execute a "mutual, final, and definite" award upon the subject matter of the submitted dispute.[78] Mistakes, miscalculations and other formal defects in the award could be corrected on motion.[79]

V.

To extend the provisions of the United States Arbitration Act to agreements executed by government officers, no far-reaching changes in the statute seem necessary. Language of the following general tenor would seem to encompass the major pertinent objectives:

> Any officer of the United States, or of a department or agency thereof, authorized to enter into a written contract on behalf of the United States government or such department or agency, may agree to settle by arbitration a controversy thereafter arising out of or with respect to such contract, or to submit to arbitration any existing controversy arising out of or with respect to such a contract. Such an agreement shall be subject to the provisions of the United States Arbitration Act.

STATUS OF THE PLEDGEE IN CORPORATE REORGANIZATION

THE recent enactment of a statute[1] purporting to give to the Reconstruction Finance Corporation special remedies as a holder of collateral pledged by railroads brings to the foreground once more the important problems involving the status of the pledgee in corporate reorganization. These pledge problems have arisen principally from the frequent use of the pledge as a security device[2] in short term loan transactions. In the ordinary collateral loan, as made by commercial banks and the RFC, the debtor gives his note in the amount borrowed and, in addition, transfers securities to the creditor under the terms of a pledge agreement which usually provides that the pledgee may sell the collateral upon default. The securities thus pledged may be stock or obligations of third parties, or, as is the case with many railroad loans,[3] bonds of the debtor itself.[4]

78. ARBITRATION ACT, § 10.
79. ARBITRATION ACT, § 11.

1. Section 331(b) of the Transportation Act of 1940, Pub. L. No. 785, 76th Cong., 3d Sess. (Sept. 18, 1940). See note 85 *infra*.
2. Glenn, *The Pledge as a Security Device* (1938) 24 VA. L. REV. 355.
3. Swaine, *The Purchase by Railroads of Their Own Obligations* (1940) 7 LAW & CONTEMP. PROB. 532; Hatch, *A Form of Depression Finance—Corporations Pledging Their Own Bonds* (1934) 47 HARV. L. REV. 1093.
4. The pledge device has also been employed in *long-term* financing in the collateral trust indenture, under which securities are pledged to a third-party trustee, usually a

The pledge agreement[5] creates for the creditor a property interest[6] in the collateral, giving him a series of important powers. First and most important[7] of these is a power of sale upon default. Should the debtor, under a common type of agreement,[8] fail to pay one installment of principal or interest, the collateral may be sold at public or private sale without notice to the pledgor. If the sale brings less than the amount of the debt, a claim lies against the debtor;[9] on the other hand, any surplus[10] belongs to the debtor.[11]

In addition to the power of sale, the contract may grant the right to accelerate the maturity of the principal debt. Under such a provision, the creditor may, on certain contingencies, among which is generally included

bank, for the benefit of collateral trust bondholders. Although the pledge rights here granted are generally similar to those found in the ordinary pledge, they may not be exercised directly by the bondholders, but rather only by the trustee, who corresponds to the pledgee in the collateral loan transaction. See generally 19 FLETCHER, CYCLOPEDIA OF CORPORATIONS (perm. ed. 1933) §§ 9102, 9118, 9132, 9134, 9138. Since liquidity is not of paramount importance in long-term borrowing, the function here performed by the pledge is different from that performed under the ordinary collateral loan.

5. The validity and nature of the pledge agreement are governed by the law of the state of delivery. JONES, COLLATERAL SECURITIES AND PLEDGES (3d ed. 1912) 160; GILBERT'S COLLIER ON BANKRUPTCY (Moore's ed. 1937) 72, 1100-1103; see Hiscock v. Varick Bank, 206 U. S. 28, 37-38 (1907).

6. The exact nature of this interest is not entirely clear. It has been referred to as a special property right "carved out of the entire estate for the benefit of the pledgee." New Haven Proceeding, Memorandum on Order No. 99 (D. Conn., May 28, 1937) Court Record, pp. 2671, 2675-6. In general, the pledgee has immediate dominion as against the pledgor, and may protect his right to possession by trover, detinue, or replevin. *In re* Hudson River Nav. Corp., 57 F. (2d) 175 (C. C. A. 2d, 1932); *In re* Jersey Island Packing Co., 138 Fed. 625, 628 (C. C. A. 9th, 1905). The pledgor, while devoid of any right to possession, has the "ultimate title" and right of redemption. *In re* Henry, 50 F. (2d) 453 (E. D. Pa. 1931); Guaranty Trust Co. v. Fentress, 61 F. (2d) 329 (C. C. A. 7th, 1932). See JONES, COLLATERAL SECURITIES AND PLEDGES (3d ed. 1912) 1-63.

7. *In re* Hudson River Nav. Corp., 57 F. (2d) 175, 176 (C. C. A. 2d, 1932).

8. For the provisions of a typical collateral loan, see New Haven Proceeding, Memorandum on Order No. 99 (D. Conn., May 28, 1937) Court Record, p. 2671 *et seq.* For those found in the common varieties of collateral trust indenture, see 19 FLETCHER, CYCLOPEDIA OF CORPORATIONS (perm. ed. 1933) 330-383.

9. JONES, COLLATERAL SECURITIES & PLEDGES (3d ed. 1912) § 597; McCune v. Harris, 9 Cal. App. (2d) 719, 50 P. (2d) 837 (1935); Crichton v. Barron, 164 La. 968, 115 So. 50 (1927).

10. The pledgee holds the surplus in trust for the pledgor [Gleaton v. Bank of Arlington, 40 Ga. App. 291, 149 S. E. 438 (1929)], who is entitled to an accounting [Dickson v. Bank of Chandler, 25 Ariz. 243, 215 Pac. 926 (1923)]. See JONES, COLLATERAL SECURITIES & PLEDGES (3d ed. 1912) §§ 649, 650; Continental Credit Co. v. Ely, 91 Conn. 553, 562, 100 Atl. 434, 437 (1917).

11. Merrill v. National Bank of Jacksonville, 173 U. S. 131 (1899); Mississippi Valley Trust Co. v. Railway Steel Spring Co., 258 Fed. 346 (C. C. A. 8th, 1919); see Swaine, *The Purchase By Railroads of Their Own Obligations* (1940) 7 LAW & CONTEMP. PROB. 532, 535.

the filing by the debtor of a petition in insolvency proceedings, declare the whole debt to be due and in default, regardless of maturity date.[12] Another right, held to reside in the pledgee unless expressly reserved, is that of receiving the interest and dividends paid on the assets pledged, and of applying such income to the principal or interest of the debt.[13] The power to vote pledged stock, on the other hand, if not expressly granted by the pledgor, does not fall to the creditor unless he buys the stock at his own sale.[14] And finally, the pledgee has the right to retain possession of the security until the debt is paid in full.[15]

These legal attributes, especially the liberal power of sale, have tended to make the pledge a favorite security device in short term financing, where liquidity is the chief characteristic sought after by lenders.[16] The commercial banks and the various government lending agencies, for instance, have been interested primarily in making loans of early maturity date, secured by liquid collateral. This purpose is better served by the pledge than by the mortgage. In the first place, a mortgage must ordinarily be foreclosed by judicial proceeding, whereas the pledge, under the usual power of sale, makes possible immediate sale without recourse to the courts. And the type of property pledged as collateral tends to be of a more salable variety than that which is commonly mortgaged. Furthermore, in the case of a mortgage, it was generally held that freedom to foreclose and liquidate was lost after the debtor went into receivership or bankruptcy. The legalistic reason given for this was that the power of the court to enjoin a sale in a summary proceeding depended upon

12. 19 FLETCHER, CYCLOPEDIA OF CORPORATIONS (perm. ed. 1933) § 9136; see Guaranty Trust Co. v. Henwood, 86 F. (2d) 347 (C. C. A. 8th, 1936), *cert. denied*, 300 U. S. 661 (1937).

13. See JONES, COLLATERAL SECURITIES AND PLEDGES (3d ed. 1912) §§ 398, 399, 721; New Haven Proceeding, Memorandum on Order No. 101 (D. Conn., May 28, 1937) Court Record, pp. 2691, 2694; Railroad Credit Corp. v. Hawkins, 80 F. (2d) 818 (C. C. A. 4th, 1936).

14. In general, unless there is an agreement to the contrary, the pledgor retains his right to vote the stock until a complete transfer of title is made to the pledgee on the books of the corporation. BALLANTINE, MANUAL OF CORPORATION LAW (1st ed. 1930) 570; Finefrock v. Kenova Mine Car Co., 22 F. (2d) 627 (C. C. A. 4th, 1927). The matter is often regulated by statute. National Bank of Commerce v. Allen, 90 Fed. 545, 552 (C. C. A. 8th, 1898).

15. Mercer Nat. Bank v. White's Ex'r, 236 Ky. 128, 32 S. W. (2d) 734 (1930). See Security-First Nat. Bank v. Rindge Land & Navig. Co., 85 F. (2d) 557, 561 (C. C. A. 9th, 1936). The pledgee has a right to redeem the security by paying the debt, as do those who succeed to his interest. *In re* International Fuel & Iron Corp., 21 F. (2d) 598 (C. C. A. 3d, 1927) (trustee in bankruptcy); International Banking Corp. v. Lynch, 269 Fed. 242 (C. C. A. 9th, 1920) (receiver); *cf.* Louisville Joint Stock Land Bank v. Radford, 295 U. S. 555 (1935).

16. Rapkin, *Power of Courts to Restrain Sale of Pledged Collateral* (1937) 21 MARQ. L. REV. 195; Howland, *The Enforcement of Secured Creditors' Claims under 77 and 77B: A Functional Analysis* (1937) 46 YALE L. J. 1109. This was not true, however, in the case of the collateral trust indenture, which secured a long-term bond issue. See also DEWING, FINANCIAL POLICY OF CORPORATIONS (3d ed. 1934) 931-953, esp. at 937.

the actual or constructive possession of the property in question by the receiver or trustee in bankruptcy. Mortgaged property was almost invariably held to have been in the insolvent's possession before the commencement of proceedings, with the result that it passed into the hands of his successor, the agent of the court.[17] But pledged property, the courts long maintained, was clearly in the possession of the creditor, and thus never passed into judicial custody at all.[18]

The functional reason for this difference in treatment lay in the fact that business relied rather strongly on the liquidity of the pledge in formulating its short term lending policies.[19] Courts, willing to recognize established business practices where no public policy appeared to dictate a contrary course, found the "possession" rationale a convenient instrument for their purpose. As a result, bankruptcy[20] and equity receivership[21] decisions tended for several decades to echo the opinion in *Jerome v. McCarter*,[22] in which the Supreme Court forbade interference with the pledgee's power of sale even after all the other assets of the debtor had passed into the custody of the court. Nor was any distinction made, at first, between a pledge of the debtor's own obligations and one of other securities.

17. Note (1938) 112 A. L. R. 508; Allebach v. Thomas, 16 F. (2d) 853 (C. C. A. 4th, 1927); *In re* Jersey I. Packing Co., 138 Fed. 625 (C. C. A. 9th, 1905); *cf. In re* Landquist, 70 F. (2d) 929 (C. C. A. 7th, 1934). But writers have doubted whether the debtor's possession was relied on as the sole basis of jurisdiction. Comment (1935) 84 U. OF PA. L. REV. 992; (1935) 48 HARV. L. REV. 1430.

18. Southwestern Lumber Co. v. Kerr, 11 F. Supp. 253 (S. D. Tex. 1934) (bankruptcy); Guaranty Trust Co. v. Fentress, 61 F. (2d) 329 (C. C. A. 7th, 1932) (receivership); *cf. In re* Henry, 50 F. (2d) 453 (E. D. Pa. 1931).

19. McGinnis, *The Sale of Collateral Security by the Pledgee Thereof After the Intervention of the Bankruptcy of the Pledgor* (1934) 9 IND. L. J. 195; Hatch, *A Form of Depression Finance—Corporations Pledging Their Own Bonds* (1934) 47 HARV. L. REV. 1093; *In re* Hudson River Nav. Corp., 57 F. (2d) 175 (C. C. A. 2d, 1932); Rogers Brown & Co. v. Tindel Morris Co., 271 Fed. 475 (E. D. Pa. 1921). But see (1935) 35 COL. L. REV. 109.

20. Between 1877 and 1931, injunctions were refused or vacated in five cases. Labor Bank & Trust Co. v. Dow, 26 S. W. (2d) 925 (Tex. Civ. App. 1929); *In re* Progressive Wall Paper Corp., 224 Fed. 143 (N. D. N. Y. 1915); *In re* Ironclad Mfg. Co., 192 Fed. 318 (C. C. A. 2d, 1912) (debtor's own obligations pledged); *In re* Mayer, 157 Fed. 836 (C. C. A. 2d, 1907); *In re* Browne, 104 Fed. 762 (E. D. Pa. 1900). Sales of collateral during bankruptcy proceedings were held valid in three instances. Hiscock v. Varick Bank, 206 U. S. 28 (1907) (before adjudication); *In re* Peacock, 178 Fed. 851 (C. C. E. D. N. C. 1910) (after adjudication); *In re* Mertens, 144 Fed. 818 (C. C. A. 2d, 1906) (before adjudication); *cf. In re* International Fuel & Iron Corp., 21 F. (2d) 598 (C. C. A. 3d, 1927) (injunction pending redemption by trustee); *In re* Cobb, 96 Fed. 821 (E. D. N. C. 1899) (turnover ordered); see Wingert v. Kieffer, 29 F. (2d) 59 (C. C. A. 4th, 1928).

21. Guaranty Trust Co. v. Fentress, 61 F. (2d) 329 (C. C. A. 7th, 1932); Carey v. McMillan, 289 Fed. 380 (C. C. A. 8th, 1923); Fidelity Ins. Trust & Safe-Deposit Co. v. Roanoke Iron Co., 81 Fed. 439 (W. D. Va. 1896) (sale of collateral valid).

22. Jerome v. McCarter, 94 U. S. 734 (1877). The court there upheld as valid a sale of the debtor's own mortgage bonds, pledged by him to secure loans. The sale took place after the adjudication in bankruptcy.

Before long, however, it became apparent that, for a variety of reasons, the possession doctrine was outliving its usefulness. First, where the pledged collateral consisted of the debtor's own unsecured debentures, a sale by the pledgee increased the outstanding unsecured debt of the pledgor to the detriment of other claimants. If, in addition, the pledgee bought the debentures himself, he was in a position to prove "two notes for one." One bankruptcy court, regarding this as manifestly unfair to the other creditors, was forced, in order to uphold an injunction against such sale, to ignore the possession doctrine entirely.[23] In the following year, however, the same court upheld the refusal of an injunction where the collateral consisted of *secured* bonds of the debtor.[24] Indeed, there is no great need, in a bankruptcy proceeding, to impose an injunction upon the pledgee of such collateral, for the result of his sale does not seem inequitable. A bankruptcy court, being concerned primarily with an equitable distribution of assets among the unsecured creditors, takes only a limited interest in the pledgee's foreclosure, and will generally have no cause to interfere with his sale unless it injures the other parties to the proceeding. Thus it is not strange that it should enjoin the sale of an unsecured debenture, which is simply a lien "manufactured" out of assets that should ordinarily go to other unsecured creditors, but refuse to enjoin that of a mortgage bond, which is in effect a fractional share in the proceeds from the sale of mortgaged property.

But in the equity receivership such considerations are of secondary importance, for the court is concerned with secured debts as well as unsecured. It seeks to rehabilitate, rather than liquidate, and to accomplish this it must for a number of reasons keep the total of the debtor's obligations as low as possible.[25] It is not surprising, therefore, that the sale of mortgage bonds, permitted in bankruptcy, was enjoined in *Mississippi Valley Trust Co. v. Railway Steel Spring Co.*,[26] an equity receivership case, for the reason that it would increase the insolvent's indebtedness. In casting about for a workable rationale to support its injunction, the court made use of the ingenious, if somewhat questionable, reasoning that such increase, by reducing the rights of each creditor to participate in the property of the insolvent, constituted an interference with assets *in custodia legis*. The problem posed by the growing inflexibility of the possession doctrine was thus solved in one situation where it had proved embarrassing.[27]

23. John Matthews, Inc. v. Knickerbocker Trust Co., 192 Fed. 557 (C. C. A. 2d, 1911). For another case involving the debtor's own bonds, see *In re* Battle Island Paper Co., 259 F. 921 (N. D. N. Y. 1919).

24. *In re* Ironclad Mfg. Co., 192 Fed. 318 (C. C. A. 2d, 1912).

25. Under the rule in the *Boyd* case, for example. The larger the indebtedness of the insolvent, the smaller will be the chance that stockholders will participate in the reorganized company. Northern P. R. R. v. Boyd, 228 U. S. 482 (1913).

26. Mississippi Valley Trust Co. v. Railway Steel Spring Co., 258 Fed. 346 (C. C. A. 8th, 1919).

27. But a subsequent decision, on similar facts, arrived at a different result. Rogers Brown & Co. v. Tindel Morris Co., 271 Fed. 475 (E. D. Pa. 1921) (debtor's mortgage

But the liquidity of a pledge of securities which were not obligations of the debtor had not as yet been subjected to judicial interference, although a sale of such collateral could in its own fashion produce harm, as, for instance, where the market price of the collateral was for the moment abnormally low. If the pledgee sold at such a time, he generally destroyed the debtor's equity and even created a large deficiency claim for himself. The courts seem, however, to have been unable to solve this particular difficulty until after the decision in the bankruptcy case of *Isaacs v. Hobbs Tie & Timber Co.*,[28] in 1931. That case, which actually involved a mortgage rather than a pledge, held that a mortgagee could not sue in another court to foreclose his mortgage, after the debtor's adjudication in bankruptcy, because the bankruptcy court from that time on had exclusive jurisdiction to deal with property that had been in the bankrupt's actual or constructive possession. In addition to the holding, however, there were dicta to the effect that it was solely within the power of the court to decree the method of liquidation of all valid liens.[29] These dicta were almost immediately seized upon by courts as placing the pledgee's power of sale within the ambit of their injunctive jurisdiction, with the result that sales were soon restrained in ordinary bankruptcies whenever they seemed to endanger orderly and successful liquidation.[30] While the principal reason for enjoining the pledgee seems to have been the danger of a sacrifice sale with its ensuing large

bonds pledged). In that case the court stressed the importance to be attached to common business practice, which had adapted itself to the lines drawn by the courts. The abandonment of this argument in Guaranty Trust Co. v. Fentress, 61 F. (2d) 329 (C. C. A. 7th, 1932) in favor of a functionally less tenable one, foreshadowed a radical change in the rights of pledgees. See (1932) 42 YALE L. J. 273; (1932) 42 YALE L. J. 276; (1933) 31 MICH. L. REV. 1174.

28. Isaacs v. Hobbs Tie & Timber Co., 282 U. S. 734 (1931); (1931) 31 COL. L. REV. 1036, (1932) 7 IND. L. J. 502. This decision was later qualified in Straton v. New, 283 U. S. 318 (1931), in which it was held that the adjudication in bankruptcy did not oust a state court of jurisdiction of an action, begun five and one-half months before the filing of the petition in bankruptcy, to enforce a lien acquired sixteen months before.

29. Isaacs v. Hobbs Tie & Timber Co., 282 U. S. 734, 738 (1931). The resulting confusion in pledge law has been deplored. See Comment (1935) 33 MICH. L. REV. 1225, 1228.

30. Since the *Isaacs* decision in 1931, there have been eight bankruptcy cases involving the pledgee's power of sale. In three of the four which refused interference the debtor had no equity. *In re* Fisher, 33 F. Supp. 155 (E. D. N. Y. 1940); Kerr v. Southwestern Lumber Co., 78 F. (2d) 348 (C. C. A. 5th, 1935), *cert. denied*, 296 U. S. 611 (1935); *In re* Chaiken, 10 AM. BANKR. REV. 14 (M. D. Pa. 1933) (unreported); *In re* Hudson River Nav. Corp., 57 F. (2d) 175 (C. C. A. 2d, 1932) (equity of redemption). And this, it appears, has gradually become the deciding factor in the bankruptcy decisions, since the cases which uphold injunctions almost always involve situations where there is either an equity or some prospect of one. *In re* Brown, 84 F. (2d) 433 (C. C. A. 7th, 1936) (equity); *In re* Belber, 7 F. Supp. 762 (E. D. Pa. 1934), *aff'd sub nom.* Grabosky v. Kephart, 72 F. (2d) 542 (C. C. A. 3d, 1934) (prospect of equity); *In re* Henry, 50 F. (2d) 453 (E. D. Pa. 1931) (not apparent); *In re* Purkett, Douglas & Co., 50 F. (2d) 435 (S. D. Cal. 1931) (probably an equity).

deficiency claim,[31] dicta in later cases apparently assumed that the injunction could be used to prevent any injury to other creditors.[32]

The enactment in 1933 and 1934 of the reorganization statutes[33] almost immediately gave rise to questions relating to the new powers[34] of the bankruptcy courts and the effect that these powers would have on the liquidity of collateral loans.[35] And in 1935 the Supreme Court, by its decision in the *Rock Island* case[36] that the issuance of an injunction against sale of pledged collateral lay entirely within the discretion of the court, recognized that forcible freezing of the secured creditors' remedies was a necessary corollary to the inclusion of their security in the final plan.[37] Some $54,000,000 of its own bonds, and of its subsidiaries', had there been pledged by the debtor

31. *In re* Purkett, Douglas & Co., 50 F. (2d) 435 (S. D. Cal. 1931); *cf.* McGinnis, *The Sale of Collateral Security by the Pledgee Thereof After the Intervention of the Bankruptcy of the Pledgor* (1934) 9 IND. L. J. 195, 219; *In re* Hudson River Nav. Corp., 57 F. (2d) 175 (C. C. A. 2d, 1932).

32. See *In re* Belber, 7 F. Supp. 762, 763-4 (E. D. Pa. 1934), *aff'd sub nom.* Grabosky v. Kephart, 72 F. (2d) 542 (C. C. A. 3d, 1934); *In re* Brown, 84 F. (2d) 433, 434 (C. C. A. 7th, 1936).

33. Sections 77 and 77B of the Bankruptcy Act, enacted in 1933 and 1934 and since amended. The Act is to be found in 52 STAT. 840 (1938), 11 U. S. C. §§ 1-1103 (Supp. 1939), and will henceforth be cited only by section. See also Chapter X of the Chandler Act, 52 STAT. 883-905 (1938), 11 U. S. C. §§ 501-676 (Supp. 1939).

34. The statutes gave the court power to approve a plan modifying the rights of both secured and unsecured creditors. Sections 77(b)(1) and 77B(b)(1); Chapter X, §§ 216, 113 and 148; see FINLETTER, LAW OF BANKRUPTCY REORGANIZATION (1st ed. 1939) 145-149.

35. Under Sections 77 and 77B the courts for the first time found themselves with the power to include pledged collateral in a plan of reorganization. 2 GERDES, CORPORATE REORGANIZATION (1st ed. 1936) 1660-1670; FINLETTER, LAW OF BANKRUPTCY REORGANIZATION (1st ed. 1939) 143. The jurisdiction of the equity court has been said to depend upon actual or constructive possession of the property by the receiver. Guaranty Trust Co. v. Fentress, 61 F. (2d) 329 (C. C. A. 7th, 1932), *rev'g* Cherry v. Insull Utility Investments, Inc., 58 F. (2d) 1022 (N. D. Ill. 1932); *cf.* Rogers Brown & Co. v. Tindel Morris Co., 271 Fed. 475 (E. D. Pa. 1921).

36. Continental Illinois Nat. Bank & Trust Co. v. Chicago, R. I. & P. Ry., 294 U. S. 648 (1935), 44 YALE L. J. 677, 35 COL. L. REV. 109, 48 HARV. L. REV. 1430, 30 ILL. L. REV. 240, (1934) 19 MARQ. L. REV. 44.

37. That the power to enjoin the sale of pledged collateral is to a large extent ancillary to the possibility that the securities will be included in the resulting plan, is shown by more than one decision. *In re* Prudence Bonds Corp., 79 F. (2d) 212 (C. C. A. 2d, 1935); *In re* Commonwealth Bond Corp., 77 F. (2d) 308 (C. C. A. 2d, 1935) (securities held by debtor in a fiduciary capacity only); *cf. In re* Nine North Church Street, Inc., 82 F. (2d) 186 (C. C. A. 2d, 1936); *In re* Diversey Bldg. Corp., 86 F. (2d) 456 (C. C. A. 7th, 1936). It has also been argued, however, that the "plan power" comes from the increased summary jurisdiction and increased power to enjoin a sale of collateral, rather than vice versa. (1939) 6 U. OF CHI. L. REV. 690. The *Rock Island* case avoided deciding that the ordinary bankruptcy court had the power to enjoin a sale by the pledgee, thus leaving the law in the uncertain state created by the *Isaacs* decision. Continental Illinois Nat. Bank & Trust Co. v. Chicago, R. I. & P. Ry., 294 U. S. 648, 676 (1935); Comment (1935) 33 MICH. L. REV. 1225.

railroad to cover a note aggregating only one-third of that amount. Basing the lower court's power to enjoin on the general provisions of Section 2(15) of the Bankruptcy Act[38] and Section 262 of the Judicial Code,[39] and on its powers as a court of equity, the Supreme Court upheld an injunction originally issued by the district court on the ground that continuing sales of the debtor's obligations would interfere with the bargaining necessary for consummation of a successful plan and so increase the outstanding bonded indebtedness as to require prohibitive contributions by junior parties desirous of participating.[40]

Although the assumption of injunctive *power* in the *Rock Island* case was couched in general terms which stressed the power of the bankruptcy court to prevent non-judicial actions tending to hamper the course of reorganization, the decision appears to have relied for *jurisdiction* upon the existence of an equity in the debtor as property[41] subject to the jurisdiction of the court within the meaning of Section 77(a).[42]

It is interesting to see how far the courts have gone, in the light of these developments, in denying to the collateral loan the characteristics of liquidity. In evaluating the pledgee's position under post-*Rock Island* law, it should be noted, first, that the courts have stated it as a general rule that they may postpone the pledgee's "remedies,"[43] but may not in the absence of valid statutory authority alter his "rights."[44] In practice, those powers of the pledgee which tend to hamper reorganization have been termed remedies, and those which do not, rights. Thus, the option to accelerate the maturity of a loan, exercise of which does not result in any interference with the

38. 30 STAT. 545 (1898), 11 U. S. C. § 11(15) (1934); see 52 STAT. 843 (1938), 11 U. S. C. § 11(15) (Supp. 1939).

39. 36 STAT. 1162 (1911), 28 U. S. C. § 377 (1934).

40. It appeared, moreover, from the record, that the total collateral pledged amounted to some $200,000,000, a sum equal to nearly half of the capital then issued and outstanding in the hands of the public. The injunction was designed to prevent continuing sales of all of this collateral, and not merely of that involved in the case. Continental Illinois Nat. Bank & Trust Co. v. Chicago, R. I. & P. Ry., 294 U. S. 648, 678-9 (1935).

41. Continental Illinois Nat. Bank & Trust Co. v. Chicago, R. I. & P. Ry., 294 U. S. 648, 682-4 (1935). "If the petition is . . . approved, the court in which such order is entered shall, during the pendency of the proceedings under this section and for the purposes thereof, have exclusive jurisdiction of the debtor and its property wherever located . . ." Section 77(a) of the Bankruptcy Act.

42. It should be noted that since the *Rock Island* case the courts have tended to limit their jurisdiction in one respect by holding that a chose in action belonging to the debtor is not such "property" as to confer jurisdiction over the person of non-resident defendants. Bovay v. H. M. Byllesby & Co., 88 F. (2d) 990 (C. C. A. 5th, 1937); *In re* Standard Gas & Elec. Co., 30 F. Supp. 21 (D. Del. 1939); see (1940) 49 YALE L. J. 568.

43. Continental Illinois Nat. Bank & Trust Co. v. Chicago, R. I. & P. Ry., 294 U. S. 648, 681 (1935); *In re* Brown, 84 F. (2d) 433 (C. C. A. 7th, 1936); *In re* Hasie, 206 Fed. 789 (N. D. Tex. 1913).

44. *Cf.* Hiscock v. Varick Bank, 206 U. S. 28, 41 (1907).

administrative processes of reorganization, has uniformly been held to be a substantive right[45] that may not be interfered with by the court.[46]

The right to retain security until full satisfaction of the debt has, on the other hand, undergone some modification. In the exercise of the powers which enable it to include pledged collateral within a plan of reorganization,[47] the court may, upon approval and adoption of a plan allocating the security to the new corporation, order a turnover by the pledgee,[48] who then has recourse to his rights as an assenting or dissenting creditor.[49] But before the adoption of a plan,[50] the pledgee may still retain his security.[51]

The status of the pledgee's right to receive the income on his collateral and apply it to the principal or interest on the debt is not quite so clear. Since the problem is generally not one of vital importance to other parties, it has rarely been litigated; but what decisions there are appear to assume, without deciding, that courts may enjoin such application of income,[52] for permission is granted on the ground that the course of reorganization is not adversely affected.[53] Much the same may be said of the right to vote pledged stock, where it is expressly granted to the pledgee.[54] It is probable that both income and voting rights will be classified as "remedies" or mere incidental powers subject to the control of the reorganization court, whenever the paramount interests of the other creditors seem to call for an injunction against their exercise.

But while the above characteristics of the pledge have, because of their relative insignificance, for the most part escaped radical change up to the present time, the power of sale has, by virtue of the *Mississippi, Isaacs,* and *Rock Island* decisions, undergone considerable alteration. Under the pres-

45. Guaranty Trust Co. v. Henwood, 86 F. (2d) 347 (C. C. A. 8th, 1936), *cert. denied,* 300 U. S. 661 (1937).

46. See *In re* Utilities Power & Light Corp., 91 F. (2d) 598 (C. C. A. 7th, 1937) (trust indenture).

47. See note 34 *supra.*

48. FINLETTER, LAW OF BANKRUPTCY REORGANIZATION (1st ed. 1939) 149; *In re* Central Funding Corp., 75 F. (2d) 256 (C. C. A. 2d, 1935).

49. FINLETTER, LAW OF BANKRUPTCY REORGANIZATION (1st ed. 1939) Chapter VI; *cf.* Comment (1936) 46 YALE L. J. 116.

50. *In re* City Mortgage Co., 25 F. Supp. 784 (D. N. J. 1938).

51. There is some doubt, however, as to whether this is true of the collateral indenture trustee. Heuston, *Corporate Reorganization under the Chandler Act* (1938) 38 COL. L. REV. 1199, 1226-7; Isaac, *The Effect of the Chandler Act on Prior Proceedings and Possession* (1938) A2 CORP. REORG. AND AM. BANK. REV. 119, 123.

52. New Haven Proceeding, Memoranda on Orders Nos. 99 and 101 (D. Conn., May 28, 1937) Court Record, pp. 2671, 2674, and 2689, 2694-6.

53. New Haven Proceeding, Orders Nos. 99, 100, 101 and 102 (D. Conn., May 28, 1937) Court Record, pp. 2823, 2825, 2829, 4151; *cf.* the general statements on pp. 1048 and 2694 of the Record; Railroad Credit Corp. v. Hawkins, 80 F. (2d) 818 (C. C. A. 4th, 1936).

54. St. Louis-San Francisco Proceeding, Petition and Order No. 142 (E. D. Mo., Apr. 30, 1937) Court Record, pp. 2437, 2449.

sure of administrative necessity, and in order to meet the constitutional objections raised by pledgees, the courts long ago discovered that the power of sale was simply a "remedy"[55] which could be altered at will, despite the fact that the liquidity afforded by this power was perhaps the most important contractual feature bargained for by the commercial banks. Even in the case of a mere "remedy," however, there are certain rules limiting the issuance of the injunction, a fact which becomes apparent upon examination of several situations in which the sale of collateral might take place.

There is, for instance, the case where the holder is neither a pledgee nor creditor of the debtor in bankruptcy. This occurs where the collateral, owned by a third party who is perhaps an officer or subsidiary of the debtor, is pledged by him to secure his own debt to the pledgee. Despite the fact that it is not directly concerned in the transaction, the debtor may nevertheless be vitally interested in the securities pledged and in the parties to the agreement. Yet courts have in two such cases[56] refused to enjoin a sale by the pledgee, even though an injunction would in one case have made possible what was perhaps the only feasible plan of reorganization.[57] In each instance the court pointed out that no stay could be imposed where the debtor had no "property" or other "suitable interest" in the collateral.[58]

Property of the debtor of some kind, then, is necessary, but the term is at best ambiguous.[59] The most important interest the debtor will generally have in its collateral, from the viewpoint of dollar value, is an equity, and, as in the *Rock Island* case, this has been held sufficient to support an injunction directed against the sale of collateral held outside of the dictrict.[60]

55. See notes 43 and 44 *supra.*

56. *In re* Hotel Martin Co., 94 F. (2d) 643 (C. C. A. 2d, 1938). The bonds had been pledged by the president of the debtor corporation to cover his own obligations. See also *In re* Patten Paper Co., Ltd., 86 F. (2d) 761 (C. C. A. 7th, 1937).

57. *In re* Patten Paper Co., Ltd., 86 F. (2d) 761 (C. C. A. 7th, 1937).

58. *Cf. In re* Adolf Gobel, Inc., 80 F. (2d) 849 (C. C. A. 2d, 1936).

59. Cases outside of the field of pledge law amply illustrate this. The property of a debtor's subsidiary, for instance, does not become the debtor's "property" except where the interests of third parties are negligible. *In re* Adolf Gobel, Inc., 80 F. (2d) 849 (C. C. A. 2d, 1936); *cf. In re* Madison Mortgage Corp., 22 F. Supp. 99 (S. D. N. Y. 1937). The interest of the debtor as vendee under a contract of conditional sale poses a similar question. *In re* Hansen, 107 Fed. 252 (D. Ore. 1901); *In re* Burgemeister Brewing Corp., 84 F. (2d) 388 (C. C. A. 7th, 1936); *In re* Lake's Laundry, Inc., 79 F. (2d) 326 (C. C. A. 2d, 1935); see Pub. L. No. 785, 76th Cong., 3d Sess. (Sept. 18, 1940). For a treatment of more intangible interests, see *In re* Rosenbaum Grain Corp., 13 F. Supp. 601 (N. D. Ill. 1935) (membership in Chicago Board of Trade) and *In re* Avondale Farms Dairy, Inc., 25 F. Supp. 605 (E. D. Pa. 1938) (good will). Leasehold interests are also, to some extent, the subject of judicial protection, since the trustee may be given a reasonable time in which to adopt or reject a lease. 2 GERDES ON CORPORATE REORGANIZATIONS (1st ed. 1936) §§ 693-6. See note 42 *supra.* See also *In re* Diversey Bldg. Corp., 86 F. (2d) 456 (C. C. A. 7th, 1936) (third-party guarantor not protected from suit on debtor's obligations).

60. Continental Illinois Nat. Bank & Trust Co. v. Chicago, R. I. & P. Ry., 294 U. S. 648, 682-4 (1935).

But there will also be other rights in the collateral which could conceivably be termed such property as would support jurisdiction.[61] There is always an equity of redemption, the right of the debtor to redeem the collateral by payment of the debt. And there is also generally a right to vote pledged stock, which may in some cases prove to be an important interest. These are possibilities, but there are no cases in which they are actually held to be interests of the proper type. In view of the paucity of cases in point, therefore, it is not clear just what kind of an estate the debtor must have in the collateral before its sale may be restrained.[62]

But if there seems to be no definable rule in the doctrinal sense for a statement by the court that "property" is involved, and that consequently the issuance of an injunction lies within its "discretion,"[63] there are nevertheless several practical reasons for the maintenance of such stay orders. Each of these reasons is in fact a danger which the court seeks to avoid by the imposition of an injunction, and an investigation into the dangers to reorganization inherent in the liquidity of the pledge will probably yield a more satisfactory set of rules than one concerned purely with the legal conclusions announced by the courts.

In the first place, the collateral may have a very low market price, entirely out of proportion to what the court regards as its real value, with the result that an immediate sale will destroy a potential equity for the debtor, thus reducing the assets of the bankruptcy estate.[64] By enjoining a present sale, the court maintains the debtor's interest in the collateral, preventing the disappearance of the interest until the securities return to their "true" price. Another less important consequence of an untimely transfer may be the

61. The existence of the equity as the *basis* for injunctive power has not been mentioned since the *Rock Island* case, the courts preferring to treat the absence of an equity as an indication that a sale would not hinder reorganization. Merchants Nat. Bank v. New York, N. H. & H. R. R., 102 F. (2d) 923 (C. C. A. 2d, 1939); *In re* Prudence Company, Inc., 90 F. (2d) 587 (C. C. A. 2d, 1937).

62. In this connection, interesting hypothetical cases are presented by the situations where the party to be enjoined is (a) a pledgee of the debtor in bankruptcy, but one who possesses the security as collateral for the debt of a third party; or (b) a creditor of the debtor in bankruptcy whose loan is secured by the pledge of a third party. In the first case, an injunction would probably issue just as it does where the object of the stay is both pledgee and creditor of the bankrupt, since the pledgee could be termed a creditor of the bankrupt by virtue of his claim against the property pledged by the debtor. Chapter X, § 106(1), (4). In the second case, the problem is more difficult, since no property of the bankrupt, in the strict sense, is involved, although he has a definite interest in the price at which the security is sold. See *In re* Prudence Co., Inc., 12 F. Supp. 364, 368 (E. D. N. Y. 1935); *cf. In re* Prudence Co., Inc., 82 F. (2d) 755 (C. C. A. 2d, 1936).

63. Continental Illinois Nat. Bank & Trust Co. v. Chicago, R. I. & P. Ry., 294 U. S. 648, 677 (1935); *In re* Island Park Associates, Inc., 77 F. (2d) 334, 337 (C. C. A. 2d, 1935); Howland, *The Enforcement of Secured Creditors' Claims under 77 and 77B: A Functional Analysis* (1937) 46 YALE L. J. 1109; (1939) 6 U. OF CHI. L. REV. 690.

64. *In re* Prudence Co., Inc., 90 F. (2d) 587 (C. C. A. 2d, 1937).

creation of a large deficiency claim, to the detriment of the unsecured creditors.[65] Both of these dangers were aimed at by the injunctions under consideration in the *Prudence* and *Merchants National* cases,[66] discussed below.[67]

Often the collateral has a value to the debtor aside from what it will bring in after satisfaction of the secured debt. It may, for instance, consist of stock which carries with it a controlling interest in another corporation,[68] or the right to propose a plan in another reorganization.[69] In such a case it will often be essential to consummation of a plan that the reorganized debtor receive such collateral, and that the pledgee be given some other type of security in its stead.[70] A sale prior to the presentation and adoption of such a plan would of course frustrate such a substitution and perhaps handicap the new company from the start.

And finally, where the debtor has pledged its own obligations, as in the *Rock Island* case, a continuing increase in the outstanding indebtedness, due to sales of the collateral from time to time, will complicate bargaining and increase the net insolvency of the corporation, perhaps making it impossible for junior interests to participate without supplying new money.[71] If the debt is well secured, the face value of securities allotted under a plan to the pledgee for his secured debt may fall far below that which would be allocable to the collateral if actually outstanding, despite the fact that the treatment of the claim in the two situations with respect to income should be comparable.[72]

These, then, are the considerations which impel courts to postpone the exercise of the power of sale. Balanced against them are the possibilities of injury to the pledgee.[73] Injunctions are vacated, for example, if the sale

65. Merchants Nat. Bank v. New York, N. H. & H. R. R., 102 F. (2d) 923, 925-6 (C. C. A. 2d, 1939); (1939) 25 VA. L. REV. 982.

66. See notes 64 and 65 *supra*.

67. See pp. 482-483 *infra*.

68. See plans approved by Interstate Commerce Commission, 233 I. C. C. 515-593, 540, 550, 576 (1939), 239 I. C. C. 7-155, 337-461, 653-746 (1940), and 240 I. C. C. 383-468 (1940).

69. Merchants Nat. Bank v. New York, N. H. & H. R. R., 102 F. (2d) 923 (C. C. A. 2d, 1939). See note 77 *infra*.

70. See Missouri Pacific Reorganization, 239 I. C. C. 7, 140 (1940). Under the plan there approved, the RFC is to receive securities issued by the reorganized railroad, in lieu of the secured note it now holds. Another type of treatment involves a new collateral note backed by the same pledged securities. New York, N. H. & H. Reorganization, 239 I. C. C. 337 (1940).

71. Continental Illinois Nat. Bank & Trust Co. v. Chicago, R. I. & P. Ry., 294 U. S. 648, 678-9 (1935); (1935) 35 COL. L. REV. 109, 111.

72. Swaine, *The Purchase by Railroads of Their Own Obligations*, (1940) 7 LAW & CONTEMP. PROB. 532; Friendly and Tondel, *The Relative Treatment of Securities in Railroad Reorganizations Under Section 77, id.* at 420, 435. But *cf. In re* Chicago & N. W. Ry., 35 F. Supp. 230 (N. D. Ill. 1940).

73. The pledgee will not be subjected to "irreparable injury," say the courts. *In re* Chicago & N. W. Ry., 18 F. Supp. 932 (N. D. Ill. 1936). In practice, this rule is just

will not endanger successful reorganization, or if the interests of other parties to the proceeding, and of administrative convenience, are equitably overshadowed by those of the secured creditor in question. In the *Prudence* case,[74] for instance, the debtor's equity had completely disappeared, along with any likelihood of its return. Reconstruction Finance Corporation, the pledgee, had been restrained from sale for some two years, during which time it had received less than one-half of the interest due on its note. Moreover, there was additional security in the form of a one million dollar guaranty by third parties, but it was expressly conditioned on the existence of a deficiency after realization by the RFC on its collateral. By the injunction, the pledgee found itself prevented from recovering on the guaranty, and deprived of a great part of its rightful control over the pledged securities. The court accordingly vacated the injunction, pointing out that a sale would take nothing out of the estate.

A comparable situation was presented in the *Merchants National*[75] case, decided two years later. There, the collateral consisted of slightly more than 10% of the capital stock of the Boston and Providence, whose property was operated by the debtor, the New Haven Road, under a lease from the Old Colony. Upon rejection of this lease by the trustees of the New Haven, the market value of the stock fell far below the amount of the loan it secured.[76] During this time, despite two attempts[77] on its part to have the stay lifted, the pledgee bank had been prevented from disposing of its rapidly dwindling security. The third attempt, however, proved successful, the court concluding, as in the *Prudence* case, that a sale would no longer deplete the assets of the estate. The consequent creation of a large unsecured claim for the deficiency was minimized in importance,[78] as was the debtor's voting interest in the stock, which had proved a major factor in the maintenance of the

about as effective as the oft-repeated dictum that an injunction will not be maintained for an indefinite period. *In re* Murel Holding Corp., 75 F. (2d) 941 (C. C. A. 2d, 1935); *In re* 235 West 46th Street Co., Inc., 74 F. (2d) 700 (C. C. A. 2d, 1935).

74. *In re* Prudence Co., Inc., 90 F. (2d) 587 (C. C. A. 2d, 1937).

75. Merchants Nat. Bank v. New York, N. H. & H. R. R., 102 F. (2d) 923 (C. C. A. 2d, 1939).

76. Between November, 1937, at which time the value of collateral exceeded the amount of the loan it secured, and the date on which the injunction was lifted, in 1939, the Boston and Providence stock fell from 90 to 20 on the Boston Exchange. New Haven Proceeding, Petition No. 281 (D. Conn., May 12, 1938) Court Record, p. 4355; see Merchants Nat. Bank v. New York, N. H. & H. R. R., 102 F. (2d) 923, 925 (C. C. A. 2d, 1939).

77. In both of its earlier decisions, the court was convinced that the preservation of the debtor's interest in the pledged stock was essential, since it might swing the vote on a question involving a new lease from the B. & P., or a merger with the B. & P., thus facilitating system reorganization in preference to "reorganization by dismemberment." New Haven Proceeding, Memoranda on Petitions for Orders Nos. 281 and 307 (D. Conn., July 19 and Sept. 22, 1938) Court Record, pp. 4615, and 4879, 4881-2.

78. Merchants Nat. Bank v. New York, N. H. & H. R. R., 102 F. (2d) 923, 925-926 (C. C. A. 2d, 1939).

injunction up to that time. Although the New Haven trustees considered the voting rights important, inasmuch as they gave the debtor the power to propose a plan in the reorganization of the Boston and Providence, the court felt that in the light of the complete lack of any equity, this interest was no longer sufficient to warrant a continued stay.

It seems, then, that if the pledgee's sale would in any way interfere with the preservation of values for the benefit of the reorganized debtor, or would greatly change the relative position of creditors, it will be prevented by an injunction which is lifted only when the collateral has lost most of its value. This presents a question in the light of the oft-repeated statement that the pledgee will not be enjoined in the exercise of his remedy unless he is to receive adequate compensation under the ultimate plan of reorganization;[79] for the treatment accorded him in the plan is governed largely by the value of the security underlying his debt.[80] If the pledged collateral declines in value during the proceedings, the share of the pledgee in the new company will probably diminish from what it would have been, had the valuation of his security been made at the time the injunction issued. And the exercise of his power of sale, the sole means by which he could have avoided this change in status, has been denied him by the reorganization court itself. The consequent effect of an injunction against sale, in such a case, would seem to raise grave doubts as to the fairness of the resulting plan to the less fortunate pledgee, under the doctrine stated in the *Boyd*[81] case and recently reiterated in *Case v. Los Angeles Lumber Products Co.*[82] A creditor whose debt was fully secured at the inception of reorganization proceedings would seem to have some claim to special treatment where his loss had in large part been due to the restraint imposed by the court for the benefit of other creditors.[83] But to the Interstate Commerce Commission, at least,

79. *In re* Prudence Company, Inc., 90 F. (2d) 587 (C. C. A. 2d, 1937); Security-First Nat. Bank v. Rindge Land & Nav. Co., 85 F. (2d) 557 (C. C. A. 9th, 1936); *In re* Murel Holding Corp., 75 F. (2d) 941 (C. C. A. 2d, 1935); *In re* 235 West 46th Street Co., Inc., 74 F. (2d) 700 (C. C. A. 2d, 1935).

80. Friendly and Tondel, *The Relative Treatment of Securities in Railroad Reorganization Under Section 77,* (1940) 7 LAW & CONTEMP. PROB. 420.

81. Northern P. R. R. v. Boyd, 228 U. S. 482 (1913). This rule of strict priority is in large measure adhered to by the Interstate Commerce Commission, in its approval of plans of railroad reorganization. Missouri Pacific R. R. Reorganization, 239 I. C. C. 7, 116 (1940) and instances there cited.

82. Case v. Los Angeles Lumber Products Co., Ltd., 308 U. S. 106 (1939), (1940) 49 YALE L. J. 1099. See Dodd, *The Los Angeles Lumber Products Company Case and Its Implications* (1940) 53 HARV. L. REV. 713.

83. See the objections raised by the Bank of Manhattan Company and the Merchants National Bank of Boston to the plan of reorganization approved by the I. C. C. for the New York, N. H. & H. R. R. Each of these banks had been fully secured at the beginning of the proceedings, and each was prevented by the injunction from selling its collateral when it began to decline in value. The I. C. C. declined to treat either as a fully secured creditor, pointing out that all secured creditors alike had been forced to

the *Boyd* case seems in such a situation to present no problem, the possible diminution of securities allocable to all creditors appearing to it a more inequitable result than the loss occasioned by a decline in the security of one.

Even assuming, however, that the rule laid down in the *Boyd* case is satisfied by such treatment of the more unfortunate pledgees, on the ground that all are equally deprived of freedom of sale, a far more serious question is presented by one of the provisions in the Transportation Act of 1940.[84] The RFC is given the power by Section 331(b) to sell its collateral during reorganization proceedings, free from any judicial interference.[85] Moreover, the provision is retroactive in operation, in that it applies to all collateral loans made by the RFC at any time in the past to any railroad not now in reorganization.[86]

Inasmuch as the "remedy" of sale can be used by a pledgee as a method of avoiding the unfavorable treatment accorded an ill-secured creditor under most reorganization plans, the RFC will thus be able, by judicious sale, to obtain better treatment for its claims than will other creditors. It is to be doubted whether the constitutionality of the provision can be attacked simply on the ground that it will in some cases effect a "retroactive" change in the rights of creditors, *inter se,* to participate in the distribution of new securities.[87] A sounder approach would seem to be one that questioned the

take a chance on their collateral. New York, N. H. & H. R. R. Reorganization, 239 I. C. C. 337, 413-418 (1940).

84. Pub. L. No. 785, 76th Cong., 3d Sess. (Sept. 18, 1940); see C. C. H. Federal Carriers Service ¶ 13413 (1940).

85. ". . . the title of any owner of a collateral note evidencing a loan from the [RFC] to a railroad not now in receivership or involved in proceedings under Section 77 of the Bankruptcy Act, or a receiver or trustee thereof, and the right of any such owner to acquire title to the collateral securing such note, free and clear of any equity of redemption, in compliance with the contract of pledge, and thereafter to deal with the same as the absolute owner thereof, shall not be affected, restricted, or restrained by or pursuant to the provisions of the [Bankruptcy Act], as amended, or by or pursuant to any other provision of law applicable to any proceedings thereunder." Section 331(b) of the Transportation Act of 1940, cited *supra* note 84. This section, together with the rest of Title III, Part III, is enacted as an amendment to the Reconstruction Finance Corporation Act, 47 STAT. 5 (1932), 15 U. S. C. § 601 *et seq.* (1934).

86. One of the bills sponsored by the RFC, S. 2956, simply referred to loans "heretofore or hereafter made" by RFC, with the result that the RFC would have received a power of sale even in present reorganizations. See *Hearings before Committee on Interstate and Foreign Commerce on H. R. 2531 and H. R. 4862,* 76th Cong., 1st Sess. (1939) 1770 (hereafter to be cited as *Hearings on H. R. 2531*), and Swaine, *The Purchase By Railroads of Their Own Obligations* (1940) 7 LAW & CONTEMP. PROB. 532, 538. S. 2009, as finally passed, applies to loans made at any time in the past, to any railroad not in receivership or Section 77 reorganization on the effective date of the statute.

87. It is interesting, in this connection, to note that § 77(j) of the Bankruptcy Act, enacted in 1935, had retroactive effect in that it secured to the owners of equipment trust certificates the free exercise of their contractual remedies. It can be argued that the

constitutionality of the provision in that it permitted unequal treatment to creditors whose claims were essentially similar. That is, it can be argued that the RFC is classified advantageously, without any justification, and that this violates a corollary of the *Boyd* doctrine that all creditors with similar claims are entitled to similar treatment.

There can be little doubt as to the existence of a discriminatory classification, for the provision clearly advances the RFC ahead of other lenders holding similar security. In the case where the RFC holds non-system securities, for instance, it may under Section 331(b) choose the best time for a sale, thus avoiding the loss attendant upon a decline in collateral. Private agencies are, on the other hand, still required to accept the chance of such decline. If their collateral dwindles, they are faced with the same prospect as the banks in the New Haven reorganization discussed above.[88] It is quite possible that the effect of the new statute may be such as to compel the ICC to make more generous provision for such creditors, for its most convincing argument, that all pledgees had been equally deprived of their remedies, would now be inapplicable.

An even more serious situation is presented where the collateral held by the RFC consists of obligations of the debtor itself, for in such a case it can sell them to itself, proving a claim as outright owner of the pledged securities, and also as an unsecured creditor to the extent of any deficiency, while private lenders may only prove to the extent of their notes. By selling the pledged bonds to itself, moreover, the RFC becomes entitled to a share in their underlying security, with the result that the value of the other bondholders' claims may be proportionately reduced.[89] Here, then, two types of senior creditor are adversely affected, to say nothing of those junior

remedy is so important to the substantive rights involved, that § 77(j) really changed the rights of creditors *inter se* after they had vested. There seems to have been no litigation on this point, however, nor any respecting a similar provision in § 703 of the Chandler Act [52 STAT. 939 (1938), 11 U. S. C. § 1103 (Supp. 1939)] securing the remedies of the United States as a creditor under a preferred ship mortgage. The RFC argued by analogy to these two provisions, pointing out that it simply desired similar treatment. *Hearings on H. R. 2531* (1939) 1783, 1787, 1789.

88. See note 83 *supra*.

89. The practical result, in a reorganization, is that holders of the same classes of bonds which originally secured the note held by the RFC will after sale by the RFC receive a smaller proportion of the reorganization securities allocable to their issue of bonds. Moreover, where the RFC proved its note, in former times, the securities allocated to the system collateral securing the note were generally kept equal to the note in face value. If $20,000,000 of new securities were allocable to the system collateral securing a note for $10,000,000, the ICC would generally in such a case give only $10,000,000 in new securities to the RFC, although compensating for the low figure by raising the proportion of fixed interest bonds. Friendly and Tondel, *The Relative Treatment of Securities in Railroad Reorganizations Under Section 77*, (1940) 7 LAW & CONTEMP. PROB. 420, 435; see plan approved in Missouri-Pacific Reorganization, 239 I. C. C. 7-155 (1940), where holders of collateral loans receive no more than 100% of the note value in new

parties who must make room for a new unsecured claim based on a deficiency.

It can be argued, on the other hand, that the RFC would obtain no better treatment after a sale to itself of the debtor's pledged mortgage bonds than it does as a noteholder, because its greater face amount in bonds is offset by its loss of a strong position as a short-term loan pledgee. But even assuming that to be true, the power of sale gives the RFC a fine strategic position, for if at any time it feels that it may be better off as a bondholder than as a collateral noteholder, it is free to make the change. This very freedom of action would in itself seem a substantial advantage.

If there is, then, a discriminatory classification as to treatment, it is probably unfair and unconstitutional under the *Boyd* doctrine,[90] unless it can be justified on broad grounds of policy. There would seem to be at least two arguments favoring such a classification. In the first place, the RFC advanced its loans as "rescue money" to keep railroads out of reorganization at a time when private agencies could not or would not help them. The character and purpose of the loans might therefore furnish one plausible ground for distinction. In the second place, it can be pointed out that the RFC has lent Government money, and that the Government is commonly given preferences in reorganizations. Other arguments are that the holders of equipment trust certificates have much the same sort of priority in railroad reorganizations, and that the funds of the RFC must

securities; Erie Reorganization, 239 I. C. C. 653, 724 (1940). But *cf. In re* Chicago & N. W. Ry., 35 F. Supp. 230, 241-243, 247-249 (N. D. Ill. 1940). The limitation on allocable face value was made possible by the fact that the injunction against sale kept the actual provable claim of the RFC down to the amount of the note, $10,000,000. And it tended to prevent inflation of the new capital structure. But under Section 331(b), the RFC will be able to buy in its collateral, which may, though selling below $10,000,000 in the market, have a face value three times that of the note. In such a case the debt of the railroad will become $30,000,000. And furthermore, if the market value of the collateral is only $6,000,000, the RFC has a deficiency claim against the railroad for another $4,000,000, making the railroad's total debt $34,000,000 instead of $10,000,000. The reorganization securities allocable to the collateral, once it has been sold in this fashion, cannot be limited in face value as they are when it is still pledged. As a result, the new capital structure must be inflated unless some additional junior class contributes money or is squeezed out. The fears voiced by the court in the *Rock Island* case will thus come true with a vengeance, unless, in the eyes of the RFC, the railroads make an about-face and "cooperate." *Hearings on H. R. 2531,* (1939) 1785-1786.

90. The *Boyd* doctrine would seem to demand, not only that senior creditors be satisfied before their juniors, but also that the members of each senior class be given equally fair treatment within the class. But the full meaning of the doctrine is not yet clear. See Rostow and Cutler, *Competing Systems of Corporate Reorganization: Chapters X & XI of the Bankruptcy Act* (1939) 48 YALE L. J. 1334, 1345-1362; Comment (1940) 49 YALE L. J. 881, 882, 890; 2 GERDES, CORPORATE REORGANIZATIONS (1st ed. 1936) 1682; FINLETTER, LAW OF BANKRUPTCY REORGANIZATION (1st ed. 1939) 463-468; MOORE'S BANKRUPTCY MANUAL (1939) 584; *cf.* Southern Pac. Co. v. Bogert, 250 U. S. 483 (1919).

be kept liquid if it is to fulfill its function of short term financing. Altogether, these arguments seem to furnish a fairly sound basis for the difference in treatment, with the result that the statute will probably be upheld.

This leaves the possibility that courts may seek in some way to counter the statute by equalizing the treatment accorded the RFC and private agencies. There are logically, perhaps, three different procedures by which the claims of the banks could be restored to virtual parity with those of the RFC. The first, and probably the only feasible one, would consist of a judicial construction limiting the operation of the act to non-system collateral held by the RFC. This might be grounded on the theory that the sale of the debtor's obligations would clearly result in an inequitable distribution under the ensuing plan, at least where creditors had had no notice, when making their loans, of the favored position to be accorded the RFC.[91] Considerations of public policy seem to lend at least as much support to such a limitation as they do to the argument that the entire provision is constitutional in its operation.[92]

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91. But in this connection it can be argued that a consideration of the equities of the distribution involves, *inter alia*, the equity jurisdiction of the bankruptcy courts conferred in Section 2a of the Bankruptcy Act. Any injunction against the sale of system securities might therefore, if made on the ground of future inequitable distribution, be "pursuant to" a provision of the Act.

92. The general purpose of the RFC amendments is that the RFC may, with the approval of the ICC, "aid in the financing, reorganization, maintenance, or construction of a railroad." H. R. REP. No. 1217, 76th Cong., 1st Sess. (1939) 9. A more specific aim is the reduction of fixed charges of railroads through replacement of high-interest obligation by low-interest collateral loans from the RFC. *Hearings on H. R. 2531* (1939) 1773–1774. But the ICC must approve each loan as to security, and the injunction against sale makes the loan less desirable, thus initially more difficult to justify as secured. *Hearings on H.R. 2531* (1939) 1786. The RFC therefore claims that the statute will permit it to lend more frequently, since it safeguards public funds advanced as rescue money when private lenders did not act. *Hearings, supra*, p. 1787. And in this way the general aims of the statute are furthered. But against this there is the objection, in the case where system securities are pledged as collateral, that the RFC obtains a certain advantage over the debtor and its other creditors. *Hearings, supra*, p. 1633. This will inevitably discourage private investors, and unless the RFC were prepared to take over the whole program itself, the consequent lack of attractiveness of railroad security, to private capital, might conceivably prevent realization of the purposes of the Act. The RFC is as much interested in encouraging private capital, provided it lends on terms the RFC considers beneficial to industry, as it is in helping the railroads. *Hearings, supra*, p. 1767. And since it can certainly stand such injunctions much better than private capital, and never considered the anti-injunction provision very important anyway, a construction of the statute limiting its operation to non-system collateral would seem eminently sound. *Hearings, supra*, p. 1785. In a sense, such a construction would bear with it a certain poetic justice, since Messrs. Jones and Clay seem in their testimony before the House Committee to have stressed examples in which non-system collateral is pledged, but—whether for lack of time or some other reason—sedulously avoided discussing the effect on private lenders of a collateral sale in which the RFC issues and buys up several million dollars in mortgage

A second method would involve a liberal treatment of the claims of the less favored pledgees. If they were permitted to receive all of the new securities allocable to their system collateral, regardless of the amounts called for by their notes, and were allowed to prove their non-system collateral at the highest market value it had attained since the original imposition of the injunction, their position would again be as good as that of the RFC.[93] But the inflation of senior claims resulting from such treatment might be held a violation of the *Boyd* doctrine with regard to the rights of the junior classes, since it would greatly diminish the amount of securities allocable to them under any sound plan.[94]

There is last of all the logical possibility of a method based on neutralization of the RFC's advantages by discrimination against it in the resulting plan. It is exceedingly doubtful, however, whether the RFC could legally be required, after it had become the owner of the bonds, to take less than other similarly situated bondholders.[95] And as a practical matter such a course would have little to recommend it, since the RFC today furnishes much of the new money often so vital to the success of a reorganization.[96] How the courts will meet the problems apparently posed by the *Boyd* doctrine, or whether they will raise them at all, presents what is perhaps the most important question that has arisen since that solved in the *Rock Island* decision five years ago.

Aside from this one question, the restriction on sale has undoubtedly benefited all parties concerned in reorganization. At the time of the *Rock Island* case, some objections were raised to the possible effect of this type of stay order.[97] While it is difficult to determine, for instance, whether short term credit has fallen off because of the loss in liquidity of the collateral loan, or whether the administrative costs of reorganization have in-

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bonds of the debtor in reorganization. *Hearings, supra,* pp. 1783, 1784, 1785, 1788. But see *id.* at p. 1765. See in general Swaine, *The Purchase By Railroads of Their Own Obligations,* (1940) 7 LAW & CONTEMP. PROB. 532, 538–539.

93. That is, they would have all the advantages which the RFC could obtain from a sale. For an indication as to how such treatment might be accomplished, see *In re* Chicago & N. W. Ry. Co., 35 F. Supp. 230, 241–243, 247–249 (N. D. Ill. 1940).

94. This is true, of course, because of the ICC's application of the *Boyd* doctrine in giving senior classes 100% paper satisfaction before providing to junior claims, and because the total capitalization of the new corporation is a fixed figure. Friendly and Tondel, *The Relative Treatment of Securities in Railroad Reorganizations Under Section 77* (1940) 7 LAW & CONTEMP. PROB. 420, 422–427. Compare, however, the discussion in note 83 *supra* and accompanying text.

95. This presents the *Boyd* problem in a new light, with the RFC invoking the doctrine. See note 90, *supra.*

96. Note, for instance, the treatment accorded the RFC in the Western P. R. R. Reorganization, 233 I. C. C. 409, 414 (1939).

97. Howland, *The Enforcement of Secured Creditors' Claims Under 77 and 77B: A Functional Analysis* (1937) 46 YALE L. J. 1109. See Rapkin, *Power of Courts to Restrain Sale of Pledged Collateral* (1937) 21 MARQ. L. REV. 195.

creased out of all proportion to the gain resulting from a preservation of the debtor's interest in the pledged securities, the relative disappearance of these objections from current legal literature would seem to indicate that the fears giving rise to them have not been realized. And another prophecy, that the loss by the pledgee of his threat to sell would result in greater delay in reorganization,[98] does not seem to have been borne out in the case of railroads, at least, if the rate of approval of plans by the Interstate Commerce Commission[99] is any index to reorganization speed.

98. Where the pledgee could threaten a sale, the debtor and others concerned were wont to hasten the progress of the proceedings, as they had much to lose by such a disposition. Today, on the other hand, the debtor has little to lose by his delay, in that direction. Indeed, courts have questioned whether excessive delay is ever a ground for vacating a restrictive injunction. *In re* Chicago & N. W. Ry. Co., 18 F. Supp. 932, 935 (N. D. Ill. 1936).

99. Dembitz, *Progress and Delay in Railroad Reorganizations Since 1933*, (1940) 7 LAW & CONTEMP. PROB. 393, 416.