The Pine Gate court conceded that the one-step approach may have been viable when applied to the particular facts in Herweg, but it

106. Id. at 584.
107. Id.
108. Id. at 600-01.
109. Id. at 606.
110. 119 F.2d at 943.
111. Id.
112. 10 C.B.C. at 599.
113. Id. at 601.
was too inflexible to be applied automatically in every instance of cram down. The facts prompting the Herweg rule differed dramatically from the situation before the court in Pine Gate. The plan in Herweg centered on the restructuring of the assets where the only security was a house, the market value of which had diminished below the cost of improvements that had been made on it. The mortgagees must have been reluctant to postpone their rights to foreclose any longer, fearing further diminution in the value of the property. The court apparently respected the mortgagees' business acumen.

In Pine Gate, on the other hand, an ongoing business was involved, developed by its owners as a tax shelter which would be lost if the creditors were allowed to reject the plan and foreclose on their mortgages. Although the debtor was unable to pay its debts the value of its property was not likely to be reduced substantially. The Pine Gate apartment complex, if fully occupied, was appraised at more than the face value of secured debt. This factor, coupled with a healthy business prognosis, meant that application of the Herweg rule would force a reasonably viable operation, albeit in financial difficulty, into liquidation. The Pine Gate court respected the statutory intent implicit in the cram down provision which seemed to have been overlooked in Herweg. Cram down was intended as a method by which the debtor could preserve its business and retain its property despite creditors' objections to the debtor's plan. Both the cram down provision and chapter XII generally provide that contract rights of secured creditors may be modified or altered, even without their consent, as long as the secured creditors receive payment or protection for their claims. Pine Gate offered a new scheme for interpreting the availability of cram down. The two-step approach permitted, in proper proportion, elements of debtor protection without jeopardizing creditor rights, as well as a necessary measure of judicial discretion.

The Reception Accorded the Pine Gate Approach

The two-step approach espoused by Pine Gate was wholeheartedly adopted by some courts while it was merely recognized and applied

114. Id. at 603 n.29.
115. See, e.g., I.R.C. § 1250.
118. E.g., In re Schwab-Adams Co., 463 F. Supp. 8 (S.D.N.Y. 1978); In re KRO Assocs., 4
in addition to the Herweg rule by others.\textsuperscript{119} In re Marietta Cobb Apartments Co.\textsuperscript{120} not only embraced the rule in Pine Gate but offered further justification for it as well.\textsuperscript{121}

The debtor in Marietta Cobb was a limited partnership owning an apartment complex as its sole asset. The debtor proposed a plan\textsuperscript{122} and the only creditor, a mortgagee, rejected it and sought removal of a stay\textsuperscript{123} to foreclose on its mortgage. The debtor requested that the plan be crammed down. Relying on Herweg, the creditor objected on the ground that since it was the sole secured creditor and it dissented to the proposed plan, cram down was impossible. The court in Marietta Cobb rejected this line of reasoning, preferring the Pine Gate approach instead.\textsuperscript{124}

Marietta Cobb was the first case to apply the two-step analysis of cram down in a situation involving a sole dissenting secured creditor. The court reasoned that if the cram down provision is interpreted in conjunction with the confirmation provision,\textsuperscript{125} together they reflect legislative intent not to foreclose the debtor from an opportunity for successful rehabilitation at the will of a single, recalcitrant creditor.\textsuperscript{126} Confirmation of a plan may be obtained after the plan has been accepted by two-thirds of each class, exclusive of those creditors not affected by the plan or for whom payment or protection has been provided under the cram down provision.\textsuperscript{127} Moreover, the court interpreted the cram down provision as a method by which acceptance may be obtained when the number of assenting creditors in a given class

\textsuperscript{119} In re Georgetown Apts., 10 C.B.C. 512 (M.D. Fla. 1977); In re Spicewood Assoc., 445 F. Supp. 564 (N.D. Ill. 1977); In re Alpine & Lake Tahoe Paradise, Ltd., 7 C.B.C. 286 (S.D. Cal. 1975).
\textsuperscript{120} 14 C.B.C. 503 (S.D.N.Y. 1977).
\textsuperscript{121} For a discussion of the impact Marietta Cobb has made on the use of cram down under chapter XII see Fine, supra note 19, at 335.
\textsuperscript{122} The precise nature of the debtor's plan is not discussed. 14 C.B.C. at 503.
\textsuperscript{123} Fed. R. Bankr. P. 12-60(a)(5).
\textsuperscript{124} 14 C.B.C. at 508.
\textsuperscript{125} Bankruptcy Act § 468, 11 U.S.C. § 868 (1976), provides:
If an arrangement has not been so accepted, an application for the confirmation of an arrangement may be filed with the court within such time as the court shall have fixed in the notice of such meeting, or at or after such meeting and after, but not before----
(1) it has been accepted in writing by the creditors of each class, holding two-thirds in amount of the debts of such class affected by the arrangement proved and allowed before the conclusion of the meeting, or before such other time as may be fixed by the court, exclusive of creditors or of any class of them who are not affected by the arrangement or for whom payment or protection has been provided as prescribed in . . . [the cram down provision] of this act. . . .
\textsuperscript{126} 14 C.B.C. at 508.
\textsuperscript{127} Id. at 508-09.
falls short of the requisite two-thirds necessary under the traditional method of acceptance. By combining this interpretation with congressional pronouncements that cram down should be treated as a mechanism protecting the reorganized debtor, the Marietta Cobb court concluded that the Herweg condition precedent\textsuperscript{128} was without statutory basis.\textsuperscript{129} Having concluded that a sole secured creditor was susceptible to cram down, the court then considered the adequacy of protection afforded the creditor under the plan. However, sufficient information concerning the earnings of the property was unavailable, preventing the court from making a finding as to the value of the property as a going concern. Until the property was given an appraised value, the court could not determine whether the value of the property was sufficient to protect adequately the value of the mortgagee’s note. Consequently, the court continued the case for later consideration of that issue.\textsuperscript{130}

\textit{In re KRO Associates}\textsuperscript{131} similarly involved only one secured creditor affected by the debtor’s plan. The debtor’s sole asset was an office building in Newark, New Jersey, in which the city was the only tenant. The plan under consideration proposed cash payment to the mortgagee plus a percentage of the earnings on the property for twelve years. The creditor rejected the plan and sought to foreclose on the mortgage. Since \textit{KRO} was decided by the same judge who presided in \textit{Marietta Cobb},\textsuperscript{132} the court, not unexpectedly, subscribed to the two-step approach of \textit{Pine Gate} as it was applied in the sole secured creditor situation of \textit{Marietta Cobb}.

\textit{KRO} suggested what would seem to be the logical final extension of the \textit{Pine Gate} approach to determine the availability of cram down.\textsuperscript{133} The crucial issue, according to \textit{Pine Gate}, is whether the plan provides adequate payment and protection for the dissenting creditor’s claim.\textsuperscript{134} Therefore, the decision as to whether to apply cram down depends upon the amount of cash payment or the estimated earning

\textsuperscript{128} The condition in \textit{Herweg} is that two-thirds of one class of secured creditors must assent to the plan prior to consideration of cram down. 119 F.2d at 943.
\textsuperscript{129} 14 C.B.C. at 509-10.
\textsuperscript{130} \textit{Id.} at 515-21. The subsequent proceedings were not reported. \textit{See} Fine, \textit{supra} note 19, at 325.
\textsuperscript{132} The Honorable Roy Babbit, Bankruptcy Judge for the Southern District of New York, decided both cases.
\textsuperscript{133} 4 Bankr. Ct. Dec. at 463-72.
capacity and future likelihood of success of the business.\textsuperscript{135} The court must make these factual determinations on an individual basis, subject to the guidelines imposed by the statute.\textsuperscript{136} These findings should not be governed by the unnecessarily broad mechanistic approach first advocated in \textit{Herweg}. Neither the number of dissenting creditors nor the nature of their claim has any relevance under the \textit{Pine Gate} analysis. As long as the overriding purpose of cram down is to guard debtors' plans for rehabilitation from frustration by obstinate creditors, then, according to the \textit{KRO} court, it should make little difference whether the sole affected creditor or all classes of creditors dissent to the proposed plan.\textsuperscript{137} Following this rationale, it is possible to confirm a plan even when \textit{all} classes of affected creditors dissent, providing that adequate payment and protection is given to each dissenter.\textsuperscript{138}

A few courts adopted the reasoning of both \textit{Herweg} and \textit{Pine Gate} when they decided the accessibility of cram down.\textsuperscript{139} The result was a hybrid approach that was possible only because the courts advocating this analysis failed to comprehend that \textit{Herweg} and \textit{Pine Gate} emphasized totally different factors. The criteria used in \textit{In re Alpine & Lake Tahoe Paradise, Ltd.},\textsuperscript{140} included the number of dissenting secured creditors as well as the adequacy of protection afforded the dissenters.

The plan in \textit{Tahoe} contemplated the sale of large parcels of its land development project in order to seek refinancing to pay off the mortgage. All twenty-six unsecured creditors assented to the plan. The secured creditor objected because the indiscriminate sale would violate a trust deed agreement between it and Tahoe which required that the property be sold sequentially. The creditor asserted that a non-sequential sale would diminish the value of the property.\textsuperscript{141} The court dismissed the petition on two theories: The sale would jeopardize the


\textsuperscript{136} 4 Bankr. Ct. Dec. at 466. The court must determine whether the creditor is adequately protected according to one of the four methods described in the cram down provision. For the text of the statute, \textit{see note 31 supra}.

\textsuperscript{137} 4 Bankr. Ct. Dec. at 466.

\textsuperscript{138} The \textit{KRO} court suggests that this proposal was made in the recent case of \textit{In re Schwab-Adams Co.}, 463 F. Supp. 8 (S.D.N.Y. 1978). 4 Bankr. Ct. Dec. at 466.


\textsuperscript{140} 7 C.B.C. 286 (S.D. Cal. 1975). \textit{Tahoe} was decided before the \textit{Pine Gate} decision cited in this note. Two earlier interim opinions had been published by the time the \textit{Tahoe} court reached its decision.

\textsuperscript{141} 7 C.B.C. at 289.
creditor’s security interest, and the plan had not been accepted by the sole secured creditor. The Tahoe court determined that the plan of arrangement offered inadequate protection to the dissenting secured creditor. Thus, the court could have denied a cram down simply by adopting the Pine Gate reasoning. Nevertheless, the Tahoe court stated that it was denying cram down because the sole secured creditor rejected the plan.

In re Spicewood Associates followed its own hybrid approach. The debtor in Spicewood owned a single asset, an apartment complex encumbered by two mortgages; in addition there were several unsecured debts. According to the debtor’s proposed plan, the senior mortgagee would receive two-thirds of the value of its claim and the junior mortgagee would receive one-twentieth of its claim after the property was sold. Both secured creditors dissented on the grounds that the plan actually constituted a proposal for liquidation.

In response to the debtor’s request for cram down, the court applied the Herweg rule and held that since both secured creditors rejected the plan, it was compelled to deny the debtor’s request. The court noted the Pine Gate standard of adequate protection for dissenting creditors, but found that even if these secured creditors were protected, their unanimous objections would block confirmation. The Spicewood court may have included the reference to Pine Gate merely to establish its awareness of the alternative approach and to show that even if the two-step analysis were applied, the ultimate result would be the same as under the Herweg approach.

The hybrid approach was again utilized in In re Georgetown Apartments. The decision in Georgetown first advocated a denial of cram down based on the Pine Gate line of reasoning. The court rejected the plan because it did not adequately protect the creditor’s security interest. However, the Georgetown court remarked that even if the plan

142. Id. at 294-95.
143. Id. at 294.
144. Id.
145. Id.
147. The plan proposed a sale to a private bidder or at public auction. Id. at 567.
148. The creditors reasoned that if the plan actually constituted a liquidation of the debtor’s assets, then the debtor belonged in a straight bankruptcy proceeding rather than a Chapter XII reorganization. Id. at 566.
149. Id.
150. Id.
152. Id. at 518.
adequately protected the secured creditor, the rationale in *Herweg* would have prevented cram down.153

*Tahoe, Spicewood* and *Georgetown* evidence a stubborn refusal to dispense with the requirement that at least one class of secured creditors accept the plan before the others can be subject to cram down.154 Each adopted the *Pine Gate* approach to the extent that it determined the adequacy of protection for dissenting classes of secured creditors, but none was willing to let the plan succeed or fail on adequate protection grounds alone. Instead, the *Herweg* requirement was superimposed upon the *Pine Gate* analysis. The hybrid analytical approach does violence to the legislative purpose that cram down serve as a reasonably obtainable means by which a debtor can achieve rehabilitation.

**The Two-Step Analysis of *Pine Gate* as the Better Approach**

The *Herweg* prohibition against cram down unless two-thirds of one class of secured creditors first assents to the plan resulted from a restrictive approach to the statutory scheme of the cram down provisions. Although the facts in *Herweg* justified a denial of cram down,155 the situation did not warrant the broadly sweeping and unnecessarily rigid pronouncement which followed.156 In writing the reorganization provisions, Congress created cram down as a specific mechanism to protect debtors with otherwise viable plans from the machinations of unreasonable creditors.157

In challenging the *Herweg* analysis, the *Pine Gate* court reformulated the standard for the availability of cram down in light of several factors which received only scant notice from the *Herweg* court. These included the language of the cram down provision, legislative intent, and the feasibility of cram down under modern business conditions. According to the reasoning of *Pine Gate*,158 *Herweg* failed to consider the statute in its entirety and further failed to take a comprehensive approach to cram down in light of other provisions pertaining to the plan of arrangement. The two-step approach adopted in *Pine Gate* properly discards the unsubstantiated requirement that a two-thirds

153. *Id.*
155. The debtor's plan could not conceivably provide adequate protection for the value of the creditor's claims. 119 F.2d at 943.
156. *See text accompanying notes 59 and 68-70 supra.*
158. *See text accompanying notes 108-11 supra.*
majority of one class assent to the plan and replaces it with the substantive requirement that dissenting classes receive adequate protection prior to being crammed down.

Clearly, *Pine Gate* is more reflective of the legislative spirit in which cram down was included in chapter XII.159 By following this method, a debtor's plan of arrangement can be more flexibly formulated. The provision was not intended to preclude a debtor's use of the protective reaches of chapter XII simply because of the arbitrary composition of its classes of secured creditors. An extension of the flexible approach in *Pine Gate* points to the conclusion that an entire class of dissenting creditors may be subject to cram down, conditioned, of course, upon the fact they receive adequate protection for the value of their debt.160 The logical result of this approach is that cram down might even be applied where there is unanimous rejection by all secured creditors.

**Cram Down Under Chapter 11 of the Bankruptcy Reform Act**

By consolidating all four business reorganization sections of the old act into one, chapter 11 seeks to eliminate antiquated distinctions no longer relevant to current business practice.161 The flexibility presently restricted to chapter XI debtors becomes available to all reorganized debtors.162 Selective public investor protection features available only in chapter X is expanded to cover all equity holders.163 Finally, several substantive changes increases the versatility of the financial standard for confirmation of a chapter 11 plan.164

The cram down provision is a key element in the fundamental framework giving debtors and creditors more freedom to define a plan, although within carefully defined limits. The procedures for creating

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162. Chapter XI was originally intended to deal with debt owed to trade creditors, the principal creditors of small corporations. Large corporations with sizable public debt were to be handled under chapter X. However, the post-war creation of middle sized corporations with some public debt blurred the distinctions between the two chapters. The distinction is no longer strictly followed and most debtors seek the quicker, more informal procedure provided in chapter XI. *See generally* H.R. REP. NO. 95-595, 95th Cong., 2d Sess. 224-28, reprinted in [1978] U.S. CODE CONG. & AD. NEWS 6295-358.

163. *Id.*

and bringing a plan to a vote are similar to those of the old act.\textsuperscript{165} In a chapter 11 proceeding, the plan is filed with the court\textsuperscript{166} and the classes of secured and unsecured creditors and interest holders vote to accept or reject the plan. Acceptance requires the assent of those holding at least two-thirds in amount and comprising more than one-half in number of the allowed claims of each class which votes.\textsuperscript{167} The vote is taken at the confirmation hearing.\textsuperscript{168} Some votes however, are automatically tallied. Creditors receiving complete payment of the face value of their claims are considered to have accepted the plan without voting.\textsuperscript{169} On the other hand, creditors receiving nothing are deemed to have rejected the plan.\textsuperscript{170}

Should a plan be rejected by a two-thirds vote of a class of claimants, the statute authorizes the court to confirm the plan despite the negative vote\textsuperscript{171} as long as the following requirements are met: The plan must comply with all applicable sections of the confirmation provision. It cannot discriminate unfairly towards any particular class. Finally, the plan must be “fair and equitable”\textsuperscript{172} with respect to each class of claimants that is impaired but has not accepted the plan.\textsuperscript{173}

The fair and equitable requirement affects the determination of a plan’s successful confirmation under cram down in two ways. On one hand, it describes the minimum amount each class is entitled to receive from the debtor in order to be considered by the court as having accepted the plan. On the other hand, fair and equitable treatment relates to the absolute priority rule.\textsuperscript{174} A senior creditor is entitled to no more than one hundred percent of its claims before junior classes receive payment, but senior creditors must receive the full value of their claims before any subordinate creditor or interest holder is entitled to any payment. The new statute contains guidelines by which to deter-

\textsuperscript{165} See Pub. L. No. 95-598, 92 Stat. 2631-38 (1978) (to be codified at 11 U.S.C. §§ 1121-29). While the general effect of the procedures under the old and new bankruptcy acts is similar, several important changes have been made. For a comparison and discussion of these changes, see 124 CONG. REC. H11,104 (daily ed. Sept. 28, 1978).


\textsuperscript{171} This is the cram down section of the confirmation provision. Id., 92 Stat. at 2635-38 (1978) (to be codified at 11 U.S.C. § 1129 (b)). For the complete text, see note 31 supra. Pub. L. No. 95-598, 92 Stat. 2637 (1978) (to be codified at 11 U.S.C. § 1129 (b)(1)).

\textsuperscript{172} Pub. L. No. 95-598, 92 Stat. 2637 (1978) (to be codified at 11 U.S.C. § 1129(b)(1)).

\textsuperscript{173} Claimants include creditors and interest holders. Interest holders are all those with equity interests in the business entity including shareholders, debenture holders and bondholders.

\textsuperscript{174} See text accompanying notes 81-93, and note 72 supra.
mine whether the plan is fair and equitable as it affects each dissenting class of impaired creditors or interest holders. These guidelines are not intended to impose rigid financial rules upon the plan, but in keeping with the flexible approach underlying the new act, they are merely intended to define the minimum requirements of what must be included in the plan. The requirements are separated according to each of the three types of classes affected by the reorganization proceeding, secured and unsecured creditors, and interest holders.

Secured Creditors

In order to comply with the fair and equitable requirement for a class of dissenting secured creditors, the plan must meet one of three specifications. In the first alternative each individual holder of a claim belonging to a dissenting class must retain its lien and receive deferred cash payments totaling at least the allowed amount of the individual claim as long as it is equal to the value "of such holder's interest" in the estate's interest in the property. The holder retains a general lien, irrespective of whether the property that is the subject of the lien is retained by the debtor or transferred to some other entity. The second alternative provides for occasions when the property that is the subject of the lien is sold free and clear of the lien. The lien then attaches to the proceeds of the sale and the creditor either receives deferred payments as prescribed in the first alternative or receives payment of the "indubitable equivalence" of the claim as provided in the third alternative. Providing the "indubitable equivalence" of the secured claims is the most speculative of the three formulas, and the one most likely to provoke litigation.

The indubitable equivalence is intended to cover payment or protection of claims made in a manner other than the methods specified in the first two alternatives. The indubitable equivalence standard was

178. Id. at 11 U.S.C. § 1129(b)(2)(A)).
179. Id. § 1129(b)(2)(A)(i)(I) and (II).
180. These are liens on all the debtor's property.
182. Id.
183. The first alternative requires the creditor to receive payments totaling the allowed amount of the claim. See text accompanying note 179 supra.
186. Id.
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posited by Judge Learned Hand in *In re Murel Holding Corp.* Judge Hand asserted that when a plan is required to treat the dissenting secured creditor "equitably and fairly," the plan must provide the creditor with complete compensation. Although the exact method of compensation may vary, the total value must correspond to the "indubitable equivalence" of the original claim.

The codification of this term into the cram down provision reflects congressional intent to rectify the difficulties courts faced under the old act in determining what constituted adequate payment or protection for the value of dissenters’ claims. The traditional view was focused upon whether the value of the security was more or less than the value of the debt. If the security exceeded the value of the debt, the dissenting creditor was entitled to the face value of the debt in order to receive adequate protection. If, on the other hand, the value of the debt was greater than the value of the security, the debtor was entitled to the value of the security. The *Pine Gate* court went so far as to allow cram down when the plan called for the appraisal of the property and the payment of that value in cash. The introduction of the indubitable equivalence is intended to resolve this problem.

In addition to resolving the valuation dilemma, the indubitable equivalence standard reflects congressional intent to take a stricter approach toward methods of compensation for dissenting secured creditors. Rather than allow appraisal and payment of the value in cash, under the indubitable equivalence standard the creditor must receive

187. 75 F.2d 941 (2d Cir. 1935). The debtor corporations in *Murel Holding* owned an apartment complex with the assessed value of $540,000, encumbered by a $400,500 first mortgage on which defaults amounted to almost $100,000. The debtor’s plan of reorganization called for a second mortgage providing $11,000, so that a tier of apartments could be renovated, improving their rentability. The first mortgagee would forego all amortization payments for 10 years but would receive the interest due on the mortgage. The court held that the plan was insufficient to justify staying the foreclosure action in state court. The court reached this conclusion because the creditor would not receive a mortgagee’s payments for 10 years and the interest did not constitute complete compensation for the property or the value of the security. Although the creditor, by statute, was not entitled to receive either one, a substitute had to be of the most “indubitable equivalence.” *Id.* at 942.

188. *Id.*


190. *See, e.g.*, *In re Pembroke Manor Apts.*, 547 F.2d 805 (4th Cir. 1977); *In re Colonial Realty Inv. Co.*, 516 F.2d 154 (1st Cir. 1975).


192. This is determined by an appraisal of the value of the property. The appraisal is often the source of much controversy. *See, e.g.*, *In re Colonial Realty Inv. Co.*, 516 F.2d 154 (1st Cir. 1975).

193. *See text accompanying note 109 supra.*

complete compensation for the debt. Although the compensation may be in an alternative form, it nevertheless must be equal in value. Payment of the present appraised value may not be held to constitute the indubitable equivalence because the creditors would be deprived of the right to any future increase in value that might accrue on the collateral. Therefore, it is logical to assume that compliance with the indubitable equivalence standard could mean in some cases that the debtor must abandon the collateral in favor of the secured creditor.

**Unsecured Creditors**

The new cram down provision also prescribes the manner of compensation for dissenting classes of unsecured creditors. They will receive fair and equitable treatment according to one of two formulas. The plan must provide individual dissenters with property having a present value equal to the allowed amount of the creditor's claim. The definition of property is intended to be broadly construed. It can be anything having value, including of course, cash. Anything reasonably equivalent to the value of the claim is acceptable to meet the requirements of the provision. This formula illustrates a determination to allow the debtor more flexibility in arranging the payout of unsecured creditors than secured creditors dissenting to the plan. While the indubitable equivalence standard implies a stricter yardstick than the one applied to secured creditors under the old act, the formula for unsecured claims implies a more versatile approach.

The alternative treatment of unsecured creditors applies to situations in which the dissenting class will not receive any payment at all. These occur when the debtor's property is insufficient to go beyond payment to a more senior class of creditors. In such cases, the absolute priority rule would prevent a junior class of creditors from receiving any amount so long as the senior claimants remained unsatisfied. The dissenting unsecured junior classes will be liable to cram

195. See note 187 and accompanying text, supra.
197. Id. The abandonment of the collateral of course presumes the debtor lacks sufficient cash to pay off the creditors. It is hoped that this standard will not be used in a case where the collateral is an essential asset of the debtor. An obvious example is a debt secured by the inventory of the debtor.
200. Id.
202. One distinguished commentator disagrees with this view. He contends that junior classes will be encouraged to accept the plan rather than run the risk of a valuation hearing which could
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down so long as senior classes have not received more than full payment of their claims. Classes on a par with the dissenting class must be treated the same as the dissenting class.\(^{203}\)

**Interest Holders**

The definition of “fair and equitable” respecting classes of impaired interest holders who dissent to the plan depends upon whether the interest holders are entitled, under a corporation’s articles of incorporation and bylaws, to a fixed liquidation preference or a fixed redemption price. If either condition applies, they must receive property equal in value to the greater of the two in order to be subject to cram down.\(^{204}\) But if the plan precludes them from receiving any value, the class can still be forced into a cram down so long as creditors or other classes of interest holders senior to it do not receive more than the full amount of their claims.\(^{205}\)

**Additional Modifications**

After it has been determined that the plan will treat all creditors in a fair and equitable manner with respect to each dissenting class of claims or interests it must then be determined that, as between each class, the fair and equitable rule is observed. This aspect of fair and equitable requires that an absolute priority rule be applied to give senior classes of creditors preferential treatment—\(i.e.,\) they receive full payment of their claims before any junior class receives payment.\(^{206}\) The absolute priority rule also affects the indubitable equivalence standard in that not only must senior creditors receive complete compensation, but they must receive payment before any creditors junior to them can receive any compensation.\(^{207}\) However, under the new act, no senior class can receive more than one hundred percent of the amount of its claims.\(^{208}\) This is the result of the prohibition against “unfair discrimination,” and constitutes a modification of the absolute priority rule.\(^{209}\) This modification should effectively prevent overreaching on result in a determination that they would not be entitled to participate at all. King, *Chapter 11 of the 1978 Bankruptcy Code*, 53 AM. BANKR. L.J. 107, 130 (1978) [hereinafter cited as King].


\(^{206}\) *Id.* For a discussion of the absolute priority rule see text accompanying notes 82-93 supra.

\(^{207}\) *Id.* For a discussion of the absolute priority rule see text accompanying notes 82-93 supra.


\(^{209}\) *Id.*
the part of senior classes.

Another modification of the absolute priority rule is the provision which allows a class of secured creditors to elect to have its claims treated as fully secured rather than as secured to the extent of the value of the collateral and unsecured as to the deficiency that remains. The election option has ramifications affecting both debtors and creditors in a cram down situation. From the debtor's perspective, the creditor's election to receive payments equal to the face amount of the debt and of a present value equal to the security frees the debtor from concern about whether the proposed payment or protection satisfies the indubitable equivalence standard. Once the creditor chooses to receive the present cash value of the claim, then the creditor is excused from consideration under the plan. The effect of the election is essentially to remove the creditor from consideration under the cram down requirements.

The effect of the election provision from the creditor's perspective is that upon confirmation of the plan it provides the creditor with payment, most often in the form of a note, of the present value of the security. The advantage is that the creditor takes a secured note that is worth the present value of the security. If the creditor retains the note over its full term, he will receive the full value of the debt. However, the individual creditor cannot choose to elect the cash payment option unless the entire class of dissenting creditors do so as well.

Further requirements necessary for cram down include all applicable provisions detailed under the traditional confirmation provision. This includes the requirement that at least one class of claimants accept the plan in order to instigate cram down against the other classes of claimants. Hence, the new provision answers in the affirmative one aspect of the Herweg-Pine Gate dispute as to whether the statute requires the acceptance of one class prior to activating cram down.


If such an election is made, then notwithstanding section 506(a) of this title, such claim is a secured claim to the extent that such claim is allowed.


211. Id. The creditor receives a note for the face value of the debt with an interest feature payable over a given period. The note is negotiable.


213. Id. § 1129(b)(1).

214. Id. § 1129(A)(10). The class can be comprised of secured or unsecured creditors, but not interest holders.

215. However, the new act leaves unresolved that aspect of the controversy that deals with the difficulties this requirement creates in a situation where the sole creditor dissents to the plan. See text accompanying notes 236-38 infra.
order to forestall one form of abuse, the provision specifically discounts acceptance by any class comprised of insiders of the debtor as constituting the requisite accepting class.\textsuperscript{216}

The availability of cram down has been expanded to debtors whose reorganization affects security interests, trade creditors, and equity holders. The new act promotes a factually based approach to cram down. In this regard, the framers seem to have embraced the \textit{Pine Gate} approach. Aside from the requirement that one class of claimants accept the plan, the new act prescribes few substantive rules. Instead, the particulars of a given plan are to be weighed according to minimum standards and the success or failure of the plan is to be determined on an individual basis. Once the plan has been proposed, the court must ascertain which classes of creditors are "impaired" by the plan. Those classes which are "impaired" and accept the plan must receive liquidation value or better in order to meet the confirmation standard.\textsuperscript{217} Secured creditors dissenting from the plan are entitled to the indubitable equivalence of the value of their claims, and the plan must be fair and equitable with respect to each dissenting class of claims or interests.

\textbf{CRITICAL ANALYSIS OF THE NEW CRAM DOWN PROVISION}

The cram down provision Congress originally adopted was designed as a means to protect debtors. Under the old act cram down allows the court to coerce dissenting creditors to adhere to a plan. Once the plan has been voted upon and the dissenting votes registered, the provision is invoked to prevent frustration of the rehabilitative process.\textsuperscript{218} Concomitantly, dissenting classes are not penalized for their dissenting votes by being given less than the amount of the value awarded assenting classes. Instead, the same confirmation standard applies to assenting and dissenting creditors under the old cram down provision.\textsuperscript{219}

In expanding its importance under chapter 11 of the new act, Congress has given cram down\textsuperscript{220} a different thrust than that of the old act. Instead of a flexible mechanism by which debtors can restructure their

\textsuperscript{216} Presumably the framers of the new act sought to avoid a situation like that which occurred in \textit{In re KRO Assocs.}, 4 Bankr. Ct. Dec. 462 (S.D.N.Y. 1978). There, several unsecured creditors were partners of the debtor. In fact, they were corporations whose directors were the same individuals as the limited partnership debtor. The unsecured creditors were the only creditors accepting the plan. \textit{Id.} at 464.


\textsuperscript{218} See text accompanying notes 17-21 and 105-17 supra.

\textsuperscript{219} See text accompanying note 30 supra.

debt and avoid the onus of bankruptcy,\textsuperscript{221} cram down has been so strictly defined under the new act that the versatility it once offered debtors\textsuperscript{222} has all but been eliminated under the guise of providing protection for dissenting creditors and interest holders. The original tenor of the cram down provision was lost when Congress designated one confirmation standard for classes assenting to the reorganization,\textsuperscript{223} but framed a stricter standard to be applied only to classes dissenting to the plan.\textsuperscript{224}

Classes assenting to the plan are entitled to receive compensation according to the "best interests" test.\textsuperscript{225} This test as it was used under chapter XI of the old act was defined as giving creditors more than they would receive in liquidation.\textsuperscript{226} Dissenting classes on the other hand, are entitled to "fair and equitable" treatment,\textsuperscript{227} and classes of secured creditors dissenting to the plan must receive the indubitable equivalence of their claims. The result of this dichotomy is that cram down under the new act offers more to dissenting classes than to assenting ones. Therefore, it encourages classes to dissent, since they will be awarded full compensation for dissenting while they would have to be content with liquidation value\textsuperscript{228} should they agree to the plan. Instead of providing a means by which the debtor can effectuate a reasonable plan despite the recalcitrance of creditors, Congress, by encouraging classes to dissent, has made it more difficult for the debtor to meet the stricter compensation demands necessary to realize a successful reorganization.

A better solution would be to require that dissenters receive no less than what they would receive had they assented to the plan. Com-


\textsuperscript{222} Cram down was initially intended to increase the debtor's ability to achieve conformation despite the truculence of one or several creditors. See In re KRO Assoc., 4 Bankr Ct. Dec. 432 (S.D.N.Y. 1978); In re Pine Gate Assoc., Ltd., 10 C.B.C. 581 (N.D. Ga. 1976).


\textsuperscript{224} See id., 92 Stat. 2637-38 (1978) (to be codified at 11 U.S.C. § 1129(b)).

\textsuperscript{225} The specific wording of the new act calls for the holder of a claim to receive "not less than the amount that such holder would receive if the debtor were liquidated." Pub. L. No. 95-598, 92 Stat. 2635-37 (1978) (to be codified at 11 U.S.C. § 1129(a) (7) (A) (iii)). The best interest standard as it was used in the context of chapters XI and XII requires the claimant to receive more than the liquidation value of the claim. While the new act does not use the same language of chapters XI and XII, it seems likely that courts will continue to apply the same standard, namely, more than liquidation value.


\textsuperscript{227} See text accompanying notes 171-74 supra. See also Pub. L. No. 95-598, 92 Stat. 2637-38 (1978) (to be codified at 11 U.S.C. § 1129(b)).

\textsuperscript{228} See note 225 supra. But see King, supra note 202, at 130.
monly, the most senior class of creditors dissents to the plan. Under a provision which entitled dissenting classes to the same standard of value as assenting ones, a senior class would still receive more of their claims than would other classes of creditors simply by virtue of the fact that, if they hold secured claims, the value of the collateral probably would have more general value than other assets of the debtor and therefore would yield a greater liquidation value. A requirement that dissenters receive liquidation value or better, rather than complete compensation, actually could protect creditors generally, in that such a requirement would prevent debtors from taking advantage of dissenters by forcing them to accept less than the value to which they are entitled.

The flexibility that Congress intended to pervade the entire reorganization scheme is drastically limited by the inclusion of the absolute priority rule. The absolute priority rule restricts the debtor's maneuverability while providing protection for creditors which Congress previously concluded to be unnecessary. Although the absolute priority rule was included as the confirmation standard in chapter X in order to prevent abuse of public interest holders by corporate insiders, it has been noted that as a result of changes in corporate composition, the rule now often works to exclude rather than protect the public in a reorganization proceeding. Furthermore, prior case history demonstrates the difficulties facing a debtor desirous of implementing cram down when beset by the restrictions imposed by the absolute priority rule. The foregoing considerations cast doubt on Congress' wisdom in incorporating this rule in the new act. Instead, Congress would have been wiser to exclude the absolute priority rule from the cram down provision.

The new cram down provision has partially resolved the Herweg-Pine Gate dispute as to whether cram down is available despite the unanimous objection of all secured creditors to the plan. The new provision states that at least one class of claims must accept the plan before

234. Id.
the other classes can be subject to cram down. The new act defines claims as those debts held by secured or unsecured creditors, so that acceptance by either class of creditor will satisfy the condition. However, acceptance by a single class of equity interest holders will not.

This condition could lead to flagrant abuse by both debtors and creditors. A debtor, for example, might incur an unsecured obligation shortly before filing a Chapter 11 petition. The debtor would have created an unsecured class of claims comfortable with the knowledge that the absolute priority rule would subordinate the unsecured creditor's claim to those of more senior secured class. The result would be that the unsecured creditor would be likely to accept the plan, since it would stand a better chance of being paid if it did. In this way, the debtor would be assured the vote of an assenting class as protection against being forced into liquidation proceedings.

The requirement also could be abused by a sole secured creditor. By requiring the acquiescence of one class of claims, the new act fails to consider the problem this condition would cause the debtor whose only creditor is unalterably and perhaps unreasonably opposed to the plan. Since the new act does not provide any exceptions, it appears that in such a situation, the court may have no choice but to dismiss the petition, unless the courts themselves decide to carve out an exception. Should such a situation occur, it is submitted that the courts should still follow the rationale of Pine Gate—i.e., that a sole secured creditor should not be permitted to frustrate needlessly the entire rehabilitative proceeding.

While it is essential that creditors and interest holders affected by a reorganization receive compensation for their claims and interests, the courts have allowed much latitude in the modification and alteration of these rights, even without the consent of the claimants. Congress might easily have accepted these limitations and still have provided the debtor with sufficient maneuverability to implement a plan of arrangement that adequately protected creditors and which could be confirmed, despite creditor dissent, via cram down. Through the insertion of several devices calculated to protect dissenting creditors, Congress has altered cram down from a mechanism to support debtors into a process replete with obstacles and diversions which have effectively transformed the procedure into a shield for creditors.

237. This could be for any sort of unsecured debt, varying in form from the trivial to the significant.
238. See text accompanying notes 108-13 supra.
Congress could have maintained the versatility of cram down, and even improved upon it if it had provided dissenting classes with the same fair treatment accorded assenting classes. A double standard of treatment obscures the ultimate goal of providing claimants with a flexible means to secure adequate compensation. Instead of the fair and equitable confirmation standard for dissenting classes and the best interests test for assenting ones, Congress should have adopted best interests as the standard universally applicable to all classes. In that way, assenting classes would not be penalized for accepting the plan, nor would dissenting classes be rewarded for their negative votes. Creditors and equity-interest holders would still receive payment or protection for the value of their debts or interests based upon the nature of their claims without setting superfluous obstacles in the debtor's path to successful rehabilitation.

CONCLUSION

In efforts to enhance the flexibility of a reorganization proceeding, Congress has incorporated an alternative confirmation standard, known as cram down into chapter 11 of the Bankruptcy Reform Act of 1978. Essential to understanding the mechanics of cram down under the new act is a firm grasp of the precedent affecting cram down in chapter XII of the old act. The ambiguities present in the chapter XII provision prompted two divergent theories for determining the availability of cram down. On one hand, the traditional one-step approach restricted cram down to situations where at least one class of secured creditors had already assented to the plan. This approach was particularly harsh when the debtor's plan affected only a sole secured creditor. The effect was to give the sole secured creditor complete veto power over the success or failure of the debtor's plan. The two-step approach challenges the traditional rule on the basis of congressional intent, statutory interpretation and modern business conditions. This approach held that the adequacy of protection, not number of dissenting secured creditors was the intended focal point of the cram down provision.

The new cram down provision attempted to resolve this dispute as well as to expand the accessibility of cram down to debtors whose plans affect creditors and interest holders. However, the new provision overcompensated for the ambiguities present in the old chapter. The requirements necessary for cram down are so strictly defined that the versatility offered the chapter XII debtor using the two-step approach has been virtually eliminated in efforts to provide protection for dis-
senting creditors and interest holders. The adoption of a stricter standard of confirmation for dissenting classes than for assenting ones, entitling dissenters to greater compensation, has the effect of encouraging creditors to dissent. The incorporation of the absolute priority rule serves no substantive function other than to hamper the debtor’s arrangement of a successful plan. The election provision deprives the debtor of the opportunity to postpone payment of debts, but gives creditors the right to demand immediate cash payment. The codification of the requirement that at least one class of creditors assent prior to invoking cram down eliminates one area of dispute but opens up possibilities for abuse. Furthermore, the new provision fails to solve the problem of the debtor whose only creditor stubbornly refuses to agree to the plan.

In sum, these requirements reduce the debtor’s flexibility while providing a corresponding increase in devices calculated to protect creditor’s rights. Congress might have prevented this result if it had adopted a clear statement of the rule which requires courts first to acknowledge the number of dissenting creditors, then to determine whether the plan provides these creditors with the same fair treatment afforded the assenting classes. The new cram down provision contains too many protective devices for creditors and too few for debtors.

Anne Webber Epstein