1948

CORPORATE MORTGAGE BONDS AND MAJORITY CLAUSES

DE FOREST BILLYOU

Follow this and additional works at: <http://digitalcommons.law.yale.edu/ylj>

Recommended Citation

DE F. BILLYOU, *CORPORATE MORTGAGE BONDS AND MAJORITY CLAUSES*, 57 Yale L.J. (1948).
Available at: <http://digitalcommons.law.yale.edu/ylj/vol57/iss4/4>

This Article is brought to you for free and open access by Yale Law School Legal Scholarship Repository. It has been accepted for inclusion in Yale Law Journal by an authorized editor of Yale Law School Legal Scholarship Repository. For more information, please contact julian.aiken@yale.edu.

CORPORATE MORTGAGE BONDS AND MAJORITY CLAUSES

DE FOREST BILLYOU†

It has long been accepted that secured creditors of a corporation may not always enforce their security in conformity with terms previously accepted by the borrower.¹ Since 1879 English and Canadian indentures have frequently contained provisions, commonly called majority clauses, enabling a specified percentage of the security holders to modify the rights of the class, including the principal and interest obligation of the corporate debtor.² Their use has become so common that a commentator on the English practice states that ". . . the draftsman who omits to insert some such provision runs the risk of being accused of neglecting the best interests of the debenture [holder] . . ."³

With rare exceptions, majority clauses allowing modification of the principal and interest obligations of a corporate debtor were not accepted in the United States until recent insistence by the ICC that they be included in the new mortgages of railroads emerging from Section 77 reorganization. The Commission, in addition, has pressed for enactment of a statute which, in effect, would incorporate such a clause in most railroad obligations. There is at least inadequate understanding of the incidents and operation of such clauses in the United States. This article seeks to ameliorate the inadequacy.

ENGLISH AND CANADIAN EXPERIENCE

The source of the English and Canadian majority clauses can probably be traced to clauses included in a trust deed prepared by Francis Beaufort Palmer in 1879⁴ and, two years later, reproduced in a revision of his compilation of *Company Precedents*.⁵ Soon thereafter such clauses appeared in many English and Canadian trust deeds and indentures.⁶

† Member of the New York Bar.

1. This is particularly true of such "public" corporations as transportation companies. See *Macon & Western R.R. v. Parker*, 9 Ga. 377, 393 (1851) (Lumpkin, J.); *Gates v. Boston & N. Y. Air Line R.R.*, 53 Conn. 333, 342, 5 Atl. 695, 698 (1885); *Philadelphia & Lewes Transp. Co.*, 114 Fed. 403 (E.D. Pa. 1902); 2 BONBRIGHT, *JUDICIAL VALUATION* 850 (1937).

2. See 3 PALMER, *COMPANY PRECEDENTS* c. XIX (15th ed. 1933); Fraser, *Reorganization of Companies in Canada*, 27 COL. L. REV. 932, 936-49 (1927); WEGENAST, *CANADIAN COMPANIES* 654-5 (1931). In British and Canadian legal parlance a "debenture" is a secured obligation, equivalent to a bond.

3. 3 PALMER, *COMPANY PRECEDENTS* 158 (14th ed. 1933).

4. This trust deed secured debentures of the New Zealand Agricultural Co., Ltd. The clauses were utilized in 1885 and in 1886 were involved in litigation.

5. PALMER, *COMPANY PRECEDENTS* 271 (2d ed. 1881).

6. E.g., see the provisions of an 1881 indenture described in *In Re The Dominion of Canada Freehold Estate & Timber Co.*, 55 L.T.R. (N.S.) 347 (Ch. Div. 1886).

As cases involving the use or attempted use of these clauses were decided, and new problems or possibilities foreseen, the clause was modified so that today in England and in Canada it is possible, under an appropriately drafted clause,⁷ for debenture holder majorities to authorize the creation of a prior lien,⁸ and the exchange of a secured obligation for an equity interest⁹ and to assent to a thorough reorganization with no provision for dissenters other than pro rata participation.¹⁰ The courts, however, have been vigilant to see that the attempted action is clearly in conformity with the indenture provision,¹¹ that those casting votes are motivated by interests of the class and not by adverse interests¹² or collateral matters,¹³ and that subsequent corporate action purporting to be in conformity with the resolution does in fact so conform.¹⁴

UNITED STATES EXPERIENCE

Prior to 1930 majority clauses permitting modification of principal and interest obligations of the debtor saw relatively little use in the United States,¹⁵ and today, as then, the typical indenture expressly provides that the corporate obligation to pay principal and interest

7. For recent English and Canadian forms of the clause see 3 PALMER, COMPANY PRECEDENTS 292-3, 355-60 (15th ed. 1938); FRASER, CANADIAN COMPANY FORMS 731-3 (2d ed. 1927); SEC, REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITY, PERSONNEL AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES, pt. vi, 138-43 (1936).

8. *In re The Dominion of Canada Freehold Estate & Timber Co.*, 55 L.T.R. (N.S.) 347 (Ch. Div. 1886); *Follit v. Eddystone Granite Quarries*, [1892] 3 Ch. 75; *Sneath v. Valley Gold, Ltd.*, [1893] 1 Ch. 477.

9. *Mercantile Investment and General Trust Co. v. River Plate Trust, Loan, and Agency Co.*, [1894] 1 Ch. 578; *Sneath v. Valley Gold, Ltd.*, [1893] 1 Ch. 477; *In re Labuan & Borneo Ltd.*, 18 T.L.R. 216 (1901); *Nat'l Trust Co. v. Maritime Coal, Ry. & Power Co.*, [1930] 2 D.L.R. 309 (N.S. Sup. Ct.); cf. *In re Joseph Stocks and Co.*, 26 T.L.R. 41 (1909) (exchange of redeemable for unredeemable shares); *In re Empire Mining Co.*, 44 Ch. D. 402 (1890) (application under the Companies Act).

10. Fraser, *supra* note 2, at 939.

11. *British America Nickel Corp. v. W. J. O'Brien, Ltd.*, [1927] A.C. 369; *Hoy v. The Swedish & Norwegian Ry. Co.*, 5 T.L.R. 460 (Ct. of App. 1889).

12. *In re New York Taxicab Co.*, [1913] 1 Ch. 1 (1912) (sale of corporate assets authorized by debenture holders, proceeds to be used to purchase those debentures tendered to the company at the lowest prices, enjoined).

13. *British America Nickel Corp. v. M. J. O'Brien, Ltd.*, [1927] A.C. 369 (vote cast for the best interest of the voting security holder and not for the best interest of the voting class).

14. *Re B. C. Portland Cement Co.*, [1915] 22 D.L.R. 609 (B.C. Sup. Ct.), *aff'd*, [1916] 27 D.L.R. 726 (B.C. Ct. of App.).

15. Swaine, *Reorganization of Corporations: Certain Developments of the Last Decade*, 27 COL. L. REV. 901, 927 (1927); SEC, *op. cit. supra* note 7, pt. III, at 226; *id.* pt. VI, at 143.

when due may be compromised or modified only by consent of each bondholder.¹⁶

Failure to accept the English type of majority clause in the United States may be attributed to several factors. The New York Stock Exchange has been reluctant to grant listing to bonds subject to modification as to principal or interest,¹⁷ and the negotiable character of such bonds in each of the forty-eight states is not entirely clear.¹⁸ This combination of circumstances deterred large issuers from proposing, and bankers from underwriting, securities subject to such clauses.¹⁹ This in turn may have set a style followed by smaller issuers. The difference in attitude is carried so far that Canadian securities, while normally subject to such a clause, if intended to be sold or listed in the United States are devoid of majority clauses.²⁰

Our courts, in the few decided cases, have indicated that under an appropriately drafted clause the same possibilities are available to bondholder majorities as in England and Canada,²¹ but subject to similar restrictions.²²

NEGOTIABILITY OF BONDS SUBJECT TO MAJORITY CLAUSES

It is deemed desirable that corporate bonds have the attributes of negotiable instruments, for transfer can then be more readily accomplished and such a bond is more readily salable. This desirability is re-

16. See the provisions reproduced in SEC, *op. cit. supra* note 7, pt. vi, at 135-7. See also *id.*, pt. iii, at 226.

17. The attitude of the Exchange is expressed in terms of an insistence that listed securities be negotiable, *cf.* STETSON, PREPARATION OF CORPORATE BONDS, MORTGAGES, COLLATERAL TRUSTS, AND DEBENTURE INDENTURES, IN SOME LEGAL PHASES OF CORPORATE FINANCING, REORGANIZATION AND REGULATION 72 (1917). However, since passage of the Hofstadter Act in 1926, see note 36 *infra*, the concern really is not as to the aspects of negotiability, but as to the integrity of the listed obligation. *Cf.* Steffen and Russell, *The Negotiability of Corporate Bonds*, 41 YALE L. J. 799, 827 n.122 (1932).

18. See pp. 597-602 *infra*.

19. *But cf.* Indenture, United States Steel Corp., Art. 7 (1903) and the listed bonds described in *Chalmers v. Nederlandsch Amerikaansche*, 36 N.Y.S.2d 717 (City Ct. 1942).

20. *E.g.* Indenture, Hiram Walker—Goodeham & Worts, Ltd. and Hiram Walker & Sons, Inc. to Guaranty Trust Co. of New York, Art. 10 (1946).

21. See pp. 595-6 *supra*. Application of Colonial Trust Co., 67 N.Y.S.2d 534 (Sup.Ct. 1946) (authorizing creation of prior lien); *Chalmers v. Nederlandsch Amerikaansche*, 36 N.Y.S.2d 717 (City Ct. 1942) (exchange of secured obligation for equity interest); *cf.* *Sage v. Central R.R.*, 99 U.S. 334 (1878) (assent to thorough reorganization without court approval of plan, and with no provision for dissenters other than *pro rata* participation).

22. *Rothschild v. Jefferson Hotel Co.*, 56 F. Supp. 315 (E.D. Mo. 1944) (contented action must clearly conform to indenture provision); *Dunham v. Omaha & C.B. Street Ry.*, 25 F. Supp. 287 (S.D.N.Y. 1938) (same); *Vogelstein v. Athletic Mining Co.*, 192 S.W. 760 (Mo. App. 1917) (same); *cf.* *McClelland v. Norfolk Southern R.R.* 110 N.Y. 469, 18 N.E. 237 (1888); see *Vogelstein v. Athletic Mining Co.*, 192 S.W. 760, 763 (Mo. App. 1917) (those voting must not be motivated by adverse interests); *Hackettstown Na-*

flected in the fact that registered bonds, not transferable by mere delivery, typically sell at a discount from the price of bearer bonds of the same issue.²³ Utility of majority clauses depends greatly on the concept of negotiability, for related to that concept is the question whether a purchaser of such a bond subsequent to, and without notice of, modification may be held to the terms of the modification. In the case of recent railroad bonds, draftsmen, confident that the limited modification provision would not impair negotiability under NIL standards, have summarized the provision on the bond itself²⁴ and have not relied on a mere general clause referring to the mortgage. As a result a purchaser is placed on notice of the possibility of past modification.

However, when the scope of majority action is broader, such as providing for reduction of principal and exchange of securities, a situation where a draftsman has less reason to be confident as to compliance with NIL standards, bonds have usually contained little other than conventional reference clauses.²⁵ In such cases it would be difficult to hold a purchaser subsequent to, and without notice of, modification, to the terms of the modification. The obligor would be faced with the general problem of estoppel based on the attitude that bond clauses referring in general terms to the mortgage are deemed to refer to the mortgage only for the purpose of disclosing details of security rights.²⁶

If such a purchaser should not be bound to the proposal the whole attempt at modification might be a failure, unless the form of assent were sufficiently broad. To avoid preferential treatment, a court might well find the assent was only to those modifications that would be binding on all subsequent as well as present bondholders.²⁷

tional Bank v. D.G. Yuengling Brewing Co., 74 Fed. 110 (C.C.A. 2d 1896) (same: collateral interests).

23. See Steffen and Russell, *Registered Bonds and Negotiability*, 47 HARV. L. REV. 741, 742 (1934).

24. See the forms of bonds set forth in the first mortgages. Chi. M. St. P. & P.R.R. 5 (1945); Chi. Ind. & L. Ry. 5-6 (1945); Denver & Rio Grande W.R.R. 6-7 (1947); Seaboard Air Line R.R. 6 (1947); but cf. St. L. & S.F. Ry. 5-6 (1946).

25. See *Chalmers v. Nederlandsch Amerikaansche*, 36 N.Y.S.2d 717, 720 (City Ct. 1942): "As in the Trust Indenture provided, such [bondholders] meeting may authorize the Trustee to grant the Company delay in connection with any payment due to the Bondholders and to take other action in the interests of the Bondholders." In Canada, majority clauses applicable to debentures are often summarized in conditions attached to the debentures.

26. *Manning v. Norfolk So. R.R.*, 29 Fed. 838 (C.C.E.D.Va.1887); *Cunningham v. Pressed Steel Car Co.*, 238 App. Div. 624, 625, 265 N.Y. Supp. 256, 258 (1st Dep't 1933), *aff'd without opinion*, 263 N.Y. 671, 189 N.E. 750 (1934): "This bond is one of an issue . . . secured by an Indenture . . . to which Indenture reference is hereby made for a statement of the rights of the holders of said bonds." Note, 33 MICH. L. REV. 604, 605-6 (1935); cf. *Stetson, op. cit. supra* note 17 at 16-7.

27. But cf. the action of the District Court, according to a preference to non-assenters, in *In re Los Angeles Lumber Co.*, 46 F. Supp. 77, 89 (S.D. Cal. 1941). See note 76 *infra*.

There has been much concern in the United States over the incidents of negotiability accorded corporate bonds.²³ In England and Canada the Bills of Exchange Act²⁹ is not applicable to corporate bonds, and negotiable character has been accorded by judicial decisions recognizing that such bonds in fact were treated by businessmen as negotiable.³⁰ Since, prior to drafting of the Uniform Negotiable Instruments Law, our courts accorded aspects of negotiability to corporate bonds³¹ there was subsequently much concern³² over the decisions indicating these bonds were subject to the supposedly more rigid requirements of the Negotiable Instruments Law.³³ In diverse ways, however, some of these bonds have been accorded incidents of negotiability. Whether, in a given jurisdiction, according such incidents is dependent on the NIL³⁴ as opposed to the more flexible common law³⁵ or special statutory provisions specifically applicable to corporate bonds,³⁶ might, in the case of bonds subject to majority action, be crucial, since such bonds, seemingly, are in open defiance of the NIL provision that an instrument to be negotiable must ". . . contain an unconditional prom-

28. Steffen and Russell, *supra* note 17; Note, 42 HARV. L. REV. 115. See Banks, *Indenture Securities and The Barkley Bill*, 48 YALE L. J. 533, 565 n.139 (1939).

29. 45 & 46 VICR., c. 61 (1882); CANADA REV. STAT., c. 16 (1927); See *President and Directors of Manhattan Co. v. Morgan*, 242 N.Y. 38, 48, 150 N.E. 594, 597 (1926).

30. *Edelstein v. Schuler & Co.*, [1902] 2 K.B. 144; *Bechuanaland Exploration Co. v. London Trading Bank, Ltd.*, [1898] 2 Q.B. 658.

31. *Mercer County v. Hackett*, 1 Wall. 83 (U.S. 1863); *Brainerd v. New York and Harlem R.R.*, 25 N.Y. 496 (1862); *SHORT, RAILWAY BONDS AND MORTGAGES* 78 (1897).

32. Steffen and Russell, *supra* note 17 *passim*; Note, 25 COL. L. REV. 71 (1925).

33. Following enactment of the NIL, courts expressed a reluctance to regard as negotiable under common law, or law merchant, modern instruments which did not meet the supposed specificity of the NIL. *President and Directors of Manhattan Co. v. Morgan*, 242 N.Y. 38, 150 N.E. 594 (1926) (interim certificates); *Fidelity & Deposit Co. of Maryland v. Andrews*, 244 Mich. 159, 221 N.W. 114 (1928) (equipment trust certificates); *Manker v. American Savings Bank & Trust Co.*, 131 Wash. 430, 230 Pac. 406 (1924) (improvement assessment bonds).

34. *E.g.*, *Enoch v. Brandon*, 249 N. Y. 263, 266, 164 N.E. 45, 46 (1928); *Manker v. American Savings Bank & Trust Co.*, 131 Wash. 430, 230 N.W. 406 (1924).

35. *E.g.*, see cases cited notes 30 and 31 *supra*.

36. In New York, subsequent to a 1926 decision indicating that interim certificates were not negotiable since they failed to meet the requirements of the NIL, *President & Directors of the Manhattan Co.*, 242 N.Y. 38, 150 N.E. 594 (1926), the legislature enacted the Hofstadter Act amending the Personal Property Law and according some of the consequences of negotiability to security receipts and equipment trust certificates, as defined, if they provided that title might pass by delivery, N.Y. Laws 1926, c. 704; see *Legis.*, 26 COL. L. REV. 884 (1926). Again, in 1930, subsequent to a decision which suggested that in order to be accorded consequences of negotiability corporate bonds would be expected to meet NIL requirements, *Enoch v. Brandon*, 249 N.Y. 263, 164 N.E. 45 (1928), the legislature added corporate bonds, as defined, to the instruments to be accorded some of the consequences of negotiability. N.Y. Laws 1930, c. 630; see *Comment*, 40 YALE L. J. 261 (1930); N.Y. PERS. PROP. LAW, Art. 8. However, since the statute is not part of the NIL, compliance does not necessarily result in acquisition of all the

ise . . . to pay a sum certain in money . . . [and] be payable on demand, or at a fixed or determinable future time. . . ." ³⁷

Some light is thrown on this problem by *Enoch v. Brandon*,³⁸ a leading case on applicability of the NIL to corporate bonds. The suit was instituted to recover the value of a bond of a Canadian corporation stolen from the plaintiff in New York and there acquired by defendant as an innocent purchaser for value and later sold by him. Each bond, unconditional on its face and payable in Montreal or New York, stated that it was ". . . entitled to the benefits and subject to the provisions of [the] . . . mortgage and deed of trust dated as of November 1st, 1921. . . ." ³⁹ This deed of trust, executed in Canada, with a Quebec bank as trustee, contained a majority clause similar to those commonly found in Canadian indentures ⁴⁰—which have never been held by Canadian courts to impair negotiability. The trial court ⁴¹ and the Court of Appeals ⁴² gave judgment for the defendant. The opinions strongly suggest, ⁴³ however, that if the nature of the obligation under Canadian law had been appreciated, and the NIL deemed the applicable standard, attributes of negotiability would have been denied to the bond, and the plaintiff allowed to recover. On the basis of common law, in

characteristics of an NIL complying instrument. Steffen and Russell, *supra* note 17, at 808.

A similar history lies behind the California statute providing that "Bonds payable to bearer or holder shall be negotiable, notwithstanding any condition contained therein or in the mortgage, deed of trust or other instrument securing the same." 1 CAL. GEN. LAWS, Act. 860 (Deering 1944), and the Minnesota statute providing that "Any bond . . . secured by a mortgage . . . when otherwise so drawn as to fall under and within the provisions of the Uniform Negotiable Instruments Act shall be deemed to be a negotiable instrument . . . whether or not the terms of the mortgage . . . purport to be incorporated therein or made a part thereof . . ." 21 MINN. STAT. ANN. § 355.041 (West 1947).

37. NEGOTIABLE INSTRUMENTS LAW § 1(2), (3); JONES, CORPORATE BONDS AND MORTGAGES § 191 (2d ed. 1890); see *McClelland v. Norfolk Southern R.R.*, 110 N.Y. 469, 475-6, 18 N.E. 258, 260 (1888) (common law). The Commissioner of Internal Revenue has urged that a security whose maturity may be extended by majority action does not really represent a debt, periodic payments on which may be deductible as interest. See *Commissioner v. H.P. Hood & Sons, Inc.*, 141 F.2d 467, 470 (C.C.A. 1st 1943), Brief for Petitioner, pp. 10-11.

38. 249 N.Y. 263, 164 N.E. 45 (1928), reversing 224 App. Div. 692, 223 N.Y. Supp. 789 (4th Dep't 1928), reversing 128 Misc. 695, 220 N.Y. Supp. 294 (Sup. Ct. 1927), 29 COL. L. REV. 365 (1929), 42 HARV. L. REV. 700 (1929), 38 YALE L. J. 825 (1929); Comment, 33 MICH. L. REV. 604, 605-6 (1935).

39. See *Enoch v. Brandon*, 128 Misc. 695, 696, 220 N.Y. Supp. 294, 295 (Sup. Ct. 1927), Record on Appeal, Court of Appeals p. 30.

40. This similarity is apparent by comparison of the language of the trust deed, See *Enoch v. Brandon*, 128 Misc. 695, 696, 220 N.Y. Supp. 294, 295 (Sup. Ct. 1927), Record on Appeal, Court of Appeals pp. 33-4, with that of a typical Canadian clause, Fraser, *op. cit. supra* note 7, at 731-2.

41. 128 Misc. 695, 220 N.Y. Supp. 294 (Sup. Ct. 1927).

42. 249 N.Y. 263, 164 N.E. 45 (1928).

43. Cf. Steffen and Russell, *supra* note 17, at 814, 826.

the absence of a showing that bankers, brokers, and investors regarded such Canadian bonds differently from conventional corporate bonds and carried out their transactions accordingly, it would be most difficult to deny these bonds attributes of negotiability commonly accorded negotiable instruments.⁴⁴

The most thorough consideration to date given to the negotiable character, under American law, of bonds subject to majority action, has probably taken place in drafting the new mortgages of railroads now emerging from proceedings under Section 77 of the Bankruptcy Act. Commencing in 1942, the Interstate Commerce Commission, purportedly dissatisfied with then contemporary reorganization procedure, sought to lay a groundwork for easing future financial difficulties and for avoiding reorganizations.⁴⁵ In approving reorganization plans for these emerging roads it directed that the new mortgages contain clauses permitting extension of the principal and interest obligations by action of specified bondholder majorities.⁴⁶ Objections were made to the Commission that provision for extensions unlimited in time might impair negotiability, and it then limited the extendable period.⁴⁷ Mortgages subsequently executed have typically provided that by the vote of holders of three-quarters of the outstanding bonds there may be postponement of payment of (1) principal for not in excess of twenty years, and (2) interest payments for not in excess of (a) five years each and (b) the original, or extended, principal maturity date.⁴⁸ Postponability

44. See cases cited notes 30, 31 *supra*.

45. 57th I.C.C. ANN. REP. 76 (1943).

46. For development of the device see *Florida East Coast Ry.*, 252 I.C.C. 423, 470 (1942), 252 I.C.C. 731, 741 (1942), 261 I.C.C. 151, 179-80 (1945); *Minn. St. Paul & S.Ste. M. Ry.*, 252 I.C.C. 525, 569-70 (1942); 252 I.C.C. 615, 629 (1942); *Denver & Rio Grande W.R.R.*, 254 I.C.C. 5, 39 (1942); *Chi. Ind. & L. Ry.*, 254 I.C.C. 539, 588 (1943); *Chi. M. St. P. & Pac. R.R.*, 254 I.C.C. 707, 736 (1943), 257 I.C.C. 223, 225-6, 235, 247 (1944); *In re Chi. M. St. P. & Pac. Ry.*, 58 F. Supp. 384, 392 (N.D. Ill. 1944); *Chi. R.I. & Pac. Ry.*, 257 I.C.C. 265, 289-9 (1944); *St. L. & S.F. Ry.*, 257 I.C.C. 399, 415, 425 (1944); *Mo. Pac. Ry.*, 257 I.C.C. 479, 530-1 (1944); *In re Mo. Pac. Ry.*, 64 F. Supp. 64, 76-7 (E.D. Mo. 1945); *N.Y.S. & W.R.R.*, 261 I.C.C. 101, 117-8 (1945); *Central of Ga. Ry.*, 261 I.C.C. 263, 326 (1945); *St. Johnsbury & L.C. Ry.*, 261 I.C.C. 563, 573-4 (1945); *Wisconsin Central Ry.*, Fin. Doc. No. 14720 at 79 (mimeo. 1947).

Where application has been made by solvent companies for authority for the issue and sale of bonds the Commission has not suggested that such clauses be included in the new mortgages. *E.g.* *Pittsburg, Bessemer & Lake Erie R.R. Bonds*, Fin. Doc. No. 15529 (mimeo. 1946). However, the suggestion has been made, in connection with application for authorization of securities proposed to be issued on termination of receivership proceedings. *E.g.* *Minn. & St. L. R.R.*, 254 I.C.C. 513, 521 (1943) (interest only to be postponed and not beyond principal maturity date); *Seaboard Air Line Ry.*, 261 I.C.C. 689, 704 (1946).

47. See *Chi. M. St. P. & P. R.R.*, 257 I.C.C. 223, 225-6, 235 (1944).

48. See *First Mortgages: Chi. M. St. P. & P. R.R.*, Art. 19, § 3 (1945); *Chi. Ind. & L. Ry.*, Art. 18, § 3 (1945); *St. L. S.F. Ry.*, Art. 16, § 6 (1946). These mortgages were executed by roads just emerging from § 77. The recently executed *Denver & Rio*

of principal and interest payments, as so restricted, would seem to constitute compliance with NIL requirements.⁴⁹

MAJORITY CLAUSES AND SECURITIES REGULATION

In the reorganization or salvaging of real estate properties in the thirties several companies emerged with debts secured by instruments subject to majority action.⁵⁰ This was attributed to dissatisfaction with the then existing reorganization facilities and the belief that these modification provisions of the indentures would facilitate future adjustment.⁵¹ Under some clauses a specified majority could permit the elimination of bondholders' liens, the sale of property, the extension of bond maturities, the reduction of interest or consummation of sweeping plans of reorganization—all on a purely voluntary basis.⁵² Since all this could be accomplished without either judicial examination or approval,⁵³ the Securities and Exchange Commission in 1936 expressed its fear that unsupervised reorganization under such clauses imperiled minorities.⁵⁴ This concern about the potentialities of majority clauses led to provision in the Trust Indenture Act of 1939 that indentures to

Grande mortgage makes no provision for extension of principal. It provides for extension of interest and limits extended unpaid fixed and contingent interest payments to, at any one time, fifteen and five per cent, respectively, of the principal of the bonds. In addition, prior to, and for the duration of, any extension, provision shall be made so bondholders may elect a majority of the Board of Directors. First Mortgage, Denver & R.G. W. R.R., Art. 19, § 3 (1947).

The prime mortgage of the road that most recently emerged from § 77 while providing for certain types of modification, expressly provides that no modification may (a) alter or impair the obligation to pay principal or interest or (b) permit creation of a prior lien. First & Refunding Mortgage, New York N.H. & H. R.R. 121 (1947).

In one case the mortgage executed by a road just emerging from equity receivership provides that by vote of holders of two-thirds of the bonds payment of not in excess of ten semi-annual interest installments may be postponed to any specified or determinable date not later than maturity date of principal. First Mortgage, Seaboard Air Line R.R., Art. 16, § 6 (1946).

49. Negotiability under the NIL is unimpaired although payment be subject to extension for a stated period. *State Bank v. Bilstad*, 162 Iowa 433, 136 N.W. 204 (1912) (one year). See *In re Chi. M. St. P. & Pac. R.R.*, 58 F. Supp. 384, 392 (N.D. Ill. 1944).

50. SEC, *op. cit. supra* note 7, pt. III, at 225-7. See *Rothschild v. Jefferson Hotel Co.*, 56 F. Supp. 315, 316 (E.D. Mo. 1944).

51. SEC, *op. cit. supra* note 7, pt. III, at 225; *id.* pt. VI, at 146; Notes, 38 MICH. L. REV. 63, 67-8 (1939), 27 COL. L. REV. 579, 584-7 (1927); McCLELLAND AND FISHER, LAW OF CORPORATE BOND ISSUES 824-5 (1937).

52. SEC, *op. cit. supra* note 7, pt. III, at 226.

53. *Id.* pt. III, at 227. However, in an appropriate case a security holder could (a) apply to a court to enjoin an improper or fraudulent proposal, *e.g.*, *Rothschild v. Jefferson Hotel Co.*, 56 F. Supp. 315 (E.D. Mo. 1944), or (b) assert his debt claim even after the modification, *e.g.*, *Hackettstown Nat. Bank v. D. G. Yeungling Brewing Co.*, 74 Fed. 110 (C.C.A. 2d 1896), or (c) assert his security claim against assets transferred to a reorganized company, *cf.* *Northern Pac. R.R. v. Boyd*, 228 U.S. 482 (1913).

54. SEC, *op. cit. supra* note 7, pt. III, at 228, pt. VI, at 149-50, pt. VII, at 16-18.

be qualified under that Act *shall* provide that the right of a security holder to receive payment of principal and interest on or after the respective due dates, shall not be impaired or affected without his consent,⁵⁵ with the single exception that the indenture *may* provide that not less than three-quarters of a class of security holders may, on behalf of all, consent to postponement of any interest payment for a period not exceeding three years.⁵⁶

The Commission's fears of the consequences of the unsupervised use of the clause were not demonic. Since release of its report in 1936, cases involving use of majority clauses have disclosed instances where, in securing the vote of security holders, misinformation was supplied⁵⁷ or was furnished by biased sources,⁵⁸ where votes were cast by those whose interests were adverse to the class being balloted,⁵⁹ and where supposedly unbiased fiduciaries participated in the voting and, inadvertently or otherwise, acquired a position adverse to their cestuis, the bondholders.⁶⁰

MAJORITY CLAUSES AND ABSOLUTE PRIORITY

Through many decades there evolved the judicial requirement that in corporate reorganization secured creditors must receive satisfaction

55. § 316(b), 53 STAT. 1173 (1939), 15 U.S.C. § 77ppp(b) (1940).

56. § 316(a)(2), 53 STAT. 1172 (1939), 15 U.S.C. § 77ppp(a)(2) (1940). *See* Continental Bank & Trust Co. v. First Petroleum Trust, 67 F. Supp. 859 (D.R.I. 1946). While the indenture may also contain provisions whereby a majority of security holders might, on behalf of a class, preclude the exercise of remedies available to the trustee for the benefit of that class § 316(a)(1), 53 STAT. 1172 (1939), 15 U.S.C. § 77ppp(a)(1) (1940), unless action has been taken under section 316(a)(2) the right of an individual security holder to enforce the corporate obligation seems unimpaired. H.R. REP. NO. 1016, 76th Cong., 1st Sess. 56 (1939).

Whether or not compliance with the Trust Indenture Act is necessary, corporations may experience difficulty in utilizing existing majority clauses, for modifications of security obligations, such as the extension of maturities with part payment of principal, may constitute a "sale" of a security requiring registration or approval under applicable federal or state statutes. *Cf.* Securities & Exchange Commission v. Associated Gas & Electric Co. *et al.*, 99 F.2d 795 (C.C.A. 2d 1938) (Public Utility Holding Company Act § 6(a)). Majority extension of corporate bonds has been held to be a "renewal" and subject to payment of the federal stamp tax, Campbell River Timber Co. v. Vierhus, 86 F.2d 673 (C.C.A. 9th 1936), and extension of bonds, with or without nominal payments of principal has been held to constitute "issuance of a security" requiring I.C.C. authorization pursuant to section 20(a) of the Transportation Act, Bonds of Minn. & St. L. R.R., 124 I.C.C. 562 (1927); San Luis Central R.R. Bonds, 79 I.C.C. 737 (1923); Bath & Hammondsport Bonds, 79 I.C.C. 267 (1923); Erie R.R. Co., Extension Contracts, 65 I.C.C. 131 (1920).

57. Rothschild v. Jefferson Hotel Co., 56 F. Supp. 315, 322-4 (E.D. Mo. 1944).

58. *See In re Los Angeles Lumber Products Co.*, 46 F. Supp. 77, 84 (S.D. Cal. 1941). 1941).

59. Rothschild v. Jefferson Hotel Co., 56 F. Supp. 315 (E.D. Mo. 1944).

60. *See In re Los Angeles Lumber Products Co.*, 46 F. Supp. 77, 82, 83, 85, 90 (S.D. Cal. 1941) (voting for a plan that failed to recognize greater rights of non-assenters to previous plan).

of their claims before equity interests may participate in the reorganized company,⁶¹ a requirement incorporated into some of the federal reorganization statutes.⁶² Supreme Court decisions of the last decade have been such that equity interests are on notice that in bankruptcy reorganization their claims are to be satisfied only after satisfaction of the claims of senior creditors.⁶³

Inherent in the nature of majority clauses is the fact that, save for what interests stockholders might be motivated to surrender voluntarily, the clauses provide a method for modification of creditor rights without curtailment of stockholder interests,⁶⁴ and it was this inherent fixity that was thought to mean the end of their use in reorganizations under the bankruptcy statute.⁶⁵ Typical of the use of such clauses are reorganizations completed⁶⁶ or attempted⁶⁷ which conspicuously fail

61. See *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106, 115-9 (1939).

62. *Group of Investors v. Chi. M. St. P. & Pac. R.R.*, 318 U.S. 523, 541-2 (1943) (§ 77); *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939) (§ 77B); *Marine Harbor Properties Inc. v. Manufacturers Trust Co.* 317 U. S. 78, 85 (1942) (chapter x).

63. See cases cited note 62 *supra*.

64. SEN. REP. No. 1619, 75th Cong., 3rd Sess. 19 (1938); *Hearings before subcommittee of the House Committee on Interstate and Foreign Commerce on H. R. 10,292* 75th Cong., 3rd Sess. 35 (1938); H. R. REP. No. 1016, 76th Cong., 1st Sess. 56 (1939); Dodd, *The Los Angeles Lumber Products Company Case and its Implications*, 53 HARV. L. REV. 713, 749 (1940). Cf. *Securities & Exchange Commission v. United States Realty & Improvement Co.*, 310 U.S. 434 (1940). "The hope of securing an arrangement [under Chapter XI] which is fair and equitable and in the best interest of unsecured creditors, without some readjustment of the rights of stockholders such as . . . is precluded by Chapter XI, is at best but negligible, and, if accomplished at all, must be without the aids to protection of creditors and the public interest which are provided by Chapter X, and which would seem to be indispensable to a just determination whether the plan is fair and equitable." *Id.* at 453.

65. Dodd, *supra* note 64, at 748-9 (1940).

66. Cf. *Sage v. Central R.R. of Iowa*, 99 U.S. 334 (1878) where, over objections of first mortgage bondholders, a foreclosure decree was upheld which contemplated purchase of the property by the first mortgage trustee and, in accordance with wishes of a majority of the bondholders expressed pursuant to provisions of the mortgage, directed conveyance of the property to a new company with stock participation being given to junior unsecured creditors and stockholders. Participation was given them without any new contribution and despite the fact that first mortgage bondholders had a \$4,623,334 claim for principal and interest and for a master fund the property could sell for no more than \$2,500,000.

67. In *Hackettstown National Bank v. D. G. Yuengling Brewing Co.*, 74 Fed. 110 (C.C.A.2d 1896), holders of three-quarters of the bonds, including the principal stockholder, attempted to suspend and postpone, for a period of six years, payment of interest on the bonds and operation of the acceleration clause, with no impairment of stockholders' interests.

In *Rothschild v. Jefferson Hotel Co.*, 56 F. Supp. 315 (E.D. Mo. 1944), an attempt was made to effect a plan embracing creation of a lien prior to the first mortgage coupled with payment to first mortgage bondholders of part of the principal and accrued interest, together with a junior bond for the balance of principal, with no impairment of stockholders' interests.

to meet requirements of absolute priority.⁶³

Since it is clear that majority clauses recently adopted in this country, have been adopted for the purpose of forestalling, delaying, and avoiding insolvency and bankruptcy reorganization,⁶³ and since the procedure adopted successfully avoids judicial scrutiny,⁷⁰ the question may be asked whether judicial aid should be extended to recognize or enforce such agreements where creditors have assented in advance to modification, during periods of financial difficulty, of their rights in a manner which does not meet equitable or bankruptcy standards of priority.⁷¹ One court has indicated that the priority rule might well establish a standard that should be met before a mortgage trustee might properly recommend modification of the interests of his bondholder

In *In re Los Angeles Lumber Products Co.*, 24 F. Supp. 501 (S.D. Cal. 1938), an attempt was made to effect a voluntary plan whereby bondholders of an insolvent company would surrender their secured claim and receive 590,065 and stockholders 239,935 shares of a new company although the stockholders made no new contribution (*Id.* at 503-5). Subsequently when confirmation of this plan was sought in 77B proceedings, the plan was altered so as to give bondholders an enlarged, and preferred, share participation (*Id.* at 506). The Supreme Court held that even as so modified the plan could not be approved and confirmed by a bankruptcy court. *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939).

68. Since Canadian courts have not adopted as precise a standard of fairness and equitableness as that adopted in the United States, Fraser, *supra* note 2, at 936, reorganization by use of majority clauses is limited only to the extent that a court "in granting its approval to any plan of reorganization would give consideration to whether the plan as a whole is such that members of the classes of security holders voting on it exercising their own judgment as members of the class could reasonably approve." Courts considering plans which allocate securities to junior interests without satisfaction of senior claims have considered such facts as the junior interests being customers of the debtor (Letter of W. Kaspar Fraser, K.C., of the Ontario Bar, to the writer, July 10, 1947), consideration of which, in light of the decision in *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939), would be regarded as irrelevant in the United States.

69. 57th I.C.C. ANN. REP. 76 (1943). See *In re Mo. Pac. Ry. Co.*, 64 F. Supp. 64 (E.D. Mo. 1945); *Rothschild v. Jefferson Hotel Co.*, 56 F. Supp. 315 (E.D. Mo. 1944); *In re Georgian Hotel Corp.*, 82 F. 2d 917 (C.C.A. 7th 1936).

70. SEN. REP. NO. 1619, *op. cit. supra* note 64, at 19; H. R. REP. NO. 1016, *op. cit. supra* note 56, at 56; *Hearings before the subcommittee of the House Committee on Interstate and Foreign Commerce on H. R. 2191 and 5220*, 76th Cong., 1st Sess. 285 (1939); SEN. REP. NO. 248, 76th Cong., 1st Sess. 26-7 (1939); Note, 27 COL. L. REV. 579, 587 (1927).

71. *Cf. Otis & Co. v. SEC.*, 323 U. S. 624 (1945) where, in approving a plan which allocated securities to common stockholders without recognizing preferred stock liquidation clauses, the court observed "No possibility exists that simplification of structure is employed here to evade or nullify creditors' rights in reorganization or to take the place of traditional reorganization." *Id.* at 634.

Even before enactment of the bankruptcy reorganization statutes, courts declined to approve debt reduction plans which were inequitable in that stockholders surrendered nothing although as many as ninety percent of the bondholders consented. See *Lake Street R.R. v. Ziegler*, 99 Fed. 114 (C.C.A. 7th 1900).

cestuis.⁷² The Supreme Court has indicated that the requirement applies to reorganization of solvent as well as insolvent companies⁷³ and has approvingly quoted⁷⁴ the language of an early case that,

" . . . any arrangement of the parties [to reorganization proceedings] by which the subordinate rights and interests of the stockholders are attempted to be secured at the expense of the prior rights of either class of creditors comes within judicial denunciation."⁷⁵

Sufficient doubt has already arisen in this country to cause those proposing use of modification clauses, and trustees of bond issues sought to be modified, to be concerned. Their concern is not limited solely to consideration of compliance with formal requirements of a majority clause⁷⁶ but extends as well to consideration of the effectiveness of action as against non-assenters.⁷⁷

MAJORITY ACTION AND THE INTERSTATE COMMERCE COMMISSION

In 1945,⁷⁸ and again in 1947,⁷⁹ the ICC unsuccessfully proposed an amendment to the Interstate Commerce Act⁸⁰ which would provide a

72. See *Rothschild v. Jefferson Hotel Co.*, 56 F. Supp. 315, 321 n.5 (E.D. Mo. 1944). In that case, modification of the indenture required, in addition to consent of the required percentage of bonds, the recommendation of the trustee. Cf. *Lake Street R.R. v. Ziegler*, 99 Fed. 114, 129-30 (C.C.A. 7th 1900).

73. *Consolidated Rock Products Co. v. Du Bois*, 312 U.S. 510, 527 (1941); cf. *Stone*, C.J. dissenting in *Otis & Co. v. SEC*, 323 U.S. 624, 647-50 (1945).

74. *Consolidated Rock Products Co. et al. v. Du Bois*, 312 U.S. 510, 527 (1941); cf. *Stone*, C.J. dissenting in *Otis & Co. v. SEC*, 323 U.S. 624, 647 (1945).

75. *Louisville Trust Co. v. Louisville N. A. & Chi. Ry.*, 174 U.S. 674, 684 (1899).

76. See the procedure followed in *Rothschild v. Jefferson Hotel Co.*, 56 F. Supp. 315 (E.D. Mo. 1944); and *National Trust Co. v. Maritime Coal, Ry. & Power Co.*, [1930] 2 D.L.R. 309 (N.S. Sup. Ct.). In the Los Angeles Lumber Products situation steps were taken in 1930, under the majority clause, to reduce bond interest. In 1940 it was successfully asserted that the formalities of the indenture had not been complied with. Accordingly, under the final plan of reorganization, non-assenters of 1930 received a greater participation. *In re Los Angeles Lumber Products Co.*, 46 F. Supp. 77, 85, 89 (S.D. Cal. 1941). This was done, curiously enough, despite an indenture provision that ". . . no alteration shall be so made . . . which shall create any discrimination or distinction whatever between any of the bonds secured . . . hereunder. . . ." Record on Appeal, *Case v. Los Angeles Lumber Products Co.*, p. 26 (1938).

77. See the procedure followed by the proponents of the plan in *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106, 110, 127-8 (1939).

78. S. 1253, as introduced, 79th Cong., 1st Sess. (1945) (hereafter cited as S. 1253); See *Hearings before Committee on Interstate Commerce on S. 1253*, 79th Cong., 2d Sess. 1-134 (1946) (hereafter cited as *Hearings on S. 1253*).

79. S. 249, as introduced, 80th Cong., 1st Sess. (1947) (hereafter cited as S. 249) and H.R. 2298, as introduced, 80th Cong., 1st Sess. (1947) (hereafter cited as H.R. 2298). See *Hearings before Committee on Interstate and Foreign Commerce on H.R. 2298*, 80th Cong., 1st Sess. (1947) (hereafter cited as *Hearings on H.R. 2298*); SEN. REP. No. 472, 80th Cong., 1st Sess. (1947); H.R. REP. No. 502 on H.R. 2298, 80th Cong., 1st Sess. (1947).

80. 24 STAT. 379 (1887), as amended, 49 U.S.C. §§ 1-27 (1943).

modification procedure to be applicable to the obligations of "carriers" defined in that Act.⁸¹ Justification for the Commission proposal was based on the need for uninterrupted railroad operation,⁸² but, in making it, the Commission showed scant regard for creditors' rights or for the policy of existing corporate and railroad reorganization statutes.

Under the 1945 proposal a solvent⁸³ carrier could be empowered to alter or modify the provisions of a bond, note, debenture or other evidence of debt,⁸⁴ and the provisions of any instrument pursuant to which such evidence of debt was issued. To be so empowered, the carrier would first apply to the Commission. Following a hearing, on notice to specified classes of security holders, the Commission could (as to the original proposal, or with such amendments as the Commission should find to be "just and reasonable") make prescribed findings.⁸⁵ Unless the proposal were then withdrawn by the carrier it would be submitted to holders of the affected obligations⁸⁶ and if the assent of holders of 75 per cent of each affected class were secured, an order would then be entered approving and authorizing the proposal and fixing a time when it should become binding on all holders of affected obligations.

81. *Id.* § 20a.

82. *Hearings on S. 1253*, at 22, 32.

83. As originally proposed in 1945 the procedure would be available as to unmatured securities of carriers "other than a carrier in equity receivership or in process of reorganization under section 77 of the Bankruptcy Act." S. 1253, at p. 3. The 1947 proposals would be available as to the matured obligations of such carriers. S. 249, at p. 3 and H.R. 2298, at p. 3. Since, under § 77, failure to pay matured debts is a basis for the filing, by creditors' holding five per cent of the carriers' debts, of an involuntary petition it is doubtful if this change could successfully stave off § 77 proceedings if sought by the creditors. *Cf. SEC v. United States Realty & Improvement Co.*, 310 U.S. 434 (1940).

84. The proposal was specifically inapplicable to equipment trust securities.

85. Under the 1945 and 1947 proposals the Commission would be required to find that the proposed modification was (a) within the scope of the statute, (b) in the public interest, (c) in the best interests of the carrier and the holders of each class of the obligations to be affected and (d) not adverse to the interests of any creditors of the carrier not affected. If the modification should constitute "issuance of a security," as defined in § 20a(2) of the Interstate Commerce Act, 24 STAT. 379 (1887), as amended, 49 U.S.C. §§ 1-27 (1943), the Commission would also be required to make the findings required by that section.

There was, in detail, some differences in the findings required by the 1945 and 1947 proposals. While in the earlier proposals the Commission would be required to find that the modification would "not be adverse to the interests of the holders of any other class of the carriers' securities," the 1947 proposal would not require this but would require as a further finding that the modification be in the best interests of each class of the carriers' stockholders.

86. The 1945 and 1947 proposals specifically provided that the proxy provisions of the Securities Exchange Act of 1934, 48 STAT. 895 (1934), 15 U.S.C. § 78n (1940) would not be applicable, and the second of the 1947 proposals, H.R. 2298, provided that a modification, found by the I.C.C. to come within § 20a(2) of the Interstate Commerce Act, 24 STAT. 379 (1887), as amended, 49 U.S.C. §§ 1-27 (1943), would be exempt from the provisions

While the ICC proposal was applicable to solvent carriers⁸⁷ and was directed, in part, toward eliminating the "threat of financial difficulties",⁸⁸ and as a means of avoiding bankruptcy reorganization,⁸⁹ it was also directed toward securing, in accord with the public interest, such modifications as elimination of antiquated or archaic provisions in security instruments.⁹⁰ In this combination of purposes there is a strong similarity to the objectives of Section 11 of the Public Utility Holding Company Act⁹¹ requiring adoption of company or commission-sponsored plans for reorganization of registered holding companies so as to secure elimination of unnecessary complexities in corporate structure, and fair and equitable distribution of voting power.⁹²

More significantly, the ICC proposal evinces in many ways a solicitude for equity interests not found in Section 11. This is apparent in the provisions made for (1) submission of only company-sponsored plans,⁹³ (2) withdrawal of any plan after Commission approval and/or amendment⁹⁴ and, what may be the most serious criticism of the proposal, (3) modification of creditors' interests with no impairment of equity interests.

The result sought by the ICC proposal, alteration of the secured or unsecured obligations of solvent carriers, has heretofore taken place only under circumstances whereby each creditor, as against junior creditors and equity interests, could insist on his contractual right, or could exchange his contractual right for what he deemed a fair equivalent⁹⁵—a result similar to what the absolute priority rule seeks to achieve in bankruptcy reorganization. This the ICC proposal would modify,⁹⁶ allowing 75 per cent of a class of creditors to modify, for all, the con-

of the Securities Act of 1933, 48 STAT. 74 (1933), as amended, 15 U.S.C. §§ 1-27 (1940).

87. While the 1947 proposals did contemplate instances where modification would be sought of matured but unpaid obligations, such a condition, while not necessarily constituting insolvency in the equity sense, *cf.* *First National Bank of Cincinnati v. Flershem*, 290 U.S. 504 (1934), could be a basis for invoking § 77. See note 83 *supra*.

88. See preambles to S. 1253, S. 249 and H.R. 2298, 57th I.C.C. ANN. REP. 76 (1943). I.C.C. ANN. REP. 76 (1943).

89. *Hearings on S. 1253*, at 24, 511; *Hearings on H.R. 2298*, at 28, 57th I.C.C. ANN. REP. 76 (1943).

90. *Hearings on S. 1253*, at 8, 21; *Hearings on H.R. 2298*, at 10.

91. 49 STAT. 838 (1935), 15 U.S.C. § 79 (1943).

92. *Id.* at § 79k(b) (2).

93. *S. 1253*, at 3-4; *S. 249*, at 4; *H.R. 2298*, at 4.

94. *S. 1253*, at 5; *S. 249*, at 5; *H.R. 2298*, at 5.

95. This frequently takes the form of refunding or extension agreements. See *Hearings on H.R. 2298*, at 41-2, 55-7.

96. The Commission did recognize that in bankruptcy reorganization creditors claims must be fully satisfied before equity interests may participate. *Hearings on H.R. 2298*, at 27; *Hearings before special subcommittee of the Committee on the Judiciary on H.R. 3237*, 80th Cong., 1st Sess. 178-9 (1947) (hereafter cited as *Hearings on H.R. 3237*); *Hearings on S. 249*, at 529.

tractual claims of non-assenters of that class against the solvent company.

Some observers have thought that the ICC proposal contemplated modification in accordance with absolute priority requirements.⁹⁷ There is, however, substantial reason to believe that the proposal would accomplish a result in conflict with the requirement.⁹⁸ This possibility, while never squarely stated by the Commission, has never been denied by them. Negatively, the proposal makes no express provision for formulation or approval of a plan which meets recognized priority requirements,⁹⁹ and, affirmatively, Commission insistence on certain features of the proposal indicates that it contemplated implementation of modifications which do not meet recognized priority requirements.

The proposal would allow modification of debt "obligations", as defined.¹⁰⁰ Balloting would be only by, and a final Commission order could only affect rights of, holders of the classes of "obligations" affected. Of more significance is the Commission response to suggestions that the percentage of assenting security holders be reduced. The Commission must have been aware that under Section 11 of the Holding Company Act¹⁰¹ reorganizations of solvent and insolvent companies had been effected without submission to security holders, but which gave participation to stockholders only after satisfaction of

97. Cf. *Hearings on S. 249*, at 563; *Hearings on H.R. 3237*, at 186.

98. The Commission regarded the bill as a means of restoring railroad credit without recourse to § 77, *Hearings on S. 1253*, at 124, and anticipated that creditors could be expected to cooperate gladly to avoid the effects of a § 77 reorganization, *Hearings on S. 249*, at 519. Nevertheless, the Commission, and others, were aware that no modification could be effected without stockholder acquiescence in the first instance, *Hearings on S. 1253*, at 25, 250, that modifications would not affect them, *id.* at 711; *Hearings on S. 249*, at 52, that they would be "very advantageous to them" *Hearings on S. 1253*, at 78, and that they would "welcome such an arrangement," *id.* at 25. That the bill itself does not contemplate changing stockholder interests, see *Hearings on S. 249*, at 301-2 and *Hearings on H.R. 2298*, at 46, 52.

99. Compare the Commission findings required by the proposal, note 85 *supra*, with the provisions of § 11, 49 STAT. 838 (1935), 15 U.S.C. § 79k (1943). Under Chapter XV of the Bankruptcy Act, 56 STAT. 787, 11 U.S.C. § 1200 *et seq.* (1942) the Commission was required to find that a proposed plan of adjustment was "in the public interest and in the best interests of each class of creditors and stockholders," *id.* at § 1210(2)(c)(i). Nevertheless, the Commission avoided passing on the fairness of Chapter XV proposals. *Midland Valley Ry.*, 254 I.C.C. 271, 281-2 (1943); *Delaware & Hudson R.R.*, 254 I.C.C. 239, 240-1 (1943) with which compare *Mahaffie and Eastman*, Commissioners, dissenting in *Montana, Wyo. & So. R.R.* 236 I.C.C. 325, 338-9 (1939).

100. "... bonds, notes, debentures, or other evidences of indebtedness ... issued under any mortgage, indenture, deed of trust, or other instrument of like nature, such bonds, notes, debentures, or other evidences of indebtedness being hereinafter in this section sometimes called 'obligations'" *S. 1253*, at 3; *S. 249*, at 3; *H.R. 2298*, at 3.

101. 49 STAT. 838 (1935), 15 U.S.C. § 79k (1943); see the discussion of the Holding Company Act cases in *Hearings on S. 1253*, at 128-30.

creditors' claims.¹⁰² Nevertheless, the ICC proposal would require, in addition to conformity with other statutory requirements, the vote of holders of 75 per cent of the affected class. Commission opposition to reduction of this percentage was on the ground that the reasonableness of the legislation depended, in part, on this percentage.¹⁰³ Since utilization of the Holding Company Act indicates that fair and equitable reorganizations can be enforced without balloting of security holders, it seems a reasonable conclusion that the ICC by its proposal sought a constitutional or legal basis for reorganizations not of a "fair and equitable" nature.¹⁰⁴

102. Thus, where assets had a total value of \$2,625,000 and there were secured claims in excess of \$5,000,000, secured creditors received the new bonds and 95.76% of the new stock. The remaining 4.24% of the stock went to unsecured creditors as *pari passu* distribution of free assets. Old stockholders received nothing. *In re Jacksonville Gas Co.*, 46 F. Supp. 852 (S.D. Fla. 1942).

In a § 11 plan for a solvent company, cash and portfolio securities went to note and debentureholders, 95% of the new common to holders of old prior preference and, because of the likelihood of preferred stockholders participating, save for the intervention of the § 11 plan, in future earnings, they received the rest of the new stock. Old common stockholders received nothing. *In re Standard Gas & Electric Co.*, Holding Act Release 5430 (1944); *modified and approval denied*, 59 F. Supp. 274 (D. Del. 1945); *rev'd and remanded*, 151 F.2d 326 (C.C.A. 3d 1945), *cert. denied*, 327 U.S. 796 (1946).

103. *Hearings on S. 249*, at 301-2, 572-3. In advancing the original proposal in 1945 the Commission recognized that if the modification procedure was a reasonable exercise of the Commerce power, Commission-directed modifications could be accomplished without balloting, and indicated that provision for assent by security holders was to enhance the reasonableness of the proposal, *Hearings on S. 1253*, at 124-5; *cf. id.* at 249. In 1947, the Commission, in opposing a proposal that the required percentage of assents be reduced, asserted, not that reduction would imperil constitutionality of its proposal, but that reduction would "place too large minorities at the mercy of the majorities." *Hearings on H.R. 3237*, at 169; *Hearings on S. 249*, at 520.

104. "Fair and equitable" plans could be effected by coupling with modification, either in the original proposal or in the form of a Commission amendment, such devices as increases in interest rates paid on the carriers' securities, creation of sinking funds or restriction, or postponement, of dividends. *Hearings on S. 1253*, at 249; *Hearings on S. 249*, at 46. To the extent that equity interests were created and existed under state law they could be altered by Commission order if they did not relate to matters essentially of state concern and if continued existence would encumber interstate commerce *cf. Seaboard Air Line R.R. v. Daniel*, 16 U.S.L. Week 4169 (U.S. Feb. 16, 1948); *Texas v. United States*, 292 U.S. 522 (1934); *Commonwealth & Southern Corp. v. SEC*, 134 F.2d 747, 752 (C.C.A. 3d 1943).

Amendments suggested to the I.C.C. proposal would make it clear that stockholders' rights might be modified. See *Hearings on H.R. 2298*, at 53-63, 66-72; *Hearings on S. 249*, at 187-96, 203-11; *H.R. 2298 as reported to the Senate Feb. 18, 1948*; SEN. REP. No. 897, 80th Cong., 2d Sess. 9, 10 (1948). If this suggested amendment be acceptable to the Commission, it might well revamp the whole proposal, basing it squarely not on bankruptcy precedents, but, on the Commerce clause—a suggestion made as early as 1929. *Rodgers, Rights and Duties of the Committee in Bondholders' Reorganizations*, 42 HARV. L. REV. 899, 919 (1929); *cf. Craven and Fuller, The 1935 Amendments of the Railroad Bankruptcy Law*, 49 HARV. L. REV. 1254, 1260 (1936); See *Hearings before the House Judiciary Committee on H.R. 6249*, 74th Cong., 1st Sess. 261 (1935) (Luther Walter). Section 11 would provide a suggestive precedent.

Enactment of such a proposal may be objected to on more general grounds. It can fairly be said that incorporation into all carrier securities¹⁰⁵ of what is essentially a majority clause would give statutory dignity to a non-statutory procedure already having recognized dangers. It would also accord some degree of dignity to use of the non-statutory analogue as a means of avoiding statutory reorganization with its well-considered safeguards and sanctions. Under the commerce clause, a plan of reorganization of a "public" corporation approved by an administrative body can clearly be enforced without balloting of security holders.¹⁰⁶ Under the bankruptcy clause, a plan of reorganization may be enforced without the approval of affected creditors.¹⁰⁷ However, this has been true only of statutes that require plans that meet the test of fairness and equitableness.¹⁰⁸ Indeed, the Supreme Court has indicated that even though more than 90 per cent of each class of affected creditors approve a plan of reorganization, it cannot be enforced in a Section 77 or Chapter X reorganization unless it is, in fact, fair and equitable.¹⁰⁹

These objections, together with the fact that the standard of fairness and equitableness was incorporated into Section 11, and has been successfully enforced by an administrative agency, strongly indicates, in the absence of circumstances not presently apparent, that lack of such

105. Except equipment trust securities. See note 84 *supra*.

106. *American Power & Light Co. v. SEC*, 329 U.S. 90 (1946); *In re Consolidated Electric & Gas Co.*, 55 F. Supp. 211 (D. Del. 1944); *In re Community Power & Light Co.*, 33 F. Supp. 901 (S.D. N.Y. 1940); see *In re Standard Gas & Electric Co.*, 59 F. Supp. 274, 279 (D. Del. 1945) ("Congress can permit . . . an administrative agency . . . [to alter creditors' rights] without creditors' vote when such is in the public interest. This is because the Constitution confers bankruptcy power upon Congress and in the exercise of that granted power Congress can, when it finds it necessary, alter such rights. . . . So, too, as an incident of the commerce power, Congress may alter creditor rights when such alteration is in the public interest.") *rev'd on other grounds*, 151 F.2d 326 (C.C.A. 3d 1945) *cert. denied*, 327 U.S. 796 (1946). Cf. Note, 46 YALE L. J. 1041, 1042 (1937) (suggesting police power as a basis).

107. As enacted in 1933, § 77 required the assent of two-thirds of a class to bind non-assenters of that class. It was thereafter customary to provide for sale at an upset price in the event that the required assent was not obtained. In 1935 this was revised by enactment of the "cram-down" provision, providing that although the assent of two-thirds of those voting is not obtained the plan may be confirmed without sale, if the judge should find that the plan provides fair and equitable treatment for the rejecting class and that their rejection is not reasonably justified. § 77(e), second paragraph; 47 STAT. 1474 (1933), as amended, 11 U.S.C. § 205(e); See Craven and Fuller, *supra* note 104, at 1276-83. The provision has been held to be a proper exercise of the bankruptcy power. *RFC v. Denver & Rio Grande W. R.R.*, 328 U.S. 495, 531-3 (1946); *in re Chicago & N.W.R.R.*, 126 F.2d 351 (C.C.A. 7th 1942), *cert. denied*, 318 U.S. 793 (1943).

108. *Group of Institutional Investors v. Chi., M. St. P. & Pac. R.R.*, 318 U.S. 523, 541-2 (1943) (Bankruptcy Clause—§ 77); *Otis & Co. v. SEC*, 323 U.S. 624, 634 (1945) (commerce clause—Holding Company Act).

109. *Case v. Los Angeles Lumber Products Co.*, 309 U.S. 106, 114-5 (1939).

a standard in the ICC proposal would constitute, as against non-assenters, an unreasonable, and therefore unconstitutional, impairment of contract rights.¹¹⁰ Whether or not a successful modification were ever accomplished under the statute, enactment would constitute introduction of another incongruity¹¹¹ into our statutory law of bankruptcy. Accomplishment, under Section 11, of objectives similar to those of the ICC proposal, and without the same dangers, suggests that such incongruity is not necessary.

110. All reorganization precedents cited by advocates of the proposal are cases involving "fair and equitable" plans. See *Hearings on S. 1253*, at 116-7, 121-31; *Hearings on H.R. 2298*, at 63-6; H.R. REP. No. 502, 80th Cong., 1st Sess. 4 (1947); *Hearings on S. 249*, at 193-96.

111. Compare criticisms of Chapter XV in Will, *Chapter XV of the Bankruptcy Act*, 7 U. OF CHI. L. REV. 203 (1940) with Will, *The Voluntary Adjustment of Railroad Obligations* 7 LAW & CONTEMP. PROB. 519 (1940).