THE CORPORATE REORGANIZATION PROVISION IN SENATE BILL 3866

A PROPOSED DRAFT OF A NEW BANKRUPTCY ACT*

Students of the subject of corporate reorganization have for some years employed much diligence and ingenuity in efforts to devise a satisfactory solution to the evils and uncertainties encountered in reorganizing large

*This comment deals only with the corporate reorganization provision of Senate Bill 3866. Senate Bill 4921, more recently introduced, proposes the addition of a corporate reorganization provision to the present Bankruptcy Act. Contrary to Section 76 of Bill 3866, this latter proposal is made applicable to railroads as well as to industrial corporations. The provisions of the two proposals in regard to the problems herein discussed are substantially similar. A few differences and additions in Bill 4921 are indicated in the pertinent footnotes.
The most pressing problems have been to devise machinery (1) to obtain an adjudication upon the fairness of the reorganization plan in advance of the consummation of the reorganization, and to protect a fair plan from a later attack such as was permitted in the Boyd case; and (2) to compel a minority to accept an honest and advantageous plan approved by the majority.  

With the help and cooperation of the federal equity courts, fairly successful practical devices have been developed to meet the first need. Briefly this machinery consists in supplementing the conventional decree of sale with a provision that a sale to any reorganization committee will not be confirmed unless a fair and timely offer of participation in the plan has been made to all entitled thereto, with reservation by the court of exclusive jurisdiction to determine whether or not the plan contained such a fair

1. For a summary of the usual procedure to reorganization by way of the consent receivership in the federal equity court and of the attendant evils and problems, see Rosenberg, A New Scheme of Reorganization (1917) 17 Col. L. Rev. 523.


3. The traditional legal conception of a mortgage bondholder is that he is a sort of tenant in common of the security with other bondholders so that unanimous consent is necessary to effect a change in the lien. Strict adherence to this doctrine has made resort to foreclosure the only means of removing a lien. The fact that dissenting bondholders under this procedure are entitled to their pro rata share in cash of the price obtained at the foreclosure sale has been the source of some of the gravest problems of reorganization. See Weiner, Conflicting Functions of the Upset Price in a Corporate Reorganization (1927) 27 Col. L. Rev. 132; Spring, Upset Price in Corporate Reorganization (1919) 32 Harv. L. Rev. 489.

Cf. cases where the mortgage indenture contains a provision permitting a majority of the bondholders to cause the mortgaged property to be purchased for their benefit and reorganized as the majority may determine; or a provision incorporated by reference in the securities, prohibiting suits to enforce the obligation except by action of a named percentage of security holders. Sage v. Central Rr., 99 U. S. 334 (1878); Crosthwaite v. Moline Plow Co., 206 Fed. 466 (S. D. N. Y. 1924); Allan v. Moline Plow Co., 14 F. (2d) 912 (C. C. A. 8th, 1926); (1927) 27 Col. L. Rev. 579, 582. These provisions are rare in this country, however, since it is believed that there are serious questions about the negotiability of securities affected by them. Swaine, op. cit. supra note 2, at 927; Steffen & Russell, The Negotiability of Corporate Bonds (1932) 41 Yale L. J. 799, 810.

In regard to the problems involved in providing for dissenting minority unsecured creditors, see Northern Pacific Ry. v. Boyd, supra note 2; Coriel v. White, 54 F. (2d) 255 (C. C. A. 2d, 1931), commented upon in 41 Yale L. J. 577 (1932); 45 Harv. L. Rev. 697 (1932).
offer; and providing for notice to be given, by extensive publication, of the provisions of the decree and the filing of any reorganization plan, and ordering in the decree that all claims not filed within the time limit set by the court should be barred from participation in any way in any of the property of the defendant corporation. This order is made effective by enjoining any subsequent suits against the corporation. While some doubts have been cast upon the validity of these devices, their use has been so generally recognized that the question of their validity seems largely academic today.

On the contrary, an effective method of compelling a dissenting minority to participate in an honest and advantageous plan approved by the majority is still lacking. Judge Sanborn, in the Phipps case ventured


The determination of the fairness of the plan is generally made upon the application for confirmation of the sale. See list of cases in Swaine, op. cit. supra note 2, at 910. The practice used in some few cases of determining the question in advance of the decree or of the sale [see Habirshaw Electric Cable Co. v. Habirshaw Electric Cable Co., 296 Fed. 875 (C. A. 2d, 1924)] has not gained general recognition because it is thought that the question of fairness is not moot at this early stage of the proceedings and hence can have no binding force. See Swaine, ibid.

5. This decree has been held binding both upon creditors who have not filed their claims, St. Louis-San Francisco Ry. v. Wall (E. D. Mo. 1913) [unreported, see Swaine, op. cit. supra note 2, at 909, n. 28); Chicago, R. I. & P. Ry. v. Lincoln Horse & M. Com'n Co., 284 Fed. 955 (C. A. 8th, 1922) as well as upon creditors who had filed their claims, St. Louis-San Francisco Ry. v. McElvain, 253 Fed. 123 (E. D. Mo. 1918)].

6. The efficacy of these devices has never been submitted to a test before the United States Supreme Court. For a painstaking, critical analysis see Cutcheon, op. cit. supra note 2. Cf. Harding v. American Sumatra Tobacco Co., 14 F. (2d) 168, 169 (N. D. Ga. 1926).

7. The sale with the fixing of an upset price has come to be used as a tool to force recalcitrants into the plan. For a thorough account and analysis of the injustice and evil by-products of the upset price and of its inadequacy to meet the problem of "nuisance strikers" or unreasonable dissenters, see Weiner, op. cit. supra note 3. See also Rosenberg, op. cit. supra note 1, at 528; Dewing, Financial Policy of Corporations (2d ed. 1926) 963; Cravath, op. cit. supra note 2, at 202; Walker, Reorganization by Decree: Recent Note-worthy Instances (1920) 6 Corn. L. Q. 154.

8. Phipps v. Chicago, R. I. & P. Ry., 284 Fed. 945 (C. A. 8th, 1922) where unsecured creditors were compelled to take stock in payment of their claims, other action on their part being enjoined, and the property was turned back to the old corporation without the formality of a sale. The procedure in this case has been well described as a "solution which, if sound, may result
daringly to extend the federal-equity-court-made law on reorganization to solve this most urgent problem. However, his decision that minority creditors might be compelled to accept the securities allotted to them under the plan has been so clouded with doubts by both courts and writers that it has proven, thus far, of little aid in meeting the problem. The belief is still generally adhered to that dissenting creditors, secured or unsecured, must be offered some cash alternative to participation in the plan.\(^9\)

If this means that dissenting creditors must be paid in full before stockholders can be allowed any interest in the reorganized company, the expense may often be prohibitive of reorganization, particularly where an industrial corporation is concerned.\(^10\) If creditors need not be paid in full, but must be paid their pro rata share of the value of the corporate assets, all of the intricate and troublesome questions of valuation must be faced. Past experience leads to the conclusion that it is well-nigh impossible to solve the problem of dissenters satisfactorily in this fashion. Either creditors are granted so tempting a cash alternative\(^11\) that the success of the reorganization is endangered, or, as is most often the case, the offer is too insignificant to be called an alternative at all.\(^12\)
The thought suggests itself that it might be well to face the apparent
fact that a fair and equitable reorganization plan can be put into operation
successfully only by compelling a minority to accept a plan approved by
the majority. It is submitted that direct and open recognition of this
fact will make unnecessary the unmerited time and attention centered
upon the illusion of a cash alternative, and focus attention on the really
salient issue—attainment of a sound, fair plan.13

Section 76 of the Proposed Draft of a New Bankruptcy Act, now before
the Judiciary Committee, is the first attempt to meet these problems
through federal legislation.14 The theory is that Congress, under its

produced more than the upset price fixed by the court.” (1932) 45 HARv. L. REV.
at 1397. See also id. at 702.

13. This pretense of offering creditors a cash alternative was responsible
for the apparent attitude of the court in the Coriel case that the consideration
of the fairness of the plan was unimportant. See (1932) 41 YALE L. J. 577,
578.

14. In England, corporate reorganizations have long been regulated by
statutes binding minority creditors to a compromise or arrangement con-
sented to by creditors holding three-fourths in value of the total claims
and sanctioned by the court. Railway Companies Act 1867, 30 & 31 Vict.
c. 127; S. Edw. VII, c. 69, § 120 (1908) substantially reenacting Joint
Stock Companies Arrangement Act, 33 & 34 Vict. c. 104 (1870). The validity
of the statute has been upheld and it has been interpreted to apply to the
removal or change of the liens of debenture holders. Slater v. Darlaston Steel
& Iron Co., [1877] W. N. 139; In re Empire Mining Co., 44 Ch. Div. 402 (1890);
Apparently unsecured creditors may be compelled to accept stock under this
legislation. See Slater v. Darlaston Steel & Iron Co., id. at 165. The same
procedure is available in Canada by special Act passed for each reorganization.
of this nature may be found in the Dominion Winding-up Act. CANADA REV.
STAT. (1906) c. 144, §§ 63, 64; but this Act does not seem to be used
very much because it is often inaccessible to the ordinary commercial cor-
poration, and furthermore the nature of the Canadian bond mortgage with
its “floating charge” and its “majority clause” permits effective consummation
of most reorganizations without statutory aid. See Fraser, Reorganization
of Companies in Canada (1927) 27 COL. L. REV. 933.

A Delaware Statute permitting a similar provision to be included in the
certificate of incorporation has never been interpreted, and apparently is never
used. DEL. LAWS 1925, p. 272, § 1, p. 275, § 4. Similar statutes in Ohio and
Kentucky applying only to railway and bridge companies have not been before
the courts for interpretation either. OHIO GEN. CODE (Page, 1926) § 9092-
9095; KY. STAT. (Carroll, 1930) c. 32, § 771-a.

The Kentucky statute expressly requires that the plan must take care of
dissenting creditors by “a provision for preserving and maintaining the right
of such holder so as not to impair the obligation of this contract.” It is gener-
ally thought that the constitutional prohibition from impairing contracts and
the extraterritorial ineffectiveness of State discharge laws invalidate State
legislation similar to the English Statute. See in this connection recent statutes
on reorganization of insolvent banks. NEB. COMP. STAT. (1929) § 8-181; KY.
STAT. (Carroll, 1932) c. 9b, § 165a-64. A reorganization under the Nebraska
YALE LAW JOURNAL

constitutions grant of power "to establish . . . uniform laws on the Subject of Bankruptcies Throughout the United States," has a free hand in matters of composition and discharge in regard to which the equity courts and State legislatures are helpless.

As anticipated, there has already been much clamor against the constitutionality of the inclusion of corporate reorganization in the Bankruptcy Act. The arguments regarding impairment of contracts and denial of due process, as well as the more technical question of the scope of the bankruptcy power, have already been thoroughly analyzed, so that a detailed discussion of the issues here would be largely repetitious. A few salient points, however, may bear additional emphasis. The history of the bankruptcy clause of the Constitution carries in its trail a host of unsuccessful objections against the enactment of various provisions which are now regarded as orthodox features of a bankruptcy law. Particularly noteworthy in connection with the corporate reorganization provision is the experience of the clause permitting composition before adjudication.

The statute was held invalid by a federal district court as impairing the obligation of contracts since it deprived depositors of the right of recourse against others than the original debtor granted under prior bank laws. Hessen Siak Shams v. Nebraska State Bank of Bloomfield, Neb., 43 F. (2d) 894 (D. Neb. 1931); (1932) 45 HARV. L. Rev. at 1397. Cf. Dorman Banking Com'r v. Dell, 52 S. W. (2d) 892 (Ky. 1932) where the constitutionality of the Kentucky statute was considered.

The most students of the subject, including those who have denied the power of the courts to modify the contractual relations between the corporation and its various creditors and members, have expressed the belief that these modifications can be imposed by federal legislation under the bankruptcy power. Rosenberg, op. cit. supra, note 1; Swaine, op. cit. supra note 9, at 131; Cutcheon, op. cit. supra note 2, at 75.

See Joint Hearings Before the Subcommittees of the Committee on the Judiciary Congress of the United States on Senate Bill 3866, the bill to amend the Bankruptcy Act (1932), Part 2, p. 339; Part 3, pp. 525, 567.

For a discussion and history of the litigation over the inclusion within the "Subject of Bankruptcies" of provisions (1) for others than traders and (2) for voluntary bankruptcies, see Remington on Bankruptcy (3rd ed. 1923) §§ 8, 9. In regard to the extension of this power to the enactment of provisions for compositions before adjudication, see id. § 3069. Any objection to the inclusion within the Act of provisions for debtors or corporations not insolvent within the definition of the Bankruptcy Act, § 1 (15), is unwarranted, since the equity definition of insolvency has been used in prior national Bankruptcy Acts without successful constitutional objection, and even under the present law a solvent debtor may voluntarily go into bankruptcy. Bankruptcy Act, § 4.

Bankruptcy Act of 1898, § 12a, as amended in 1910; similar provision in Act of 1867, § 43 as amended by Act of 1874, § 17.
ruptcies” has not been questioned since the convincing opinion of Judge Blatchford in the Reiman case.\(^2\)

The proposed section is fundamentally an extension of the benefits of composition to corporate debtors. The present composition section, particularly since it has been most strictly construed, is inadequate to deal with the complexities of reorganization plans.\(^2\) It is undeniable that this inadequacy has excluded large corporations from the composition privilege in bankruptcy afforded to ordinary individuals. Despite some innovations inserted to meet the peculiar exigencies of a corporate composition, the proposed legislation is sufficiently analogous to the existing composition provision to weather the constitutional bogey, it would seem. The provisions affecting rights of stockholders seem justified to the extent that they are incident to or necessary for effecting a composition with creditors. The authorization to bind dissenting minority creditors and stockholders to a composition or plan which may require them to accept something other than cash or short-term notes in satisfaction of their claims\(^2\) is perhaps quite a novel feature. But the main purpose of the composition provision is to save the debtor from liquidation and to enable him to continue in business under an adjustment approved by, and to the interest of, the majority of the creditors. Although the original composition clause required settlement in “money,” and although the consideration in practice is generally cash or notes, the language of the present composition provision is open to the interpretation that long-term notes or even corporate securities may be offered as consideration for a composition, and the meager court interpretations of this language have not settled the issue to the contrary.\(^2\) If, as seems to be the case, it is almost impossible

---

20. In re Reiman, Fed. Cas. No. 11, 673 (S. D. N. Y. 1874) deciding upon the constitutionality of the composition clause of the 1867 Bankruptcy Act. See also In re Klein, (Circuit Court for Dist. of Mo.) reported in note to Nelson v. Carlant, 1 How. 285, 277 (U. S. 1843); Kunzler v. Kohaus, 5 Hill 317 (N. Y. 1843).

21. See Rosenberg, op. cit. supra note 9, at 14: “Compositions in bankruptcy theoretically offer a way in which the will of a majority of unsecured creditors may be imposed upon a dissenting minority, but the Bankruptcy Act is of little practical service, since large reorganizations deal not only with secured as well as unsecured creditors but also with the issue, readjustment and scaling down of stock. The bankruptcy court, so far as the decisions go, has not sufficient power to deal with these problems, nor can it give new money a lien prior to existing claims.” Also, see In re Frear, 120 Fed. 978 (N. D. N. Y. 1903); In re Berler Shoe Co., 246 Fed. 1018 (S. D. N. Y. 1917).

22. Draft, § 76 (b) (3), (g) (2) and (3).

23. Remington on Bankruptcy, op. cit. supra note 18, § 3092: “The wording of the section is very significant—the use of the word ‘consideration’ instead of the word ‘money’ in the part that relates to what shall be deposited for the creditors and the use of the word ‘money’ in the part that provides what shall be deposited to pay costs and priority claims.” But the courts have shown a reluctance to force creditors to accept anything other than cash. In the only case found under the composition provision in which the question of paying creditors’ claims in corporate securities was directly before the court, the
for a corporation to take advantage of the privilege of composition unless it is authorized to settle claims by distributing securities in the reorganized company, such authorization seems quite in keeping with the purpose of our Bankruptcy Laws. At least, our Supreme Court in 1883 enforced a Canadian statute against American security holders in a Canadian company compelling them to accept new securities under a reorganization plan agreed to by the majority, declaring that such procedure was “no more than is done in bankruptcy when a ‘composition’ agreement with the bankrupt debtor, if assented to by the required majority of creditors, is made binding on the non-assigning minority.”

As to the objection against impairment of contracts, it is settled that this prohibition does not apply to the national legislative bodies. The further requisite of due process is one that may not so easily be disposed of. In the case above referred to, however, the Supreme Court expressed the opinion that “in no just sense do such governmental regulations deprive a person of his property without due process of law. They simply require each individual to so conduct himself for the general good as not unnecessarily to injure another.”

To say the least, there would seem to be argument to support a holding by the Supreme Court that this section is constitutional. There is no clear-cut authority for the argument of unconstitutionality. It is hard to believe that the Supreme Court will be induced by abstract arguments to hold these provisions unconstitutional unless the Court is convinced that they are economically unsound or practically useless. Consideration, therefore, of the substance and merits of the section would seem to be of much more importance than the abstract question of constitutionality.

The decisions are clear that a bid at the sale in bankruptcy by a group of creditors with a plan of reorganization will not be permitted to force securities upon dissenting creditors in payment of their claims. In re J. B. & J. M. Cornell Co., 186 Fed. 859 (S. D. N. Y. 1911); In re Prudential Outfitting Co. of Delaware, 250 Fed. 504 (S. D. N. Y. 1918). Cook on Corporations (8th ed. 1923) § 884.

27. An objection to the enactment of the proposed section probably merits more attention is that a possible extension of the jurisdiction of the federal courts is involved. See Joint Hearings, supra note 16, Part 2, p. 423. The advisability of retaining the consent receiverships for purpose of reorganization in the federal courts has been questioned. See Frankfurter, Distribution of
Attention must first be drawn to the important limitation upon the scope of the proposed section. It is made applicable only to "moneyed, business or commercial" corporations other than "municipal, railroad, insurance, or banking" corporations. These exclusions obviously greatly limit the scope of the provision, since it is a well-known fact that the majority of reorganization problems in this country arise in connection with railroad reorganizations. However, reorganization plays an important part in the life of large industrials, most of these reorganizations being voluntary, i.e., consummated outside of court. The availability of an effective judicial procedure for such reorganizations will supply a definite need, if only by lending support indirectly to voluntary reorganizations, since it would deprive "strikers" and unreasonable recalcitrant parties of a goodly portion of their power. It has been suggested that there may be important economic reasons for encouraging and facilitating the reorganization of embarrassed industrial corporations instead of permitting or forcing them to liquidate at the cost of displacing numerous employees and sacrificing an investment which may be fundamentally sound though temporarily in difficulty. If this be true, legislation facilitating corporate reorganization, even though limited to industrials, is of no little moment.

Judicial Power Between United States and State Courts (1928) 13 CONN. L. Q. 499, at 526; Note (1927) 41 HARV. L. REV. 70, 73. This point is of particular moment at present in view of the pending bills to limit the jurisdiction of the federal courts. See Comment (1932) 31 MICH. L. REV. 59. The Norris-La Guardia bill (S. B. No. 939, H. B. No. 11508) abolishing Federal jurisdiction based on diversity of citizenship, recommended by the report of the Committee on the Judiciary of the United States Senate, would eliminate the use of the federal equity receivership for purposes of reorganization. The proposed addition to the Bankruptcy Act, however, would bring some of these cases into the federal courts by another door. This, of course, will reduce the limiting effects of the Norris-La Guardia bill. But if it be granted that federal jurisdiction in reorganization cases is desirable, this indirect modification of the Norris bill would be justified.

28. Apparently these exclusions were carried over from the provisions excluding these corporations from the rest of the Bankruptcy Act, § 4 (a) & (b) ... Furthermore, reorganizations of railroads are to some extent under the control of the Interstate Commerce Commission. 41 STAT. 494 (1920), 49 U. S. C. § 20-a (1926); Comment (1931) 44 HARV. L. REV. 838. It was probably thought best by the draftsmen of this bill to leave this important special field open for separate legislation. Senate Bill 4921, including railroads within its scope, provides that railroad corporations engaged in interstate commerce obtain "the authority of the Interstate Commerce Commission to the extent required by law" before issuing securities. Sub-division (f) (6).

29. See Dewing, CORPORATE PROMOTIONS AND REORGANIZATIONS (1914); op. cit. supra note 7, Bk. V, c. 8; Cravath, op. cit. supra note 2, at 213.

30. The "striker" difficulties in voluntary creditors' committee reorganizations are particularly vexing. See Dewing, op. cit. supra note 7, at 1159.

To return to the problems outlined at the beginning of this comment, to what extent does the proposed section adopt or add to the existing judicial machinery for effecting reorganizations, and how sound are the measures it proposes?

In regard to the machinery for adjudicating the fairness of the reorganization plan so that it will be insured against belated attack, the proposed section effectively provides this practically in same manner used in the federal equity courts in connection with the foreclosure decree. But the section improves upon the existing procedure by affording a much better opportunity for securing a fair plan. Under the present system, the plan must necessarily be formulated and majority adherence obtained before the plan can come into court because all must be in readiness to bid at the sale, this being the only generally recognized means available to effect a judicial reorganization. This means that the plan has practically been in force perhaps two or three years before it reaches the court which naturally feels reluctant to set the plan aside at so late a date, even though it is admitted that a more sound and just plan might well have been made. The proposed section permits of the court coming into the picture quite early in the game. The corporation may come directly into court for the purpose of reorganization, and a plan accepted by only twenty-five per cent of any class of creditors and ten per cent of all creditors may be proposed by any creditor or the debtor for consideration at a hearing duly noticed for that purpose. Before the plan can be confirmed there must be written acceptance on the part of creditors holding two-thirds in amount of the claims of each class to be affected by the plan (unless a sale or appraisal provision is made, in which event the two-thirds consent is unnecessary), and on the part of two-thirds of the stockholders where the corporation is not insolvent in the bankruptcy sense. Upon the filing of the requisite acceptance, the judge must hear such objections as may be made to the plan and must satisfy himself that the plan is equitable before he confirms it. To aid him in the determination of the fairness of the plan, the judge is authorized to "require the debtor to file such schedules and submit such other information . . . as may be necessary to disclose the conduct of the debtor's affairs and the

32. Draft, § 76 (c) (4) provides that the judge "shall determine a reasonable time within which the claims and interests of creditors and stockholders may be filed or evidenced and after which no such claim or interest may participate in any plan, except on order, for cause shown." Section 76 (h) provides that "upon confirmation of the plan the property . . . shall be transferred by the trustee . . . to the reorganized corporation or the new corporation . . . free and clear of all claims of the debtor, its stockholders and creditors except such as may consistently with the provisions of the plan be reserved in the order or decree directing such transfer."

33. See, for example, Chicago, Milwaukee & St. Paul Reorganization, 131 I. C. C. 673, 694 (1928).

34. Draft § 76 (d).

35. Id. § 76 (e).

36. Id. § 76 (f) (1).
fairness of any proposed plan." 37 Furthermore there must be filed with
the acceptances of the plan "a statement showing what . . . claims and
shares of stock have been purchased or transferred by those accepting
the plan after the commencement or in contemplation of the proceeding
and the circumstances of such purchase or transfer." 38

No sale is necessary so far as unsecured creditors are concerned if the
requisite proportion of acceptance is obtained, and even if this acceptance
is not obtained, as well as in the case where secured creditors are involved,
there need be no sale provided the plan offers protection for all dissenters
by way of "appraisal and payment in cash of the value of such liens and
claims or at the objecting creditors' election, of the securities allotted to
such liens and claims under the plan" 39—apparently adopting the procedure
of Coriel v. White. 40 The exclusion of the necessity for a public sale has
been thought desirable. 41 There has not yet been sufficient investigation or
analysis of the implications of this procedure to justify a conclusive view
as to its desirability. A sale has some utility as a procedure to determine
the distributive share of dissenters in industrial reorganizations. Whether
entrusting valuation to the court and eliminating the judicial sale will be
satisfactory is still an open question.

The most significant provisions of the proposed amendment concern the
compulsion upon the minority to accept a fair plan approved by the
majority. In regard to unsecured creditors, the section apparently codifies
the procedure of the Phipps case. Subdivision (b) (3) provides that the
plan may include "the issuance of securities . . . for cash, or in exchange
for existing securities, or in satisfaction of claims or rights." Subdivision
(g) (3) further provides that a plan confirmed by the court "shall be
binding upon . . . all unsecured creditors, provided two-thirds in amount
of the unsecured creditors shall have accepted the plan in writing filed
in the proceeding." These provisions are obviously, and doubtless pur-
posefully, left open to the interpretation that unsecured creditors may under
the prescribed circumstances be compelled to accept securities in lieu of
a cash dividend.

However, these provisions are not open to Mr. Swaine's criticism that
it would be economically unsound to permit a court, necessarily inex-
perienced in the intricacies of corporate finance, to formulate the plan of

37. Id. § 76 (e) (3).
38. Id. § 76 (e). Senate Bill 4921, § 73 (e) (5) contains the proviso to this
requirement "that if the Judge is satisfied by reason of the number of securities
outstanding and the extent of the public dealing therein the preparation of such
a statement would be impractical, he may direct that it be not filed."
39. Id. § 76 (f) (5).
40. Supra note 3.
41. Comment (1932) 45 HARV. L. REV. 697, 699: "A public sale entails a
considerable waste of the debtor corporation's assets; the cost of organizing the
new corporation is only one of the expenses involved. It may even jeopardize
the ultimate success of the reorganization by causing an undue delay. The
creditor, moreover, has little to gain by it . . . An appraisal without a sale
would accomplish precisely the same result."
reorganization for the parties. The compulsion cannot be exercised at the mere whim of the court, but only when the plan has been endorsed by the specified majority of parties affected and has also been approved as equitable by the court. In other words, instead of merely the court and the reorganization managers deciding upon the compulsion, as the implications of the Phipps case might permit, a large majority of creditors must support this action, and the minority dissenters are provided the opportunity to place before the court their objections in regard to the fairness of the plan.

The more cogent objection made by many to such a provision, namely, that an ordinary creditor should not be precluded from taking his pro rata share of the liquidation value of the corporate assets and should not be forced into becoming an investor, still remains. This objection is much weightier, moreover, where an industrial or commercial corporation is concerned than where a railroad or public utility is involved. The public interest in maintaining private industrial and commercial enterprises as going concerns has not yet been sufficiently demonstrated to produce the general feeling that the corporate enterprise should be perpetuated at the sacrifice of the individual creditor’s rights. It is, of course, possible to carry this solicitude for individual creditors so far as to require the corporation to liquidate if it is unable to raise money for the purpose of paying off dissenters in full. But if the industrial corporation is required to offer dissenting creditors a substantial cash alternative, the possibility of industrial reorganizations is very narrowly limited. Furthermore, financial assistance is apt to be much less readily forthcoming if a large sum must be diverted from the enterprise to pay off dissenters. It seems, then, that unless the existing strict limitation upon reorganization of industrials is to be maintained, the provision of the proposed section is a necessary one.

It should be noted that the proposed section does not go beyond the Phipps case to the extent to which some would carry the doctrine of that case. While unsecured creditors may be forced to accept securities in lieu of a cash dividend, secured creditors, dissenting from the plan, are entitled upon seasonable request, to have their liens upon the corporate property protected in one of three ways: “(a) by the sale of such property subject to such liens and claims, or (b) by a sale free of such liens.

42. Swaine, op. cit. supra note 9, 22 Col. L. Rev. at 130-131.
43. The unsecured creditor “has advanced credit to the corporation with a view to a cash return upon possible liquidation; not to the potential necessity of investing in the stock of his customer or even in his notes.” Comment (1932) 41 Yale L. J. 577, 581.
44. See supra note 31.
45. See Dewing, op. cit. supra note 10.
46. Rosenberg, op. cit. supra note 9, 24 Col. L. Rev. at 271: “The power of the Court to deal in like manner with secured creditors has not been expressly adjudicated but the theory of the Boyd case and the Phipps case would seem to apply with at least equal force to secured creditors as it does to unsecured creditors.”
and claims at not less than a fair upset price, and the transfer of such liens and claims to the proceeds of such sale, or (c) by appraisal and payment in cash of the value of such liens and claims, or, at the objecting creditors’ election, of the securities allotted to such liens and claims under the plan.”

Convincing arguments have been made in favor of the power to modify secured claims as well as unsecured ones. The draftsmen of the proposed bill, however, apparently influenced by the traditional ideology of “absolute priority” and “tenancy in common” in regard to mortgage bonds and by the general policy of the Bankruptcy Act to leave property liens unaffected, did not see fit to venture this far. Moreover, since mortgage bond issues are not so common in the industrial corporate financial structure as they are in railroad financing, the importance of extending the doctrine of the Phipps case to secured creditors was not so impelling.

The machinery provided by the section does avoid the cumbersome foreclosure proceedings of the federal equity courts and furthermore, extends the application of the procedure of the Coriel case, whereby no sale at all need be held, to secured creditors. This provision goes beyond the Coriel case and the Phipps case in both of which cases there were only ordinary unsecured creditors involved. It is to be regretted that the proposed bill does not in any way define the method of appraisal to be used. The proposal of the Coriel case, that the appraisal of the claims should be made on the basis of the sum which the corporate assets would bring if sold at a public sale, is not incorporated in the section, nor is any other of the numerous possible bases adopted. The appraisal might be based on the capitalization of the new or reorganized company, or upon the liquidation value of the old company, or upon the value of the old com-

47. Draft, § 76 (f) (5). Any one of these provisions may be used in lieu of the two-thirds consent requirement in regard to any class or classes of unsecured creditors. § 76 (e).

48. “It is possible that relatively harsher treatment may be accorded those interests which have become permanently connected with the ‘going concern’ than that accorded to temporary creditors since the former can be considered as committed to the enterprise, participating in its successes and bearing the burden of its failures. . . .” Bonbright & Bergherman, Two Rival Theories of Priority Rights (1928) 28 Col. L. Rev. 127, 153n. See, also, Rosenberg, op. cit. supra note 46; Spring, op. cit. supra note 3.

49. Supra note 3; Bankruptcy Act § 67d.

50. See Dewing, op. cit. supra, note 7, at 1104.

51. The sale free from liens or the sale subject to liens have long been familiar to the bankruptcy courts. REMINGTON ON BANKRUPTCY, op. cit. supra note 18, §§ 2575-2585. The bankruptcy court is not hampered by the burdensome and ambiguous act of Congress of 1893, c. 225, 27 Stat. 751, 28 U. S. C. A. §§ 847, 848, 849, which applies to the foreclosure sales in the federal equity courts. Israels, Reorganization Sales; Section 847 of the Judicial Code (1932) 32 Col. L. Rev. 668; Robertson v. Howard, 229 U. S. 254, 260 (1913).

52. See supra notes 8, 9.
pany as a going concern. This failure to establish a standard of valuation or to indicate partiality for any of the divergent methods of appraisal which have been used dodged one of the biggest problems of reorganization. The alternative offered the creditor in this situation to accept the value of the securities allotted him under the plan instead of the appraisal value of his liens or claims against the old company, is of very dubious soundness, as has been pointed out earlier in this comment, since it is apt to encourage security holders to elect cash in such numbers as to defeat the reorganization.

When the corporation is not insolvent in the bankruptcy sense, stockholders' rights must also be given consideration. The distribution of the shareholders' equity in this case involves further difficult questions. The full import of the provision of the proposed section requiring, before confirmation of the plan, consent on the part of stockholders holding two-thirds in amount of the stock cannot readily be ascertained without considerably more study of stockholders' status and rights in the corporation in general than the limitations of this discussion would permit. Apparently the section embraces cases of so-called stockholders' reorganization which can be effected under statutes in most states by a sale or transfer of the corporate assets in exchange for securities in the new or transferee corporation, if a specified majority of the stock consent. The state statutes generally provide that dissentient stockholders have the right to an appraisal and payment in cash of the value of their stock. The proposed section would apparently abrogate the right to appraisal and payment in cash and would compel minority dissenters to accept the securities allotted to them. Also, probably agreements as to surrender of stock, or waiver of priority, or creation of new preferred stock—customary sacrifices asked of stockholders—may be forced upon minority dissenters.

54. Supra, note 11. "It is evident that this option permits the creditors to share in the increased value of the corporate properties resulting from their transfer to a new corporation pursuant to the reorganization plan while relieving them of its speculative burdens. Such an outcome is clearly undesirable." Comment (1932) 41 Yale L. J., 577, 582.
55. Draft, § 76 (e): "A plan shall not be confirmed until its has been accepted in writing filed in the proceeding . . . unless the debtor shall be determined to be insolvent, by or on behalf of stockholders of the debtor holding two-thirds of the stock of each class. . . ."
56. Speaking of the treatment of stockholders in voluntary reorganizations Mr. Cravath says: "It is in dealing with the stock and with the rights of stockholders that the most difficult and perplexing questions are apt to arise." Op. cit. supra note 2, at 214.
58. In regard to the difficulties involved in effecting these measures under present conditions, see Cravath, op. cit. supra note 2, at 214-216.
Whether the proposed legislation goes beyond this and permits the levy of an assessment upon a dissenting minority if the requisite majority agree to pay it cannot be ascertained. The language is susceptible of this interpretation. It may as well be taken to mean, however, that refusal to pay an assessment will result in forfeiture of the stockholder's equity.

It should be noted that in these cases where the corporation is not "determined to be insolvent" in the bankruptcy sense, no plan can be confirmed without the two-thirds stockholders' consent. There is no alternative provision that can be made in their regard as in the case of creditors. It may well be questioned whether the two-thirds consent requirement may not in many cases where the stockholders' equity is small attribute to them a bargaining power disproportionate to the value of their equity.

Before concluding, a few of the obvious advantages of the proposed bankruptcy provision over the present equity receivership should be emphasized. Under the Bankruptcy Act, the trustee takes title to all property wherever located, thus avoiding the conflicts and expense of ancillary receiverships. The possibility that a few unfriendly creditors may obstruct the consummation of a plan by petitioning the corporation into bankruptcy and forced liquidation is obviated. "Tyranny and extravagance" on the part of reorganization committees is less possible under the proposed bill since the court must pass on the fairness of the plan and upon the reasonableness of the amounts paid for services or expenses incident to the reorganization. The "stupid and burdensome statute" of 1893 does not apply to sales under the Bankruptcy Act, so that if the reorganization plan is executed by way of sale rather than by the other means afforded by the provision dispensing with the sale, the procedure is far more simple and direct than is possible in the federal equity courts.

There is no doubt, from the legal point of view, that the proposed legislation, despite the limitations and omissions, will simplify and improve upon the machinery of the equity courts for effecting corporate reorganizations. The significance of such legislation, from the business and economic viewpoints, is a matter meriting further study. B.M.

59. Supra note 47.
60. § 70a.
61. Supra, note 10.
62. Draft, § 76 (f) (1) & (2).
63. Rosenberg, op. cit. supra note 1, at 525.
64. Supra, note 51.
65. Senate Bill 4921, in addition to the provisions of Bill 3866, contains provisions for the protection and compensation of a receiver appointed by a State or Federal Court prior to the institution of proceedings under the Bankruptcy Act, Subdivision (i); for the transfer of property from the bankruptcy court to an existing State or Federal Court receiver in cases where the suit under the bankruptcy provision is dismissed because no plan is proposed, accepted and confirmed within a reasonable time, Subdivision (i); and for the procedure in cases where liquidation is ordered, Subdivision (k).
STATE TAXATION OF MOTOR VEHICLES ENGAGED IN INTERSTATE COMMERCE

The statement that the regulation of interstate and intrastate commerce by motor vehicle is one of the grave social problems of the day no longer requires corroboration by reference to statistics.1 Included in the numerous ramifications of the general problem of regulation 2 is the question of the power of the states to impose taxes upon interstate commerce by motor vehicle. For state taxation imposed upon operators or vehicles engaged in interstate commerce by motor vehicle to be valid under the commerce clause of the Constitution,3 three general requirements must be met. The tax must be imposed for a proper purpose, it must be reasonable in amount, and it must not be discriminatory against interstate commerce. State taxes upon interstate commerce by motor vehicle fall broadly into two classes; namely, those taxes imposed only upon users of the highways for hire, and those taxes, such as operator’s license fees and vehicle registration fees, imposed upon all users whether for hire or not.4

Such taxes, whether of one class or the other, if they are to be sustained at all, must not impinge, conceptually at least, upon the established doctrine of constitutional law that a state may not tax the privilege of engaging in interstate commerce; for this principle, as an abstract proposition, knows no exception.5 To sustain state taxes upon interstate commerce by motor vehicle without contravention of this doctrine, grounds have been found which have their basis in the fact that the states own and control the highways. Power to control the roads in the interest of public safety and order has been held to extend, in the absence of federal legislation preëmpting the field,6 to interstate as well as intrastate commerce.

1. Prefatory statistics are given in Lilienthal and Rosenbaum, Motor Carrier Regulation by Certificates of Necessity and Convenience (1926) 36 YALE L. J. 163, and Brown and Scott, Regulation of the Contract Motor Carrier under the Constitution (1931) 44 HARV. L. REV. 530; or refer to BUS FACTS FOR 1931 (National Association of Motor Bus Operators) for later figures.

2. For discussions of many of these problems see Lilienthal and Rosenbaum, supra note 1; Lilienthal and Rosenbaum, Motor Carrier Regulation; Federal, State and Municipal (1926) 26 CoL. L. REV. 954; and Brown and Scott, supra note 1 (authors counsel for National Automobile Chamber of Commerce).

3. Art. I, § 8, cl. 3.

4. Users for hire are “privileged” users whereas other users are users of “right.” See Comment (1931) 40 YALE L. J. 469 for the meaning of the difference.

5. Interstate Transit, Incorporated v. Lindsey, 283 U. S. 183, 185 (1931); Sprout v. South Bend, 277 U. S. 163 (1928). This is so regardless of how small the tax is. Cudahy Co. v. Hinkle, 278 U. S. 460, 467 (1929).

6. For contemplated federal legislation see (1931) 31 CoL. L. REV. 1025; Lilienthal and Rosenbaum, supra note 2, at 980 et seq. For suggested conditions to the subsidization of state roads under the Federal Highway Act, see (1931) 40 YALE L. J. 469, 474. The federal government will doubtless never attempt to establish a complete system of control over interstate commerce by
and has been held to include the incidental power to exact from all alike the funds necessary to effect control. And there is the added power, springing from ownership of the roads, to exact from all users of the roads alike, compensation for their use. But so far as interstate commerce is concerned, these have been the limits of the power of the state to impose taxes in return for use of the roads. For state taxes on such commerce to be valid they must be for these purposes alone and must be no more onerous than is reasonably necessary. If the state cannot show one or both of these general purposes, then a tax imposed upon interstate operators for the privilege of using the roads will be invalid without the necessity of proof by the operator either that the tax is discriminatory or that it is unreasonable. At least the only two Supreme Court cases precisely in point so indicate.

In Sprout v. South Bend, a license fee of $50 was imposed upon all busses of a certain seating capacity plying South Bend streets for hire. There was no showing either that the fee was exacted to defray the costs of supervision and administration or that the sum demanded was reasonable for such purpose. There was no allocation of the proceeds to street maintenance or construction; nor was there any apparent relationship between use of the streets and the size of the fee. The Supreme Court held that the exaction of the license fee under these circumstances could not be sustained "either as an inspection fee or as an excise for the use of the streets of the city," and that it was accordingly invalid as to an operator in interstate commerce. In Interstate Transit, Incorporated v. Lindsey, a Tennessee statute purported, inter alia, to impose a privilege tax upon motor vehicle, so that some state supervision will continue to be permissible even after Congress acts.

7. Federal legislation would not put an end to this power unless surrender of the power to tax should be made a condition to further federal assistance under the Federal Highway Act. The provision in section 9 of the act against exacting "tolls" has been held not to apply to taxes imposed to defray the costs of supervision and road maintenance and construction; see Carley & Hamilton v. Snook, 281 U. S. 66, 74 (1930): "It cannot be supposed that Congress intended to procure the abandonment by the states of this well recognized type of taxation (vehicle registration fees) without more explicit language than that prohibiting tolls found in § 9."

8. "Interstate operator" as herein used means "operator in interstate commerce." An operator would not have to cross state lines at all to be an operator in interstate commerce. "Intrastate operator" similarly means "operator in intrastate commerce."

10. 277 U. S. 163 (1928).
12. The defendant Sprout was also engaged in intrastate commerce, but the Court held that this fact was immaterial in view of the fact that it did not appear that Sprout could have avoided the tax by withdrawing entirely from his intrastate business; 277 U. S. 163, 171 (1928).
interstate bus lines. The statute was a general revenue measure exacting taxes for the privilege of engaging in numerous occupations and allocating the proceeds of such taxes to the general fund of the state. The plaintiff was required under the statute to pay for its interstate bus business a tax of $500 per bus operated by it across Tennessee highways. As in the Sprout case there was no showing that the tax was imposed to defray reasonable inspection costs; nor was there any affirmative showing that the tax was intended as compensation for use of the roads, since there was no allocation of the tax to highway purposes and since the tax to be paid by any operator was measured by the number and carrying capacity of his busses, a standard of measurement having no relationship to use of the roads. The Supreme Court held that the tax was therefore invalid as applied to interstate commerce, stating that there was no need in the absence of a showing of a proper purpose to "consider whether the tax exacted from this appellant is unreasonably large or unjustly discriminatory."

Hence it seems that an interstate operator, simply by setting up a state statute exacting a tax from him for use of the roads in interstate commerce, thereby invalidates the tax as to such commerce unless the person charged with the collection of the tax can show "affirmatively" that the tax is assessed for a proper purpose. As to taxes exacted to defray the expenses of regulation and inspection, such an affirmative showing might well be made by evidence outside the taxation statute. But it would be more difficult to make such a showing of a purpose to

---

14. Several types of intrastate and interstate bus businesses were enumerated under the statute, but the standard of measurement was the same for all, 283 U. S. 183, 187 (1931).

15. Mr. Justice Brandeis, speaking for the court stated that: "the tax cannot be sustained unless it appears affirmatively, in some way, that it is levied only as compensation for use of the highways or to defray the expense of regulating motor traffic. This may be indicated by the nature of the imposition, such as a mileage tax directly proportioned to the use, . . . or by the express allocation of the proceeds of the tax to highway purposes, . . . or otherwise."

16. The tax per bus in addition to vehicle registration fees was as follows, TNN. ACTS (1927) c. 89 § 4:

<table>
<thead>
<tr>
<th>Capacity</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not more than 5 passengers</td>
<td>$50.</td>
</tr>
<tr>
<td>6—10</td>
<td>100.</td>
</tr>
<tr>
<td>11—15</td>
<td>200.</td>
</tr>
<tr>
<td>16—20</td>
<td>350.</td>
</tr>
<tr>
<td>21—30</td>
<td>500.</td>
</tr>
<tr>
<td>over 30</td>
<td>750.</td>
</tr>
</tbody>
</table>

17. 283 U. S. 183, 190 (1931).

18. In American Motor Coach System v. Philadelphia, 28 F. (2d) 736 (C. C. A. 3d, 1928), where a $50 license fee was imposed for each bus using the city streets for hire, the court held that the necessary showing of purpose was made by proof that the $50 figure was arrived at before the ordinance was drawn up as the result of an estimate of the costs of regulation.
exact compensation for use of the roads by evidence *altiunde* unless proof of a purpose to exact from each operator of a group the average cost to the state per member of the group would suffice.\textsuperscript{10}

There are apparently several methods whereby a legislative body may insure the presence of the necessary evidence within the taxation statute. Perhaps the most definite way is by allocating the proceeds of the tax to highway purposes.\textsuperscript{20} Though a simple statement contained in the act to the effect that the tax is assessed to compensate for use of the highways might be so included for the purpose of deception, no doubt it would satisfy the preliminary requirement of purpose regardless of the fund to which the tax was allocated.\textsuperscript{21} In the absence of a statement of purpose and of allocation to highway purposes, a proper purpose would be indicated by any standard for measuring the tax having some logical relationship to use of the state highways\textsuperscript{22} such as a flat fee to cover the costs entailed

\textsuperscript{19} Where the tax is proportioned to use, evidence outside the statute would not be necessary, as is later indicated. Where it is not proportioned to use, it will more nearly represent the actual costs to the state of each operator's use if intended to defray inspection costs than if intended to serve as compensation for use. Hence, there are grounds for a difference in attitude as to evidence outside the statute. But since the only result of a preliminary showing of purpose is to put the burden on the interstate operator to show unreasonableness or unjust discrimination, Interstate Transit, Incorporated v. Lindsey, 283 U. S. 183, 186 (1931), evidence of a purpose to exact average costs per vehicle might be accepted as a sufficient preliminary showing of purpose in either case.

\textsuperscript{20} Compare Clark v. Poor, 274 U. S. 554 (1927), where there was such allocation, with Interstate Transit, Incorporated v. Lindsey, 283 U. S. 183 (1931) where such allocation was missing. Allocation to highway purposes indicated a proper general purpose in Hendrick v. Maryland, 235 U. S. 610 (1915) and Kane v. New Jersey, 242 U. S. 160 (1916) where vehicle registration and driver's license fees not proportioned to use of roads were upheld.

\textsuperscript{21} S. D. Session Laws (1931) c. 183, § 6 provide that: “the following license fee and compensation for the use of the highway shall be paid annually . . . ” See Prouty v. Coyne, 55 F. (2d) 289, 293 (D. S. D. 1932), stating that this is a sufficient preliminary showing of purpose to put the burden of proof upon the contesting interstate operator. (1931) 31 Col. L. Rev. 1025, 1030 cites Interstate Transit, Incorporated v. Lindsey, 283 U. S. 183 (1931) as indicating that such a statement would be sufficient.

\textsuperscript{22} Such standards of measurement are indicated in the following cases: Interstate Busses Corporation v. Blodgett, 276 U. S. 245 (1928) (one cent per mile) (also allocation to highway purposes); Broadway Express v. Murray, 69 F. (2d) 233 (W. D. Okla. 1932) (one-half cent per mile for class B operators, two-fifths of a cent per mile for class A operators) (also allocation of proceeds); Louis v. Boynton, 53 F. (2d) 471 (D. Kan. 1931) (5/10 mill per gross ton-mile) (also allocation of proceeds); Roachell v. Gates, 47 S. W. (2d) 35 (Ark. 1932) (4% of gross income multiplied by the ratio of Arkansas mileage to total mileage); State v. Public Service Commission, 242 N. W. 668 (Wis. 1932) (1 to 2 mills per ton-mile). See 50 Traffic World 169 (1932) for discussion of the new Louisiana tax upon vehicles for hire. Vehicle registration fees are measured by carrying capacity and horsepower. Operators for hire
per user regardless of the amount of use, plus a ton-mile tax for which the unit rate per ton-mile varied with the gross weight of vehicle and load. Mr. Justice Brandeis intimated in the Interstate Transit case that the Supreme Court might possibly be satisfied with a standard of measurement having as rough a relationship to use of the highways as one proportioning the amount of the tax to the number of passengers carried, without consideration of the distance traveled by each passenger. But a standard of measurement based upon seating or carrying capacity, maximum weight, horsepower or the like and not varying with mileage or with some factor varying with mileage, would not bear the necessary relationship; nor would a flat rate for all vehicles or operators.

Should the requisite "affirmative" showing of a proper general purpose be made by proof of the statute alone, or by proof of facts outside the statute, the burden would then be upon the interstate operator to show either that the tax is unreasonable or else that it is discriminatory against interstate commerce. In considering the reasonableness or unreasonableness of state taxes imposed upon interstate operators because of their use of the roads, it is not material whether the operator is subjected to one or several taxes which have use of the highways as the basis of their validity. Yet, each must be reasonable for the particular purpose for which it is intended; and, where more than one are intended for the same purpose, the total charge for that purpose must be no more than reasonable.

pay an additional 50% of the vehicle registration fee but are entitled to refunds as follows:

<table>
<thead>
<tr>
<th>Distance travelled per annum</th>
<th>Amount of refund</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 5,000 mi.</td>
<td>3/4 of the 50% extra fee</td>
</tr>
<tr>
<td>&quot; &quot; 10,000 &quot;</td>
<td>1/2 &quot; &quot; &quot; &quot; &quot; &quot;</td>
</tr>
<tr>
<td>&quot; &quot; 20,000 &quot;</td>
<td>1/3 &quot; &quot; &quot; &quot; &quot; &quot;</td>
</tr>
<tr>
<td>&quot; &quot; 30,000 &quot;</td>
<td>1/4 &quot; &quot; &quot; &quot; &quot; &quot;</td>
</tr>
<tr>
<td>30,000 mi. or more</td>
<td>none</td>
</tr>
</tbody>
</table>

Such a statute would doubtless satisfy the requirement of purpose, though the relationship of the amount of the tax to use is a rough one.

23. Standards of measurement could be devised with even greater precision but would be somewhat less workable.
25. A tax measured by the number of passengers carried would vary with mileage only in so far as the average distance travelled per passenger approximated the same figure for all the bus lines subject to the tax. The same would be true as to a tax measured by tons of freight carried.
27. Interstate Busses Corporation v. Blodgett, 276 U. S. 245 (1928). Nor is the mere fact that fewer kinds of taxes are imposed upon the intrastate operator than upon the interstate operator material, ibid.
28. Thus, if an interstate operator should bring his own gasoline into a state and there use it in his own business, he would not be subject to a sales tax but would seemingly be subject to a use tax if the proceeds were devoted to highway purposes; State v. Johnson, 173 La. 669, 138 So. 503 (1931). Cf. Nelson v. Kentucky, 279 U. S. 245 (1929); also Boeing Air Transport v. Edelman, 61 F. (2d) 319 (C. C. A. 10th, 1932) reversing in part 51 F. (2d) 130
A claim of unreasonableness might well arise even though the tax or taxes imposed upon the interstate operator were no more than the actual cost to the state entailed by his use of the roads. In such a case the argument would have to be addressed to the question of the reasonableness of the costs incurred by the state. As to actual pavement expenses, the expenses of supervision on the road, and other expenses directly entailed by use of the roads, no question would arise where the charges were no more than the costs entailed by the interstate operator, for the reason that the courts would doubtless accept as reasonable any system of direct supervision devised by the legislative body. But a question might well arise as to fees charged for the preparation of voluminous papers, and for hearings and examinations before commissions and the like, if the fees should be large because of the elaborateness of the administrative system. A case is suggested by the Oklahoma statute litigated in Broadway Express v. Murray. The statute provides, inter alia, that a certain class of motor carriers for hire must pay, in addition to vehicle registration fees, a license fee of $100 plus a tax of one-half cent per mile of highway traversed. Assuming that the administrative expense incident to the examination of each applicant under the statute exhausts the entire $100 fee whether the prospective operator desires to traverse a very few or many miles of state highway, an operator contemplating but limited use of the roads for hire in interstate commerce might well contend that in a case such as his such an elaborate and expensive administrative procedure is not justified if at his expense. The attitude of the Supreme Court in regard to such a contention would depend upon the keenness of its desire to protect the small operator. A very recent case may indicate a sentiment on the part of the Court that the whole problem of motor transportation could best be solved if only relatively few large operators had to be dealt with. If that feeling actually pervades the Court, it would perhaps say that the practical necessity for uniformity justifies the establishment of a single system of administration for all in a general class, even though the occasional applicant suffers thereby.

Where the total of all charges based upon use of the roads exceeds the actual cost to the state entailed by an interstate operator's use, it may be stated as a general proposition that such a fact should render the tax

(D. Wyo. 1931); noted in (1932) 45 Harv. L. Rev. 385. Likewise registration fees above the costs of regulation would have to be as compensation for highway purposes. Where an interstate operator paid "use" taxes on gas, vehicle registration taxes and additional taxes for use for hire, the total of all taxes predicated upon use of the highways would have to be no more than reasonable.

30. 60 F. (2d) 293 (W. D. Okla. 1932).
31. Stephenson v. Binford, Sup. Ct. Dec. 63 (U. S. 1932), in which a Texas statute providing for the regulation of rates of intrastate contract carriers was upheld. Cf. Brown and Scott, supra note 1, at 551. It has been stated that if the statute should be upheld it would result in the displacement of the small operator for the reason that his business is dependent upon underbidding for survival.
invalid as to him, since a profit accruing to the state from its dealings with an interstate operator would amount to taxation of the privilege of using the highways. But practical considerations necessitate occasional obfuscation of this general doctrine in order to permit the assessment of taxes by a feasible scheme.

Although the requirement of a standard based upon use of the roads in the case of those taxes, such as vehicle registration and driver's license fees, which are imposed upon all operators, might be impracticable, such a requirement in the case of additional taxes imposed upon users of the roads for hire, because of the comparative smallness of that group, could be more easily complied with. Considering the size of the average charges per operator, there is a strong argument in favor of requiring that many of the taxes upon vehicles for hire be proportioned to use. But this argument does not exist as to the smaller fees charged for such use, nor does it exist in general as to vehicle registration or driver's license fees. Yet, because of the great increase in the amount of vehicle registration fees for the larger buses and trucks, proportionment to use has been required in the case of the larger registration fees. And perhaps the Supreme Court might be persuaded so to decide though the question of the unreasonableness of vehicle registration fees to be paid by interstate operators has not been before the Court since Kane v. New Jersey was decided in 1916.

When a standard of measurement not proportioned to use is permissible, the actual use made of the roads by various individuals paying the

32. There are nearly 26 million motor vehicles in the United States; (1932) 11 Bus Transportation 349; of which 3,466,303 are trucks and 93,000 are busses; (1932) 50 Traffic World 389.
33. 45,400 busses are operated for hire, (1932) 11 Bus Transportation 54. It is not known exactly how many of the 3,466,303 trucks are operated for hire.
34. For example, in Texas, out of 206,000 trucks only 5,500 or less have a rated carrying capacity of over 7,000 pounds; Sproles v. Binford, 286 U. S. 374 (1932). The heavier registration fees would ordinarily fall on approximately such a proportion of the total group.
35. The tax in Interstate Transit, Incorporated v. Lindsey, 283 U. S. 183 (1931) was $500 per bus of capacity from 21 to 30 passengers. In Clark v. Poor, 274 U. S. 554 (1927), the additional tax for hire for a 3½ ton truck traveling over a regular route was $200; Ohio Gen. Code (Page, 1928) § 614-94.
36. For example, the $5 license fee charged users for hire in State v. Public Service Commission, supra note 22, in addition to a ton-mile tax which would be proportioned to use.
37. For example, the South Dakota registration fee for a truck weighing 9,000 pounds is $400 per annum. Prouty v. Coyne, supra note 21. The Ohio registration fee on a five ton truck jumped from $90.50 in 1926 (Ohio Gen. Code (Page, 1928) § 6292-1) to $155 in 1931 (Ohio Gen. Code (Page, 1931 Supp.) § 6192-1).
39. But see the additional discussion infra as to this point.
same tax may vary considerably. The result is that the less frequent users pay more than the cost entailed by their use, so that the state derives a profit from the tax on them even though no profit results from the tax on all users as a whole.\textsuperscript{41} But such a tax is apparently reasonable so long as the total tax collected from all users does not materially exceed the total expense incurred by the state.\textsuperscript{42}

Even though a tax imposed upon an interstate operator is proportioned to use it is not \textit{ipso fact\o} reasonable, since the essential purpose is to equate the tax charged per unit of use by the interstate operator with the cost entailed to the state per unit of use. Hence, even where the tax is proportioned to use, the interstate operator should theoretically be able, by showing that the amount exacted exceeds the cost to the state, to invalidate the tax as unreasonable. As a practical matter, however, this abstract power is of small value to the operator. One reason is that when the Supreme Court refuses to require that the standard of measurement be proportioned to use with scientific accuracy, it necessarily recognizes that the adjustment of the charges against an interstate operator to the costs actually entailed by his use of the roads may be only approximate. As a result, even though the charges imposed exceed the cost to the state, they should be sustained as reasonable so long as they approximate it. Another reason is that complexities of accounting and the prevalent non-existence of much of the necessary evidence render it exceedingly difficult for the operator to prove with any degree of certainty the actual cost to the state from his use of the roads.\textsuperscript{43} If he should be able to show that the tax imposed exceeded the cost to the state, the amount of the difference necessary to make the tax unreasonable would largely depend upon the legislative intent. If an intent to exact more than cost value of the use made of the roads could be shown, no doubt a relatively small excess charge would make the tax unreasonable. On the other hand, in the absence of a legislative intent to make a profit, the excess charge would have to be relatively large before the courts would feel that the discrepancy should not be ignored.\textsuperscript{44} Beyond this it is impossible to generalize.

\begin{itemize}
\item \textsuperscript{41} Intrastate operators may be required to pay a privilege tax in excess of compensation to the state for use made; Carley & Hamilton v. Snook, 281 U. S. 66 (1930).
\item \textsuperscript{42} American Motor Coach System v. City of Philadelphia, supra note 18, where a flat fee of $50 on all busses raised a total sum only slightly in excess of total expenses of regulation without regard to cost of street maintenance.
\item \textsuperscript{43} See Interstate Busses Corp. v. Blodgett, 276 U. S. 245 (1928) and Clark v. Poor, 274 U. S. 554 (1927) where the interstate operator made no effort to prove the cost to the state entailed by his use. In Kane v. New Jersey, 242 U. S. 160 (1916) the interstate operator attempted to show that a vehicle registration fee was in excess of costs of regulation, but made no effort to show that it was in excess of cost of regulation \textit{and use}, to both of which purposes the proceeds of the tax were allocated. Due to the difficulty of proof, discrimination is the most utilized ground for a claim of invalidity.
\item \textsuperscript{44} See General American Tank Car Corporation v. Day, 270 U. S. 367, 373 (1926).
\end{itemize}
So far as the commerce clause alone is concerned, the question of discrimination arises only where there is different treatment of interstate and intrastate operators who are in the same class.\(^4\) Where varying standards of measurement are applied to interstate and intrastate operators otherwise in the same class, in order to sustain a claim of unjust discrimination against interstate commerce, the interstate operator must prove that in practical operation the intrastate standard of measurement subjects the operator to a smaller tax burden than does the interstate standard, and that the difference in the two burdens is substantial in nature. It is not enough merely to show that there is a variance in the standards of measurement.\(^4\) Nor would it suffice to show that in particular instances the two standards of measurement would give results unfavorable to interstate commerce without showing that this would also be true in the general run of cases for which taxation statutes are of necessity devised.\(^4\) The amount of the difference adverse to interstate commerce necessary to sustain an allegation of unjust discrimination would, as in the case of the amount of excess of charges over cost necessary to constitute unreasonableness, largely depend upon the legislative intent.

45. Questions of discrimination under the 14th Amendment arise where carriers of particular products; Schwartzman Service v. Stahl, 60 F. (2d) 1034 (D. C. Mo. 1932) (farm and dairy products and newspapers); Smith v. Cahoon, 283 U. S. 553 (1931) (farm and sea products); are exempted from various types of regulation; or where different taxes are imposed upon different types of carriers; Broadway Express v. Murray, supra note 22 (three classes of carriers subjected to different tax rates), where the classification does not have as a basis the distinction between interstate and intrastate commerce.

The exemption provision contained in KAN. LAWS (1931) c. 236, § 2 sustained in Continental Baking Co. v. Woodring, 286 U. S. 352 (1932) is typical: "This act shall not apply to motor carriers who shall operate wholly within any city or village of this state, or private motor carriers who operate within a radius of twenty-five miles beyond the corporate limits of such city, or any village, nor to the transportation of live stock and farm products to market by the owner thereof or supplies for his own use in his own motor vehicle; or to the transportation of children to and from school." The act there ligated exacted taxes from and imposed insurance requirements, safety and sanitary regulations, etc. upon motor carriers whether in interstate or intrastate commerce.


47. In speaking of the related question of discrimination under the Fourteenth Amendment the Court said in General American Tank Car Corp. v. Day, 270 U. S. 367, 373 (1926) that: "where the statute imposing a tax which is in lieu of a local tax assessed on residents, discloses no purpose to discriminate against non-resident taxpayers, and in substance does not do so, it is not invalid merely because equality in its operation as compared with local taxation has not been attained with mathematical exactness. In determining whether there is a denial of equal protection of the laws by such taxation, we must look to the fairness and reasonableness of its purposes and practical operation, rather than to minute differences between its application in practice and the application of the taxing statute or statutes to which it is complementary."
Where the same standard of measurement is applied to interstate and intrastate operators alike, a claim of discrimination may arise where the amount of the tax is not proportioned to use of the roads, but is the same for the infrequent and frequent user so long as both are operating the same number of similar vehicles in the same type of business. In such a case the benefit to the infrequent user per dollar of taxes paid would be materially less than the benefit to the frequent user. The only case directly in point, decided by a statutory three-judge federal court, indicates that the representative interstate operator, unlike the intrastate operator, is an infrequent user.\footnote{48} Apparently any interstate operator, whether a frequent or infrequent user, may raise the claim of unjust discrimination against interstate commerce, and if the claim is substantiated as to the representative operator, then the tax is invalid as applied to interstate commerce generally.\footnote{49}

If the representative operators are as indicated above, then there would be discrimination against interstate commerce wherever the standard of measurement was not proportioned to use of the roads. But whether or not such discrimination is unconstitutional, should be determined, as the question of when taxes must be proportioned to use so as not to be unreasonable, in the light of practical considerations. Where consideration of factors such as the number of operators and the amount of taxes involved indicates that the requirement of a standard of measurement relating to use would not be impracticable, the requirement that the representative interstate and intrastate operators receive equal benefits per dollar paid should be stressed. On the other hand, should consideration of the material factors involved indicate that such a requirement would be an undue burden on all concerned, then the requirement of equal yield per tax dollar paid should be relegated to the background, so that the tax, if reasonable, would be a valid burden on interstate commerce.\footnote{50} But in any event the burden of proof is on the interstate operator to show discrimination, and there are no presumptions in his favor.\footnote{51}

\footnote{48. Prouty v. Coyne, \textit{supra} note 21, at 293.}
\footnote{49. \textit{Ibid.}}
\footnote{50. This was done in Kane v. New Jersey, 242 U. S. 160, 168 (1916): "A resident desiring to use the highways only a single day would also have to pay the full annual fee." (italics ours). In such a case, then, the representative operators make the \textit{same} amount of use instead of the interstate representative being the infrequent and the intrastate representative being the frequent user.}
\footnote{51. Clark v. Poor, 274 U. S. 554 (1927). In view of Interstate Transit, Incorporated v. Lindsey, 283 U. S. 183 (1931) and Sprout v. South Bend, 277 U. S. 168 (1928), it would seem that the only reason that the interstate operator in Clark v. Poor lost his case was that he was so sure that the general regulatory scheme involved was invalid as applied to interstate commerce that he took the case too lightly. But this appearance is not entirely correct, as the Court has but gradually shifted to the view that the larger taxes must be proportioned to use; the shift not having been completed until Sprout v. South Bend was decided in 1928. In Kane v. New Jersey, 242 U. S. 160, 168 (1916) Mr. Justice Brandeis indicated that any compensating tax which was reason-}
Since the attitude of the courts would, or should, vary with the resultant of all factors involved, it is difficult to generalize as to when a claim of discrimination should be recognized and when it should be ignored. This difficulty is enhanced by the dearth of authority directly in point. It may safely be said, however, that as to taxes not proportioned to use, an inter-state operator should be able to sustain a claim of discrimination in the case of the larger extra taxes imposed for use of the roads for hire. But he should not be able to sustain a claim of discrimination in the case of the smaller taxes and fees, where proportionment to use would entail administrative expenses grossly out of proportion to the net revenue intended to be raised by the tax. As to the larger vehicle registration fees imposed upon operators of vehicles of greater power, heavier weight, or larger capacity, one lower federal court has required proportionment to use. However, in view of the fact that because of reciprocity statutes and general administrative policies, registration fees are not generally exacted from operators not contemplating moderately extensive use, the wisdom of forcing the states to extend the extensive administrative organization required by taxes proportioned to use to the field of vehicle registration fees is doubtful.

**EFFECT OF PRIORITIES ALLOWED BY STATE STATUTES IN BANKRUPTCY PROCEEDINGS**

Although prior to the National Bankruptcy Act all regulation of the administration of insolvent estates was exercised by the states, its passage has been held to suspend the state insolvency laws. But under section 64b dealing with priorities in the distribution of bankrupt estates, state in-
solvency laws have been recognized as still in force to the extent that they regulate priorities. After enumerating certain classes of debts entitled to priority, the section concludes: "(7) debts owing to any person who by the laws of the states or the United States is entitled to priority. . . ." It is not clear, however, whether administration under the state insolvency statute prior to the proceedings in bankruptcy is necessary in order to entitle a creditor to priority under section 64b (7). If the state statute does not provide for a particular mode of administration, but merely indicates the order of distribution of an insolvent estate, it is probable that prior state administration would not be essential.

Today the more common state statutes dealing with insolvent estates, not being so broad in their scope as to be general insolvency laws, are not suspended by the Act. But administration under one of these statutes may be suspended by bankruptcy. Thus, a valid assignment for the benefit of creditors made under state law may be avoided by bankruptcy within four months of the assignment. Although it has been strongly urged that since the assignment is void as to the trustee, the state law should not govern, the priorities applicable under the assignment statutes have been

4. In re Wright, 95 Fed. 807 (D. Mass. 1899); In re Worcester County, 102 Fed. 808 (C. C. A. 1st, 1900); In re Daniels, 110 Fed. 745 (D. R. I. 1901); In re Western Implement Co., 166 Fed. 576 (D. Minn. 1909).

5. Under the 1926 amendment 64b (7) concludes: "Provided, that the term 'person' as used in this section shall include corporations, the United States and the several states and territories of the United States." Prior to 1926 it had been held that "person" did not include the United States. Davis v. Pringle, 268 U. S. 315 (1925), rev'g Standard Oil Co. v. Miller, 3 F. (2d) 438 (C. C. A. 4th, 1925), aff'd In re Atlantic G. & P. S. S. Co., 289 Fed. 145 (D. Md. 1923); (1925) 9 MINN. L. REV. 376; see Colin, The Priority of the United States in the Payment of its Claims Against a Bankrupt (1924) 24. COL. L. REV. 360. In re Western Implement Co., 166 Fed. 576 (D. Minn. 1909), held a state a person under the section, but In re C. O. Pick Co., 9 F. (2d) 207 (D. Ore. 1925), held the State Industrial Accident Fund not a person.

6. § 64b (7) in the present act was formerly § 64b (5) and where § b (7) is referred to it will include § b (5) of the act prior to 1926.

7. In In re Jones, 151 Fed. 108 (W. D. Mich. 1907), the court refused to grant a priority based on the state insolvency law in the absence of an action under the statute. Administration under the statute was not usual in Michigan and priority would not have been granted by the state courts. But in other cases priorities have been allowed without an action. In re Goldberg Bros., 144 Fed. 566 (D. Me. 1906); In re Iroquois Machinery Co., 166 Fed. 629 (D. R. I. 1909) (costs of attachment granted preference although no insolvency law at time of attachment and no assignment which would have brought it under another statute). When different priorities were granted under different forms of administration, difficulty would arise.

8. 6 REMINGTON, BANKRUPTCY (3d ed. 1923) § 2848.

9. Under § 3a (5), 11 U. S. C. § 21 (1926) an assignment for the benefit of creditors is an act of bankruptcy. For cases where an assignment has been superseded by bankruptcy, see In re Bryant, 104 Fed. 789 (E. D. Tenn. 1900); Wilber v. Watson, 111 Fed. 493 (D. R. I. 1901); In re Lewis Neurburger Inc., 240 Fed. 947 (C. C. A. 2d, 1917).
applied even when the assignment itself has been set aside.\textsuperscript{10} Similarly, when a state receivership under a statute granting priorities to certain classes of debts is superseded by bankruptcy,\textsuperscript{11} the priorities will be allowed.\textsuperscript{12} But it is not certain that priority will be granted under section 64b (7), either after an assignment or receivership, to claims such as receiver's and assignee's fees and costs for which priority may not be specifically provided by the state statute.\textsuperscript{13} 

Where the priority urged is for costs incurred in an attachment suit which has been set aside by the bankruptcy court, the majority of cases have allowed the costs of a bona fide suit if they were granted priority by the state law.\textsuperscript{14} On the other hand, it has been held that the costs of such a proceeding does not constitute a debt and so cannot come under section 64b (7).\textsuperscript{15} Moreover, it is urged that an attachment, unlike a receivership or assignment for the benefit of creditors, is not for the preservation of the estate but solely to gain a preference which is contrary to the policy of the Act. The preference being avoided, it is argued that the same policy would prevent the costs being granted a priority.\textsuperscript{16} An analogy may be drawn to costs incurred by an assignee or his attorney in drawing assignment papers, or in opposing bankruptcy, such a claim being denied a preference\textsuperscript{17} although it would have been preferred in administration under the assignment.

The priority granted a class of debts by state law appears to be enforceable under section 64b (7) only in the absence of definite provision for such debts in other sections of the act.\textsuperscript{18} Thus, since section 64b (5) reads: "Wages due to workmen, clerks, traveling or city salesmen, or servants, which have been earned within three months before the date of

\begin{enumerate}
\item In re Goldberg, supra note 7. \textit{Contra:} In re Slomka, 122 Fed. 360 (C. C. A. 2d, 1903).
\item § 3 a (5), 11 U. S. C. § 21 (1926) makes the appointment of a receiver while a debtor is insolvent an act of bankruptcy. See Bank of Andrews v. Grudger, 212 Fed. 49 (C. C. A. 4th, 1914) and cases cited (1932) 41 \textit{YALE L. J.} 1234.
\item Such statutes will be enforced under § 64b (7) unless the claims granted priority are otherwise provided for by the Act as explained \textit{infra}.
\item See (1932) 41 \textit{YALE L. J.} 1234, 1236.
\item In re Iroquois Machinery Co., \textit{supra} note 7; In re Amoratis, 178 Fed. 919 (C. C. A. 9th, 1910); In re Nicholson, 13 F. (2d) 55 (D. R. I. 1926). Costs of a suit have been allowed a priority. In re Daniels, \textit{supra} note 6. Fees of a sheriff making the attachment have been allowed priority. In re Lewis, 99 Fed. 935 (D. Mass. 1900). \textit{Contra:} In re Whitney, 2 F. (2d) 889 (W. D. Tenn. 1924) (levy on real estate and bankruptcy before sale).
\item In re The Copper King, 143 Fed. 649 (N. D. Cal. 1906).
\item Wison v. Clarke, 285 Fed. 726 (C. C. A. 5th, 1923) (Action to create a lien that was avoided by bankruptcy).
\item Randolph v. Scruggs, 190 U. S. 533 (1903).
\item 6 \textit{REMINGTON, BANKRUPTCY} § 2855 and cases cited. States may not vary the order of payment provided by the Act. In re McDavid Lumber Co., 190 Fed. 97 (N. D. Fla. 1911); or postpone a claim, Barks v. Kleyne, 15 F. (2d) 153 (C. C. A. 8th, 1926) (fraudulent conveyance set aside, but the court refused
the commencement of the proceedings, not in excess of $600 to each claimant,” it has been held exclusive as to priorities of wage claims against the bankrupt estate, even to the extent of precluding priorities granted to a class of employees not covered by the Act. Thus, in the early case In re Rouse, Hazard Co., it was held that section 64b (5) was exclusive as to wage claims. Later decisions have seemed to disregard this holding to some extent, although it is probable that it will still be followed. In Emerson v. Caster the court refused to decide whether section 64b (5) or the state law under section 64b (7) should control since the amount of priority would have been the same in either event. Subsequently, in In re Western Condensed Milk Co. priority under section 64b (7) was granted wage claims accruing more than three months before bankruptcy, the Supreme Court denying certiorari. It was admitted that the cases were not in accord, but no attempt was made to distinguish adverse holdings, and in fact none were cited. The court relied to some extent on In re Laird, a case involving a lien perfected under the state statute and therefore clearly distinguishable. The court could have avoided conflict with the earlier cases holding section 64b (5) exclusive, by reasoning, as was done in later cases, that the three months' limit in the Bankruptcy Act dated from the inception of administration under the state law rather than from the time of filing the petition in bankruptcy. This would have achieved the desired result, since the state statute limited priority to wages earned within ninety days of the insolvency proceedings (in this case a state receivership) to the extent of $100 for each claim. Such reasoning, however, cannot avoid the conflict where the amount allowable as a priority to each claim under the state statute is greater than that permitted by section 64b (5), or where priority is given to wages earned more than three months before insolvency proceedings. Moreover it is not clear that "proceedings" as used in 64b (5) is meant to include proceedings other than bankruptcy. The most recent decisions on the point do not follow the Western Condensed Milk case.

19. Allowances for each claimant were limited to $300 before the amendment of 1926. 11 U. S. C. § 104 (1928).
22. 91 Fed. 96 (C. C. A. 7th, 1899).
27. In re Seattle Cut Glass Co., 1 F. (2d) 409 (W. D. Wash. 1923); In re Rodgers & Garrett Timber Co., supra note 26.
It has been held that section 64b has no application to liens as they are covered by section 67 of the Act. It is possible, therefore, that in those states granting wage claimants a lien against an insolvent estate, wage claims will receive a greater preference than provided under section 64b (5). It seems clear that a lien for wages perfected and not avoidable under section 67 should be enforced as to wage claims outside the three months period. As to wages within the three months' period, the cases seem to indicate that section 64b (5) is exclusive, for although there is some authority for allowing a lien for wages earned in that period, there is serious doubt that these cases will be followed.

Another problem closely associated with that of wage claims is created by statutes granting priority to awards of workmen's compensation and compensation insurance premiums. Difficulty in this connection is largely due to the unfortunate wording of statutes, which state that the same priority shall be granted as is accorded wage claims. As a result, courts are again presented with the confusing conflict between wage priorities under section 64b (5) and section 64b (7). For example, in a case involving workman's compensation premiums under a Wisconsin statute the bankruptcy court refused to commit itself upon the conflict between the state assignment statute allowing proof of labor claims accruing with six months of the assignment and section 64b (5), which would limit the claims to those accruing within three months of the "proceedings"; the court contented itself with the statement that a preference cannot be given for a claim that arose more than six months prior to the filing of the petition in bankruptcy. An earlier district court decision involving the same statute held that while a state statute could not enlarge the scope of section 64b (5), the claim could be brought under section 64b (7), and consequently would not be subject to the $300 limit then provided in 64b (5). Under the New York statute which also allows compensation

32. See In re Slomka, supra note 10. The confusion of courts in distinguishing between a lien and priority will probably result in the consideration of both classes under § 64b as governed by § 64b (5).
35. Id. at 277. This does not seem an application of either statute but a compromise.
37. N. Y. Consol. Laws (Cahill, 1930) c. 66, § 34.
the same status as is provided for wage claims, an employee who had been injured before bankruptcy and whose compensation had not been fully paid, was denied priority on the ground that wages were granted priority only under the state assignment statute, and there had been no assignment in that case.38 The result seems unfortunate in the light of section 64b (7) and the extent to which other bankruptcy courts have gone in allowing priorities regardless of the lack of prior state administration. In Oregon the state set up an Industrial Accident Fund to which employers paid a percentage of their payroll.39 These payments were made a preferred claim in insolvency proceedings and in bankruptcy.40 One bankruptcy court allowed the priority;41 but in the same year a different court refused to grant the payments priority on the ground that the fund was not a "person" under section 64b (7).42 Under some statutes the claims for premiums are granted a lien rather than a priority and so do not come under section 64b.43 But in two cases defects in filing of liens have been held to prevent priority of any sort.44 More carefully worded statutes granting priority to awards of workmen's compensation and compensation insurance premiums without reference to wage claims and made expressly applicable to the case of bankruptcy, would assure recognition under section 64b (7).45

Preferences will be allowed landlords for rent within the limits granted by state statutes 46 even where common law distraint is still available.47 In many jurisdictions the statute creates a lien,48 but bankruptcy courts have on occasion considered these statutes as giving no greater rights than those which merely grant a priority,49 and both types of statute may be

40. Id., § 49-1830.
41. In re Ireland, 4 F. (2d) 813 (S. D. Cal. 1925).
42. In re C. O. Pick Co., supra note 4 (decided on the authority of the Pringle case, supra note 4, also handed down that year).
43. For a collection of provisions, see 2 Schneider, Workmen's Compensation (1922) § 570 note 1. Cf. In re Lexie Mining Co., 1 F. (2d) 344 (W. D. Pa. 1923) (held to be a secret lien that would not be enforced).
44. In re C. A. Taylor Logging & Lumber Co., 28 F. (2d) 526 (W. D. Wash. 1928); In re Unit Lock Co., 49 F. (2d) 313 (N. D. Okla. 1931).
45. See Note (1932) 41 Yale L. J. 776 as to provability of such claims in bankruptcy without regard to priority.
46. In re Southern Co., 180 Fed. 838 (D. Ind. 1904); In re Chandron, 180 Fed. 841 (D. Ind. 1904).
47. A landlord's lien is not one that can be set aside as a preference under § 67 and if the landlord has distrained he may keep the proceeds of sale. Bird v. City of Richmond, supra note 28.
48. See Remington, Bankruptcy ((3d ed. 1923) § 2856 for the cases under various state laws.
49. In re Brinson, 1 F. (2d) 824 (S. D. Fla. 1924) (priority granted under statute providing for lien).
considered together. It is generally held that priority will not be accorded rent accruing after adjudication, although a statutory provision allowing a lien for a limited amount of future rent has been enforced in bankruptcy, and where the parties contract for a lien to protect future rents, it will be enforced. As the priority is strictly limited to rents, water rents due a city and costs incurred in discharging a mechanic's lien may not be granted a priority. If, however, the parties contract to include taxes and insurance premiums as part of the rent, these charges will be included in granting priority. Priority is granted on the theory that a landlord should be compensated for the loss of his right to distrain. Consequently priority will not be allowed rent accruing under a lease to a tenant who has given up the premises to a new occupant, no goods of the first tenant being subject to distress in that situation. As in the case of priorities granted claims under Workman's Compensation Laws, the problem is primarily one of statutory phrasing and construction. Other classes of claims which have been allowed priority under section 64b (7) include cost of convict labor, debts owed by a guardian to a ward, freight charges incurred while the railroads were under government control, labor and materialmen's claims in the logging industry, debts owed from community property, labor and materialmen's claims against mining and manufacturing corporations, and double liability on bank stock.

50. See (1932) 41 YALE L. J. 894.
52. In re Homann, 45 F. (2d) 481 (C. C. A. 2d, 1930) (deposit for rent).
57. In re Western Implement Co., supra note 4; In re Worcester County, supra note 6.
The constitutional limits within which a state must keep in providing for priorities that will be enforced under section 64b (7) is indicated by a recent decision, which held a Tennessee statute giving residents a priority over foreign corporations in the distribution of insolvent estates unconstitutional under the 1926 amendment to section 64b (7), although prior thereto the validity of the statute had been upheld.

PROFIT SHARING FOR EXECUTIVES AND EMPLOYEES—THE AMERICAN TOBACCO COMPANY, A CASE IN POINT

Profit sharing for laborers and executives has been heralded as an industrial program which retains the essential capitalistic feature of production for profit, and at the same time minimizes the unequal distribution of wealth and the evils of absentee ownership. The share of each individual in the portion of profits allocated to his group is generally measured by his fixed wage, the index of the value of his services. The distribution of profits is made in the form of periodic payments of cash or stock, or in the opportunity to purchase stock at advantageous prices. If to the workingman's share of profits, a voice in management of the enterprise were added, the implications of the "new capitalism" prophesy a society of industrial harmony and economic prosperity. But the happy


65. See note 5, supra.

66. In re Standard Oak Veneer Co., 173 Fed. 103 (E. D. Tenn. 1909) (held unconstitutional as to citizens of other states but valid as to foreign corporations).

1. The literature is extensive and sometimes inspired. See CARVER, THE PRESENT ECONOMIC REVOLUTION IN THE UNITED STATES (1925); PROFIT SHARING IN THE UNITED STATES (1917) U. S. Bureau of Labor Statistics, Whole no. 203 (1917); NATIONAL CIVIC FEDERATION REPORT ON PROFIT SHARING BY AMERICAN EMPLOYERS (1921); NATIONAL INDUSTRIAL CONFERENCE BOARD, EMPLOYEE STOCK PURCHASE PLANS (1928) and supplement EMPLOYEE STOCK PURCHASE PLANS AND STOCK MARKET CRASH (1930); Foerster and Diegel, EMPLOYEE STOCK OWNERSHIP IN THE UNITED STATES (1928); Balderston, MANAGERIAL PROFIT SHARING (1928); Commons, INDUSTRIAL GOVERNMENT (1921); Bloomfield, FINANCIAL INCENTIVES FOR EMPLOYEES AND EXECUTIVES (1923) where an adequate index to periodical literature is given. For English experience see British MINISTRY OF LABOR, REPORT ON PROFIT SHARING (1920), and an excellent study BOWIE, SHARING PROFITS WITH EMPLOYEES (1922). For France, see Laguerre, SOCIÉTÉS ANONYMES À PARTICIPATION OUVRIÈRE (1920).

2. Magruder, Labor Copartnership in Industry (1922) 35 HARV. L. REV. 910. A journalistic specimen is Nelson, Le Claire—An Existing City of the Future, (1914) 77 INDEPENDENT 100. The Columbia Conserv Co. and Maison Le Claire in France are notable examples of such a development. For an interesting example of philanthropic attempt of an owner to give employees control by testamentary trust see Hoglan v. Moore, 219 Ala. 497, 122 So. 824 (1927); but cf. Nichols v. Olympia Veneer Co., infra note 14.
promises of profit sharing to laborers are at present far from realization. Although short-lived experiments in profit sharing in the United States date as early as 1870, the period of greatest expansion occurred in the five years of 1921-1925, when about 250 companies initiated their plans. Still, less than 3% of the total number of wage earners have been allowed to participate in profit sharing. The average addition to the fixed wage is a 10% increase, and the average life of a plan is no more than nine years. To its proponents, the most disappointing fact in the history of profit sharing is the failure of the rank and file laborers to respond to the opportunity of sharing in profits. In fact organized labor, both here and abroad, has bluntly opposed the introduction of profit sharing on the grounds that the interest of labor lies in a secure and decent fixed wage, and that profit sharing induces a loyalty to each enterprise and thereby obstructs general trade organization. Actually, the adoption of profit sharing for laborers has in the main depended upon the convincing appeal it may be able to make to the employer as a solution of modern labor problems, and not the least element of persuasion has been the hope that employees can be dissuaded from a militant self-interested organization.

Extensive adoption has come in periods of industrial unrest and increasing profits. Uniformly, the employer has retained the right to discontinue the participation of the employees in profits. In short, profit sharing in the form of bonuses or stock purchase plans has neither furnished the

3. These statistical trends are noted in the more objective studies cited above.

4. BOWIE, op. cit. supra note 1, at p. 90. NATIONAL CIVIC FEDERATION REPORT, op. cit. supra note 1 at pp. 6-8. NATIONAL INDUSTRIAL RELATIONS CONFERENCE BOARD, PROFIT SHARING (1920) p. 28.

5. See Sullivan, Objections to Profit Sharing, pp. 110-135, Nat'l Civic Federation Report on Profit Sharing (1921). PEASE, PROFIT SHARING AND CO-PARTNERSHIP (1913). Fabian Tract No. 170 (1913). (1926) 33 AMERICAN FEDERATIONIST, II, p. 1191. That the interest of labor lies in a decent fixed wage is supported to some extent by the fact that the chief successes of profit sharing have come in stabilized enterprises supplying a constant demand where profits are certain. See cases of Boston Gas Co. (CIVIC FEDERATION REPORT, op. cit. supra note 1, at p. 38) and of So. Metropolitan Gas Company in England. British Ministry of Labor op. cit. supra note 1, at pp. 47 to 54. The objection of organized labor have been met by declarations that unions could be based on co-operation with employers rather than present day antagonism. See BOWIE, op. cit. supra note 1, ch. XIV; CARPENTER, INDUSTRIAL CO-PARTNERSHIP (1921).

6. "Profit sharing plans now in use have been introduced . . . mainly with the idea of securing the co-operation and loyalty of the working force." NATIONAL INDUSTRIAL CONFERENCE BOARD, REPORT ON PROFIT SHARING (1920) p. 6. This body is an association of employers organizations. One firm reported the fact that its employees remained at work during a strike as justification for the plan. See CIVIC FEDERATION REPORT (1921) at p. 63; See also U. S. Bureau of Labor Statistics, op. cit. supra note 1, at p. 9; BOWIE, op. cit. supra note 1 pp. 60-68.

workingman with an appreciable increase in his portion of wealth 8 nor endowed him with any substantial legal rights. The executive, however, by exerting the pressure of his superior bargaining power through bonus schemes and stock participation, has gained both advantages.9 Significantly, the fact that there is but one case10 in which an employee tried to assert rights under a scheme of stock participation is evidence of the one-sided and arbitrary manner in which profit sharing is adopted. There the Standard Oil Company of Indiana had set up a stock purchase with the usual arrangement for installment payments over a period of years, to be supplemented by contributions from the company. Full ownership of the stock by the employee, which realized the company's contribution of one half of the purchase price, depended upon continued employment. A mechanic, employed by the week, who was discharged three months before the period terminated, could not compel his employer to show cause for his discharge and had to content himself with the return of his own payments plus interest. Nor, in another instance, did a novel "labor co-partnership" fare better as against the right of a non-active shareholder. There a group of workingmen formed a corporate enterprise, and attempted to distribute the profits in the form of high wages to themselves. The court in a suit brought by the widow of one of the founders, considering those wages unreasonable and in reality a distribution of profits, reduced them and allowed the plaintiff to share in the increased earnings.11

The cases reflect the superior bargaining power of executives. Although directors will be held to good faith towards stockholders in determining

---

8. Case of Boston Gas Co. is representative of successful operation. In the period from 1908-1919, the average money wage ranged from $850 to $1344 and bonuses were 7% to 8% thereof realizing each worker $69 to $94. CIVIC FED. REPORT (1921) p. 36. NAT'L INDUSTRIAL CONF. BOARD. EMPLOYED STOCK PURCHASE PLANS (1928) p. 35.

9. It is of course difficult to define executive class. Perhaps a valid definition would be: one who is in a position to direct efforts of others in the enterprise. For a brief competent study of theory of profit sharing for executives see Taussig & Barker, American Corporations and Executives (1925) 40 QU. JRN. ECON. 1.

10. Larkin v. Stewart, 248 Ill. App. 152 (1928). cf. Willson, Democracy in Industry, The Industrial Relations Plan of the Standard Oil Company (1923) OIL AND GAS J., Dec. 27, 1923. According to Willson, the Company's policy provided that employees could not be discharged save for second violation of one of 16 reasons and lists of these causes were prominently posted. Cf. Day-Elders Motor Corp. v. Hexter, 92 N. J. Eq. 258, 110 Atl. 591 (1920) where sales manager successfully contested right of employer to discharge him without reasonable cause and gained the allotment of stock agreed upon. See note 16, infra.

11. Nichols v. Olympia Veneer Co., 139 Wash. 305, 246 Pac. 941 (1924). The wages of stockholding employees had been raised to $8 a day. The average wage was $4. The court ruled $6 as proper and awarded the non-active stockholder $2 a day for the working days since increase to entry of judgment, over a year. See Scott v. P. Lorillard Co., 108 N. J. Eq. 153, 154 Atl. 515 (1931) dividends paid only to employee stockholders illegal. But cf. note 17, infra.
the amount of compensation for corporate executives, an otherwise proper contract, driving a good bargain, will be enforced.\textsuperscript{12} Bonus payments, measured by worth of services and varying with profits, are legal modes of compensation, provided an agreement is made to that effect beforehand.\textsuperscript{13} Likewise, contracts are valid whereby a corporation agrees to repurchase its own stock should the employee decide to withdraw from a stock purchase plan.\textsuperscript{14} As against the stockholders' interest in profits, the courts have held that compensation, contingent in amount upon net earnings, is a cost of the enterprise and not a distribution of funds usually allocated to shareholders, although the plans themselves stipulate a deduction for dividends before payment of the bonus.\textsuperscript{15}

The executive has augmented his bargaining power by his control over management.\textsuperscript{16} Although when the executive is a director as well,\textsuperscript{17} a higher standard of fiduciary responsibility is imposed, yet despite these restraints, such executives can obtain a substantial portion of the profits for themselves.


\textsuperscript{15} See cases \textit{infra} note 16; and Fraker v. Hyde & Sons, 135 App. Div. 64, 119 N. Y. Supp. 879 (1st Dep't 1909) where such stipulation held not a condition precedent to right of executive to recover his share.

\textsuperscript{16} The proponents of profit participation for laborers maintain that its present shortcomings would be remedied were its beneficiaries allowed to participate in management. Supra note 2.

\textsuperscript{17} The relationship may also exist between majority and minority stockholders. Bosworth v. Allen, 168 N. Y. 157, 61 N. E. 163 (1901); BALLANTINE, \textit{CORPORATIONS} (1930) 6: "The concentrated management and control of the corporate form promote efficiency, but also create the possibility of abuse of power." See especially Berle, \textit{Corporate Powers as powers in Trust} (1930) 44 HARV. L. REV. 1049.
The experience of the American Tobacco Company with a bonus plan and with a stock purchase plan affords an illuminating example. In 1912, the then directors of the corporation proposed a bonus plan which was ratified by the stockholders at their annual meeting. The plan provided that in each year 10% of the surplus of net profits over the net profits of 1910 would be distributed in shares of two and one half percent to the president and one and one half percent to each of the five vice-presidents. In 1910 the net earnings were $8,222,248.42. In 1930, the net earnings were $43,345,370, and that year the president received a bonus of $840,000 in addition to a fixed salary of $168,000 and “special cash credits” of $270,000. Payments to vice-presidents totalled $1,830,000, in addition to salaries and “credits” of $700,000.

The court refused to grant a temporary injunction restraining further payments at the instance of a minority stockholder seeking to recover the excess above a reasonable compensation from the recipients. It based its decision on the grounds that the distribution was a payment of compensation; that compensation out of profits is legal; and that the precise amount was a matter within the discretion of the majority stockholders. By treating the matter as a question of a contract between the few directors as executives on the one hand, and the scattered majority stockholders on the other, the opinion assumes an equality of bargaining power between the two that is inconsistent with the fiduciary relation which directors occupy towards stockholders. Although the first two grounds advanced by the court are already well supported, they are nevertheless, open to question since they obscure the fact that profit participation directly taps the funds hitherto allocated to stockholders. A more serious objection, however, can be made to the refusal of the court to investigate the reasonableness of the sums realized by the directors as compensation. Here the court has less support in previous cases. When directors vote themselves compensation, the act is voidable at the instance of majority stockholders, and the directors have the burden of proving reasonableness. Once the act is ratified by the majority, the burden is thrown upon the dissenting stockholders. Where the executives are themselves the majority stockholders, the courts have frequently reduced excessive compensation, especially

18. Rogers v. Hill, 60 F. (2d) 109 (C. C. A. 2d, 1932), reversing decree below. Judge Swan dissented vigorously, maintaining that even if it were not a distribution of profits, the sums named were unreasonable. The Supreme Court has granted writ of certiorari in this and the second case, below.

19. Supra note 13 and 15.

if the dominant stockholders, actively engaged in the business, are Transparently seeking to increase their share of profits as against non-active shareholders. But even where, as in the instant case, the numerical majority of shares is not held by the directors, the presence of their self-interest justifies the demand that they show the reasonableness of the sums voted them. It cannot be said that an inquiry into reasonableness would impair the freedom of action necessary to efficient corporate management by directors, since the compensation here is fixed by operation of a by-law which removes discretion from the directors. Furthermore, the courts may well admit the desirability of profit sharing by executives, since executive enterprise is responsible for part of the gain in net earnings. But the reward should be proportionate to the ability of the executive, the difficulty of the position, and the success achieved. In evaluating these factors, the court may compare the present reward of the executive with previous compensation and with the rewards of executives in similar capacities in other enterprises.

The directors of the American Tobacco Company were able to extract the major benefits from an employees' stock purchase plan as well as from the bonus. The general tendency of such plans, even when designed for


22. Certainly, the reasonableness of the sum fixed is psychologically compelling. Extended arguments were made in court in the principal case by counsel for Am. Tobacco Co. to show the reasonableness of the sums. See Brief and Transcript of Record on Appeal. Note opinion in Putnam v. Juvenile Show Co., supra note 13.

23. See Judge Swan's dissent. The New Jersey courts have raised doubts concerning power of majority stockholders to fix compensation for employees. See Scott v. P. Lorillard, supra note 11; Lillard v. Oil Paint & Drug Co., supra note 20.

24. The respective roles of Lucky Strike Advertising and the post war reaction in inducing women to smoke cigarettes is purely speculative.


all employees, to concentrate the benefits in the executive class, was exaggerated in this particular instance by the dominant part the executives took as directors in formulating the plan. The New Jersey statute provides a machinery whereby stockholders' preemptive rights may be waived for the benefit of employees, who wish to purchase new issues of stock on especially favorable terms. After two-thirds of the stockholders had assented to a general plan, the directors allotted the major portion of the shares to themselves and, incidentally, to the lawyers who drafted the plan. The par value and purchase price of the shares was fixed at twenty-five dollars payable from dividends accruing thereon to the recipients as beneficiaries of a transfer by trust. The market value was $116. In a suit by a minority stockholder to set aside the plan, the court ignored the essence of the plan as compensation, refused to consider whether the sums realized as shares were reasonable, and declared that the plan was legally adopted by agreement between directors and majority stockholders pursuant to the state statute. Apart from the unreasonableness of the compensation, had a higher standard of fiduciary responsibility been enforced, there would have been ample justification for a finding of bad faith and an order compelling the directors to resubmit a detailed plan to the stockholders.

As instances of executive profit sharing, these two cases throw into relief the contrasting status of general employee participation in profits. Although the decisions may commend themselves as recognition of executive enterprise, they hardly aid the fulfillment of the promises of profit-sharing advocates to alleviate the evils attendant upon unequal distribution of wealth in a profit economy. Admittedly, the general acceptance of profit sharing by workingmen depends upon economic and legislative developments. Criticism of the two cases, one involving the Standard Oil stock

---

27. Of stock purchase plans: "one of the outstanding conditions met with in the previous study was the tendency either for management to sell originally only to a selected group of employees or for an originally large group gradually to become a select group ..." SUPPLEMENT, NATIONAL INDUSTRIAL RELATIONS CONFERENCE BOARD, op. cit. supra p. 4 and of bonuses, same, REPORT ON PROFIT SHARING (1920) p. 49.


29. N. J. STAT. (1925) c. 175, § 1; see supra note 18. According to statute, the plan is to be for "any or all" of the employees. It may require re-phrasing.

30. Rogers v. Guaranty Trust Co., 60 F. (2d) 14 (C. C. A. 2d, 1932). The opinion may be entirely dicta, for the district court's decree dismissed the case as involving internal affairs of a foreign corporation. 60 F. (2d) 105 (S. D. N. Y. 1932). The decision above affirmed the decree but the opinion went on to the merits. See dissent, Judge Swan, at p. 120, 122.

31. The statute (supra note 34) requires that the directors "shall first formulate such plan or plans and pass a resolution declaring that ... adoption thereof is advisable, and shall call a meeting of stockholders to take action thereon." Again, redrafting may be necessary.

32. 72 NEW REPUBLIC 343 (Nov. 9, 1932).
purchase plan, and the other a "labor co-partnership" is out of place. In the first, the court could do no more than enforce the contract between the parties. In the second, the court could hardly discard the existing social conventions which support the rights of absentee stockholders to their share of profits, in order to promote a novel scheme of labor co-partnership. But there is no reason why excessive compensation to executives acquired by abusing the mechanism of profit sharing should not be reduced to reasonable amounts. Such relief provides the minority stockholder with his ultimate guaranty against the arbitrary discretion of directors and majority stockholders.