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CHAPTER XV OF THE BANKRUPTCY ACT—AN AMERICAN ADAPTATION OF THE FAIT ACCOMPLI

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THAT the advantages of the *fait accompli* as a means for achieving a desired result are appreciated in this country as well as abroad is apparent from an examination of the procedure for Railroad Adjustments presented in Chapter XV added to the Bankruptcy Act by the latest of the so-called Chandler Acts.¹

While Chapter XV under its terms is to have a life span of only one year,² inasmuch as the business depression is only one of several important reasons for the present plight of the railroads³ it may be assumed that there will be strenuous activity on behalf of its extension. To the small group of reorganization counsel who conceived its terms and successfully fostered its enactment,⁴ it is certain to be a success even though no plan other than that of the Baltimore and Ohio Railroad becomes operative under its provisions.⁵

It will be a success in the eyes of its sponsors if for no other reason than that the B. & O. will not be in the process of reorganization and will be

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¹ Pub. L. 242, 76th Cong. 1st Sess. (Approved by the President, July 28, 1939).

² § 755: "The jurisdiction conferred upon any court by this chapter shall not be exercised by such court after July 31, 1940, except in respect of any proceeding initiated by filing a petition under section 710 hereof on or before July 31, 1940."

³ See 202 ICC 347, 351 (1934); Clay, What Shall We Do about the Railroads? c. II, p. 4 (Ransdell 1939).

⁴ See S. Hearings on H.R. 5407, 76th Cong. 1st Sess., at 92, 114 (1939).

⁵ As of January 1, 1940, four roads have submitted plans to the ICC for action under Chapter XV: the B. & O. R. Co., ICC Finance Docket No. 12150; the Lehigh Valley R. Co., ICC Finance Docket No. 12283; the Montana, Wyoming & Southern R. Co., ICC Finance Docket No. 12517; and the Chicago Memphis & Gulf R. Co., ICC Finance Docket No. 12663. The first two submitted their plans prior to the enactment of Chapter XV.

insulated and protected therefrom for some few years to come, an example of what can be accomplished by utilizing the machinery provided.

With agitation for its extension in prospect, and because of the influence it may have on general reorganization machinery and legislation, it becomes desirable to examine this new streamlined procedure for meeting railroad corporate financial crises, to assimilate it with existing procedures and to evaluate it in the light of desirable railroad and reorganization policy.

PROCEDURE UNDER CHAPTER XV

Most recent corporate reorganization legislation⁶ has been designed to provide stockholders, creditors, the court and any governmental agency participating therein with full opportunity to examine the corporation involved and all proposals for its rehabilitation without pressure or influence on behalf of any interested party or group of parties. Chapter XV, however, presents a reversal of that trend. Under its provisions, as will be seen, there is only one plan and that plan is a virtual *fait accompli* before being presented to the only two disinterested agencies having any jurisdiction over it, the Interstate Commerce Commission and the court.

The machinery is set in motion by the management of a railroad faced with interest or principal maturities which it is unable to meet, in other words, a railroad insolvent in the equity sense. To avoid an equity receivership or Section 77 proceedings the management devises a so-called "plan of adjustment"⁷ which by definition may propose "postponements or modifications of debt, interest, rent, and maturities and modifications of the securities or capital structures."⁸ In spite of the scope of this language, it is quite apparent from the act that no plan affecting equity securities is contemplated, for no machinery is provided under which stockholder acceptance of a plan could be obtained.⁹ For this reason as well as for the practical reason discussed later that sufficient assents to meet the percentage requirements of Chapter XV could probably not be obtained to any plan modifying the position of stockholders, it seems quite clear that no so-called "drastic" reorganization plan will be effected pursuant to the provisions of this chapter.

The management's distress plan having been formulated, it is next presented to all affected creditors in as persuasive terms as the proxy regu-

⁶ § 77 as amended (11 U.S.C.A. § 205 (1937)); § 77B as amended (11 U.S.C.A. § 207 (1937)); and Chapter X (52 Stat. 883 (1938), 11 U.S.C.A. §§ 501-676 (Supp. 1938)) of the Bankruptcy Act.

⁷ § 710 (1).

⁸ § 705 (7).

⁹ § 706, relating to persons affected by the plan, refers only to "creditors." So too do §§ 710 (1), (3), and 725 (2), which relate to acceptances of the plan.

lations of the Securities and Exchange Commission will permit.¹⁰ When "creditors holding at least 25 per centum of the aggregate amount of all claims affected by said plan of adjustment" have signified their acceptance of the plan,¹¹ it may be submitted to the Interstate Commerce Commission for consideration under Section 20a of the Interstate Commerce Act.¹² The Commission in acting on the application of the B. & O. under Section 20a held that it was not required "to approve the plan as such."¹³ Further, Chairman Eastman in a letter to Senator Wheeler pointed out that the commission was in doubt as to whether the language of Chapter XV as passed by the House of Representatives required its approval of the basic merits and fairness of the plan.¹⁴ Presumably to clarify the commission's functions in this respect, the act requires it to make certain specific findings.¹⁵ These include findings:

- a) That the railroad is not in need of reorganization of the character provided for by Section 77;¹⁶
- b) That the road's inability to meet its debts is reasonably expected to be temporary only;¹⁷
- c) That the plan, after due consideration of the railroad's earnings prospects in the light of its earnings experience and reasonably expected charges:
 - (i) is in the public interest and in the best interest of each class of creditors and stockholders;
 - (ii) is feasible, financially advisable, and not likely to be followed by insolvency or by need of reorganization;
 - (iii) does not provide for fixed charges in excess of what probable future earnings will adequately cover;
 - (iv) leaves adequate means for such future financing as may be requisite;
 - (v) is consistent with adequate maintenance of the property; and
 - (vi) is consistent with the proper performance by the railroad of its functions as a common carrier.¹⁸

Whether these required findings indicate a Congressional intent that the commission examine the fairness of the plan would appear to be an

¹⁰ See SEC Regulation X-14, as amended February 15, 1940, promulgated pursuant to the authority conferred by § 14 (a) of the Securities Exchange Act of 1934, 48 Stat. 895 (1934), 15 U.S.C.A. § 78n (a) (Supp. 1938).

¹¹ § 710 (1).

¹² 41 Stat. 494 (1920), 49 U.S.C.A. § 20a (1929).

¹³ B. & O. R. Co. Financial Readjustment, 230 ICC 243, 266 (1938).

¹⁴ Hearings, op. cit. supra note 4, at 186, 189.

¹⁵ By virtue of the second proviso of § 710 (2), however, the B. & O. and Lehigh Valley plans are not subject to this requirement. Whether the proviso is within the power conferred upon Congress by Art. I, § 8, cl. 4 of the Constitution, to establish "uniform laws on the subject of bankruptcies throughout the United States" is an interesting question. See *In re Sink*, 27 F. (2d) 361 (Va. 1928); *In re Davis*, 13 F. Supp. 221 (N.Y. 1936).

¹⁶ § 710 (1) (a).

¹⁷ § 710 (1) (b).

¹⁸ § 710 (1) (c).

open question. While the commission is to find that the plan "is in the public interest and in the best interest of each class of creditors and stockholders,"¹⁹ the court, after duplicating all the commission findings, must also be satisfied "that the plan is fair and equitable as an adjustment, affords due recognition to the rights of each class of creditors and stockholders and fair consideration to each class thereof adversely affected, and will conform to the law of the land regarding the participation of the various classes of creditors and stockholders. . . ."²⁰

Whether this difference was intentional or is merely a fortuitous result of the inevitable trading and compromise in every Congressional conference will probably never be determined, but, as a result, the powers and duties of the commission with respect to the fairness of the plan are as uncertain as before.²¹

The proceedings before the commission present the first instance where the *fait accompli* will play an important role. Chairman Eastman in his aforementioned letter to Senator Wheeler also pointed out that the commission in the past has been and in the future is likely to be influenced in its deliberations with respect to a plan by the fact that much time and money have been spent on its preparation and that consents thereto have been obtained from a substantial number of the interested parties.²² As first introduced, Chapter XV required no minimum or maximum number of acceptances before submission to the commission,²³ so that the degree of pressure resulting from this factor was a matter solely within the control of the management of the railroad involved. The plan could have been submitted before any solicitation of assents so that commission consideration would have been comparatively free from this influence or the management could have waited until a large percentage of the parties affected had been induced to accept it.²⁴ The original provisions referred to have been changed in two ways. Submission to the commission must now wait until holders of at least twenty-five per cent of the affected

¹⁹ Ibid.

²⁰ § 725 (3).

²¹ That the sponsors of Chapter XV did not desire commission examination of the fairness of the plan is apparent from the letter of Col. Anderson, counsel for the B. & O., to Congressman Chandler in which he takes the position that the private interests as between the company and its creditors give rise to judicial questions that should not be considered by the commission. See H.R. Hearings on H.R. 3704 and H.R. 5704, 76th Cong. 1st Sess., at 88 (1939).

²² See Hearings, op. cit. supra note 4, at 186 et seq.

²³ See H.R. 3704, 76th Cong. 1st Sess., § 710.

²⁴ In this connection cf. § 77 (d) of the Bankruptcy Act, 11 U.S.C.A. § 205 (d) (1937), providing for commission and court consideration of any 77 plan before submission to creditors; § 176 of Chapter X of the Bankruptcy Act, 52 Stat. 891 (1938), 11 U.S.C.A. § 576 (Supp. 1938), prohibiting solicitation of assents to a Chapter X plan until after its approval by the court.

claims have indicated their acceptance of the plan, although there still is no maximum on the number of acceptances which the management may obtain before presenting the plan for commission consideration.²⁵ The other change is the inclusion of what appears to be a pious wish: "That in making the foregoing specific findings the Commission shall scrutinize the facts independently of the extent of acceptances of such plan and of any lack of opposition thereto."²⁶

While the commission is required to make the specific findings previously referred to, it apparently has no authority to modify the plan as presented.²⁷ This further limits the scope of commission action, for either it must make the requisite findings with respect to the plan as presented or refuse to issue its order and thereby nullify all the time, effort and money spent on the preparation of the plan, as well as on the acceptances previously obtained.

More persuasive upon the commission than either of the foregoing will be the fact that unless its approval is given to the plan as presented, the railroad involved will probably be thrown into reorganization or receivership proceedings. While a drastic reorganization may be exactly what the road in question requires, the economic consequences accompanying reorganization or receivership proceedings are so far-reaching that a government agency will be loath indeed to lay itself open to the charge that it was responsible for their initiation. An examination of the commission's opinion in the Baltimore and Ohio case reveals quite clearly how important a part this reluctance played in their deliberations. After pointing out that the B. & O. plan merely deferred the road's obligations without reducing them and that this was an important weakness, the commission nevertheless concluded:

The alternative [if commission approval were withheld] is clearly reorganization under the bankruptcy statute. In such a proceeding, security holders undoubtedly would be called on for much greater immediate sacrifices than this plan contemplates. Approval of the applications by us will make the option available to the parties interested.²⁸

Under the circumstances the commission granted the necessary authorization.

The commission has also faced this dilemma under slightly different

²⁵ At the time the B. & O. plan was presented to the commission, holders of over 30% of affected claims had agreed to accept the plan. See Hearings, *op. cit.* supra note 21, at 49.

²⁶ § 710.

²⁷ See § 710 which refers merely to the issuance of an order authorizing the securities called for by the plan.

²⁸ B. & O. R. Co. Financial Readjustment, 230 ICC 243, 266 (1938).

circumstances but with the same result. For example, Section 15 of the Emergency Transportation Act of 1933 prohibited the commission from approving an RFC loan to a carrier (a condition precedent to such a loan)²⁹ "if it is of the opinion that such carrier is in need of financial reorganization in the public interest" with the proviso that the prohibition does not apply to loans to receivers or trustees.³⁰ In addition, Section 5b (2) of the Reconstruction Finance Corporation Act contains a similar prohibition on the extension of RFC railroad loans and requires a certification by the commission "that the railroad or railway is not in need of financial reorganization in the public interest."³¹

Because many of the contemplated loans or extensions were desperately needed by the applicant railroads to enable them to meet maturities and thus avoid reorganization, the commission issued the certificates of approval required by the above sections in instances in which, judged from many standards, the railroad did require reorganization and in fact found it necessary to initiate reorganization proceedings within a few months of the date of the certificate and the RFC loan.

The Chicago & Northwestern Railway Company is a very striking example of how far the commission has been willing to go in the past to avoid any responsibility for the institution of reorganization proceedings.³² Between February 23, 1932 and September 29, 1934, the RFC with commission authorization lent the Northwestern approximately \$43,000,000 or at the rate of \$1,400,000 per month for the thirty-one months.³³ Within a week of the last of these loans,³⁴ the road applied for an additional \$7,500,000 and within a month the commission by division four authorized a further loan of \$4,138,000.³⁵ Commissioner Mahaffie who had dissented previously without an opinion³⁶ was moved to express his views on this occasion and said in part:

The applicant has failed to earn its fixed charges by \$6,034,124.70, \$11,216,820.37, and \$7,875,418.69, in the years 1931-33 respectively. In 1934 its deficit in net income

²⁹ See § 5 of the Reconstruction Finance Corporation Act as amended, 15 U.S.C.A. § 605 (1939).

³⁰ 48 Stat. 216 (1933), 49 U.S.C.A. § 265 (Supp. 1938).

³¹ 48 Stat. 1109 (1934), 15 U.S.C.A. § 606g (Supp. 1938).

³² Other striking examples include the Chicago, Milwaukee, St. Paul & Pac. R. Co., 202 ICC 597 (Dec. 17, 1934) which went into § 77 proceedings on June 29, 1935, and the Erie R. Co., 221 ICC 427 (May 25, 1937) § 77 proceedings for which were initiated January 18, 1938. For a further statement on this subject see S. Hearings Pursuant to S. Res. 71 (74th Cong.), 75th Cong. 1st Sess., pt. 13 at 5921 (1939).

³³ See 202 ICC 347 (1934).

³⁴ 202 ICC 267 (1934).

³⁵ 202 ICC 347 (1934). The application was submitted October 6, 1934, and approved October 17, 1934.

³⁶ See 202 ICC 267 and 271 (1934).

will apparently not differ greatly from that of 1933. Even those figures do not appear accurately to represent the situation in that had normal expenditures for maintenance been made the deficits shown would be larger. . . . *On the basis of present traffic and earnings the money now lent can hardly carry the property beyond May 1, 1935. . . .*

While I hope the majority proves correct, I am unable upon the facts before us to join in the findings.³⁷

Failure to authorize this loan which was used to meet unpaid vouchers, current and past due taxes, and interest due December 1, 1934, would inevitably have forced reorganization proceedings. So too would a refusal in April of 1935 to authorize the extension of the \$3,800,000 RFC loan maturing April 13, 1935,³⁸ yet the commission authorized both, with a finding in each case that the road was not in need of reorganization in the public interest. Less than three months later, however, on June 28, the Northwestern's petition under Section 77 was filed at Chicago.

Faced with the alternative of complete approval or complete rejection³⁹ the commission will almost certainly approve a voluntary plan accepted by at least twenty-five per cent of the interested parties,⁴⁰ particularly when its duties and authority are uncertain and when to refuse to do so will expose it to the charge of having precipitated reorganization of the carrier involved. In other words, it seems unlikely that the Interstate Commerce Commission will be in a position in Chapter XV proceedings materially to affect the character, terms, fairness or wisdom of the management plan.

From the commission, the plan next goes to court. As a prerequisite to filing the plan in the appropriate United States district court,⁴¹ the management must have obtained assents to the plan from creditors holding more than two-thirds of the aggregate amount of affected claims including a majority of each affected class.⁴² If it has not secured the required number of assents in response to its solicitations before and during commission consideration of the plan, commission approval will provide a persuasive additional argument for creditor acceptance.

Immediately following the filing of the petition, a special court of three judges is to be convened in the manner provided by Section 266, as amended, of the Judicial Code.⁴³ The special court, after hearing, is

³⁷ 202 ICC 347, 351 (1934) (italics added).

³⁸ 207 ICC 123 (1935).

³⁹ As indicated earlier, the commission apparently has no authority to amend a plan but must accept or reject it as presented. See § 710.

⁴⁰ See Hearings, op. cit. supra note 21, at 49.

⁴¹ In the language of the statute: ". . . the United States district court in whose territorial jurisdiction such railroad corporation has had its principal executive or principal operating office during the preceding six months or a greater period thereof. . . ."

⁴² § 710 (3).

⁴³ § 713.

promptly to enter an order approving the petition as properly filed if satisfied that it complies with the chapter and has been filed in good faith, or dismissing the petition if not so satisfied.⁴⁴

As introduced, Section 714 contained no reference to hearings in connection with the court's approval of the petition as properly filed.⁴⁵ As a result of a suggestion during the committee hearings,⁴⁶ the words "after hearing" were substituted for "upon convening" but no provisions with respect to notice of such hearing were included and so far as the statutory requirements are concerned the "hearing" may be purely *ex parte*.⁴⁷ This hearing may, however, be of considerable importance, for the court's jurisdiction depends, among other things, upon the requisite number of assents having been obtained, including a majority of each class. The determination of the validity of the segregation into classes, and of the accuracy of these and other required allegations should be made under circumstances affording full opportunity to all creditors desiring to be heard thereon.⁴⁸

In line with the rapid tempo of the entire proceedings, the special court is required by the statute to "fix a date for a hearing to be held promptly after the filing of the petition and notice of such hearing or hearings shall be given to all persons in interest in such reasonable manner as the court shall direct."⁴⁹

After the hearing, the court may either approve the plan as filed or modify the plan and approve it as modified.⁵⁰ Whether it may reject the plan and dismiss the proceedings is open to doubt. The authority, if it exists at all, does so by implication only, for there is no such express authority conferred by the statute.⁵¹

⁴⁴ § 714.

⁴⁵ See H.R. 3704, 76th Cong. 1st Sess., § 714 (1939).

⁴⁶ See Hearings, *op. cit. supra* note 21, at 52.

⁴⁷ In the B. & O. proceedings the hearing apparently was *ex parte*, for the petition was filed on July 28, 1939, and the order approving the petition was entered July 31, 1939. The 29th and 30th, incidentally, were a Saturday and Sunday. Apparently also no general notice of a hearing on the approval of the petition was given. In re B. & O. R. Co., 29 F. Supp. 608 (Md. 1939).

⁴⁸ Cf. §§ 141-9 of Chapter X of the Bankruptcy Act, 52 Stat. 887 (1938), 11 U.S.C.A. §§ 541-9 (Supp. 1938), providing for answer, notice and hearing in connection with the approval of the petition.

⁴⁹ § 720.

⁵⁰ § 721.

⁵¹ Cf. § 77 (e) of the Bankruptcy Act, 11 U.S.C.A. § 207 (e) (1937), and § 236 of Chapter X of the Bankruptcy Act, 52 Stat. 899 (1938), 11 U.S.C.A. § 636 (Supp. 1938). While § 727 of Chapter XV provides for dismissal of the proceedings if no plan is confirmed by the court within one year, there is no provision for earlier dismissal and this section is further susceptible of the limited interpretation that it relates only to confirmations delayed because of insufficient acceptances.

It is at this stage of the proceedings that the *fait accompli* is most effective, for the special court like the commission must make certain findings. If it finds:

1. That at the time of filing the petition, the plan had been assented to by holders of not less than two-thirds of the aggregate amount of affected claims and by a majority of each class;⁵²
2. That the plan as submitted or as modified by the court has been accepted in its final form by holders of more than three-fourths of all affected claims and at least three-fifths of each class;⁵³
3. That the corporation and the plan meet the requirements which the commission has already found that they do meet and in addition that the plan is fair and equitable as an adjustment, affords due recognition to the rights of each class of creditors and stockholders, gives fair consideration to each class thereof adversely affected and will conform to the law of the land regarding the participation of various classes of creditors and stockholders;⁵⁴
4. That all corporate action required to authorize the issuance or modification of securities contemplated by the plan has been taken;⁵⁵
5. That the petitioner has not done any act or failed to perform any duty as a result of which it would be barred from discharge as a bankrupt;⁵⁶ and
6. That, after hearings on the matter, all considerations paid or to be paid by or for the petitioner in connection with the proceedings and the plan are reasonable or will be determined by the court to be reasonable before paid;⁵⁷

the court is to file an opinion setting forth these findings and enter a decree approving and confirming the plan which decree shall bind all creditors of the petitioner whether or not they have approved the plan.⁵⁸ The only exception to the binding effect of the plan is with respect to owners of equipment leased or conditionally sold to the railroad.⁵⁹ This decree binding all parties to the so-called "voluntary" or management plan is, of course, the goal of the entire proceedings.

In connection with the findings required by clause (3) above, relating to the plan and the corporation, the act assumes the same attitude of piety adopted in connection with the commission's similar findings and provides:

That in making the findings required by this clause (3), the court shall scrutinize the facts independently of the extent of acceptances of such plan, and of any lack of opposition thereto, and of the fact that the Commission, under section 20a of the Interstate Commerce Act, has authorized the issuance or modification of securities as proposed by such plan, and of the fact that the Commission has made such or similar findings. . . .⁶⁰

⁵² § 725 (1).

⁵⁵ § 725 (4).

⁵⁸ § 725.

⁵³ § 725 (2).

⁵⁶ § 725 (5).

⁵⁹ Ibid.

⁵⁴ § 725 (3).

⁵⁷ § 725 (6).

⁶⁰ § 725 (3).

This provision like the earlier one relating to the commission findings⁶¹ is a result of the deliberations of Senate and House conferees and was not in the act as it originally passed either house. It discloses most strikingly the conferees' perception of some of the basic procedural deficiencies.

A brief glance at the court's position will lead almost inevitably to the conclusion that it is likely to have no more effect upon the management plan than has the commission. The court has before it a plan accepted by holders of more than seventy-five per cent of the interested claims and by at least sixty per cent of each class.⁶² In addition this plan has been approved with findings, though with disclaimers also perhaps, by the Interstate Commerce Commission, an agency with a large staff of railroad experts. Finally, and this is of great practical significance, much time and considerable money has been spent to bring the plan to the final stage of the procedure.⁶³ The *fait accompli* is complete.

With respect to this plan the court apparently has two alternatives: (1) to approve it as submitted or (2) to determine after necessarily difficult analyses what changes, if any, are desirable and to amend the plan in line with these determinations. The latter, in addition to the complicated study necessary to reach the determination will, if any material change is made, involve a repetition of virtually all the work already done and will require resolicitation of all affected creditors and resubmission to the commission. This will probably nearly double the cost to the railroad.

That these considerations do, as they inevitably must, weigh heavily in a court's consideration of a plan is apparent from an examination of Judge Chesnut's opinion in the B. & O. proceedings. Objection was raised in the proceedings by a security holder who is also a railroad economist, that the plan did not satisfy the provision of the Chandler Act requiring that "it is not likely to be followed by the insolvency of said corporation, or by need of financial reorganization or adjustment"⁶⁴ because it made no provision for 1944 principal maturities totaling approximately \$123,000,000. After a general discussion of the objection, in the course of which it agreed that meeting these maturities from excess earnings was most improbable

⁶¹ § 710.

⁶² Cf. § 77 (e) of the Bankruptcy Act, 11 U.S.C.A. § 207 (e) (1937), § 174 of Chapter X of the Bankruptcy Act, 52 Stat. 891 (1938), 11 U.S.C.A. § 574 (Supp. 1938), both of which provide for court approval of the plan before presentation to and acceptance by security holders.

⁶³ Up to July 1, 1939, the B. & O. had incurred about \$600,000 of expenses in connection with its plan. Inasmuch as substantial fees and expenses have been incurred since that date, it is not unreasonable to assume that the aggregate cost will exceed \$1,000,000. See *In re B. & O. R. Co.*, 29 F. Supp. 608 (Md. 1939).

⁶⁴ § 710 (2) (c) (ii). See also § 725 (3).

but finally concluded that refunding at that time might be possible, the court said:

In any event, as pointed out by the Interstate Commerce Commission, the inevitable alternative is reorganization under the Bankruptcy Act which, as has been pointed out, is highly undesirable in the interests of all classes of security holders. It is suggested that the plan might be modified, but modification in this respect would require re-submission to stockholders at very great additional expense and with uncertainty as to result. The suggested modification does not seem to us sufficiently definite and practicable to justify this expense and possible jeopardy of the plan.⁶⁵

Without delving too deeply into the substance of the B. & O. plan, the objection in question is a basic one. That the B. & O. with no substantial unpledged or unmortgaged assets will be able to meet these maturities, to say nothing of the maturity in 1948 of \$157,000,000 principal amount of first mortgage bonds, is open to very serious question. Yet the plan was approved as submitted by a court composed of three of the ablest members of the federal judiciary, Circuit Judge Parker and District Judges Chesnut and Dobie.

While the B. & O. plan is the only one which has so far proceeded to completion, in view of the character of the procedure set up by Chapter XV the result will apparently be the same with respect to other plans.⁶⁶ In addition to the specific provisions heretofore discussed which lead to that conclusion, the general tone of the entire statute leaves an indelible impression that its authors contemplated a speedy passage for the plan through commission and court with no alterations by either.

Without in the least disparaging either the commission or any three-judge court which might be selected, it seems highly unlikely that any Chapter XV plan involving a substantial number of creditors will be amended materially or rejected by either of them. The commission apparently has not the authority to amend and is not likely, as the previous discussion has indicated, to reject any plan presented to it. The court, on the other hand, has at best a doubtful authority to reject the plan, and for what appear to be overwhelming reasons is not likely either to attempt to reject it or to amend it materially.^{66a}

⁶⁵ *In re B. & O. R. Co.*, 29 F. Supp. 608 (Md. 1939).

⁶⁶ The Securities and Exchange Commission in its report to the Senate Committee on Interstate Commerce (Hearings, *op. cit. supra* note 4, at 61) concludes: "In substance, the effect of the bill appears to be to limit the courts to approving and confirming so-called 'voluntary' or management plans."

^{66a} Subsequently to the preparation of this material, the commission, on December 4, 1939, handed down its first opinion on a Chapter XV plan since the enactment of the Chapter, the plan being that of the Montana, Wyoming & Southern Railroad Co., *op. cit. supra* note 5. As anticipated herein, the plan was approved in the form presented although Commissioners

THE PLAN

In the foregoing discussion emphasis has been placed primarily on the procedure through which the plan will pass and very little has been said about the probable character of the typical Chapter XV plan. This is an equally important consideration, for unless these plans are likely to require amendment, the procedural weaknesses of the act are of little consequence.

While, of course, the capital structure of each road will govern the details of each plan, certain general characteristics may be pointed out which will be present in most Chapter XV plans.

First, it is most unlikely that any Chapter XV plan will affect stock interests. This is true for several reasons. As pointed out earlier, the statute makes no provision for effecting a plan involving stockholders.⁶⁷ Further, it is apparently contemplated that the plan will always be promulgated by the management,⁶⁸ and it will be in the best interests of the stockholders whom the management represents that no plan adversely affecting stock interests be presented. In addition, because stockholders have no present claim for anything which can be deferred or compromised, it will be difficult to present a plan touching stock interests unless it not only affects them adversely but does so without any present inducement for their agreement to the adverse treatment. Any such plan, of course, would probably never receive the requisite number of assents.⁶⁹

Mahaffie and Eastman dissented. A revealing segment of the majority opinion reads: ". . . The alternative to putting into effect the proposed plan is either receivership or bankruptcy. The plan of adjustment has been accepted by the holders of more than three-fourths of the aggregate amount of bonds affected by the plan, this being the only class of securities involved. We have scrutinized the facts relative to this application independently of the extent of the acceptance of such plan by the bondholders, and of the lack of any opposition thereto, and conclude that on the record here before us the authorization sought should be granted." This was followed by the findings required of the commission under Chapter XV. The dissenting commissioners, on the other hand, stated that the record did not justify a finding that the applicant's inability to meet its debts may reasonably be expected to be temporary only, or one that the plan is in the best interest of each class of creditors and stockholders. Supporting their first conclusion, they pointed out that the plan itself provides that the two per cent of the interest contingent on earnings is not to be cumulative. A clear implication from this is that the company does not expect to earn in the future the full five per cent which the bonds now carry. In support of their second conclusion, they cite the *Los Angeles Lumber Co.* case discussed later herein and conclude that the plan does not meet the standards of a "fair and equitable" plan asserted in that case.

⁶⁷ See §§ 706, 710 (1), (3), and 725 (2).

⁶⁸ See §§ 710, 725 (6). As a practical matter no one but the management will be in a position to undertake the expense of the preparation and presentation of a plan.

⁶⁹ This was the element to which Judge Chesnut referred in overruling the objection to the B. & O. plan previously referred to, on the ground that acceptance of the objection would

For these statutory and practical reasons, the plan will almost certainly be one in which stock interests are unaffected. In the four plans now in various stages of Chapter XV proceedings neither the interests of stockholders nor those of unsecured creditors are directly modified in any way.

Second, since the whole purpose of the plan is to avoid receivership or Section 77 proceedings, it will be necessary to provide for a substantial immediate reduction in fixed charges and for a postponement of impending principal maturities. In order to obtain the necessary acceptance of the plan, however, these reductions and postponements must either be temporary only or be balanced by some present inducement as, for example, a present cash payment. This means that Chapter XV plans are likely to follow one of two patterns. Either they will provide for complete or partial deferments with no substantial over-all or permanent reduction in principal and interest, or they will offer some present inducement for the reductions proposed.

The B. & O. plan illustrates the first type. It contains provision for both partial and complete deferments. Portions of interest on some issues will be fixed charges and paid currently while the unpaid portions of the interest made contingent will not be wiped out but merely deferred. In addition, some principal maturities are completely deferred. In presenting this plan to security holders it was strongly urged that, with one exception, it would not reduce their total claims and that therefore they would lose nothing by it in the long run. Added to this was the threat that if the plan were not accepted, the road would go into Section 77 proceedings, and "that such proceedings would be long and expensive, with resulting confusion and losses to security holders, and might result in a total suspension of all interest payments for an indefinite period."⁷⁰

Other plans involving mainly principal and interest deferments are those of the Lehigh Valley Railroad Co.⁷¹ and the Chicago, Memphis & Gulf Railroad Co., a leased line of the Illinois Central Railroad Co.⁷²

require submission of the modified plan to stockholders which would involve "uncertainty as to result" and "possible jeopardy of the plan." See *In re B. & O. R. Co.*, 29 F. Supp. 608 (Md. 1939).

⁷⁰ Plan of the B. & O. R. Co., dated August 15, 1938, ICC Finance Docket No. 12150. The material sent to security holders is also reproduced in *Hearings*, op. cit. supra note 4, at 117 et seq.

⁷¹ Dated August 25, 1938, ICC Finance Docket No. 12283. See also *Moody's Manual of Investments, Railroad Securities* 1672 (1939).

⁷² ICC Finance Docket No. 12663. The plan provides for extension of all the \$735,000 of first mortgage bonds of the road until December 31, 1962, which is the date the lease to the Illinois Central expires, and for the reduction of the interest on the bonds from 5% to 3%. This plan is particularly interesting because it provides for a permanent reduction in interest with-

The other and more attractive possibility which will be available to a limited number of roads only, however, is that of affecting a permanent reduction of either principal or interest or both by offering a present cash inducement. Such a plan has been promulgated by the Montana, Wyoming & Southern Railroad Co.⁷³ It proposes to meet the 1939 maturity of its only bond issue by paying bondholders \$150 in cash per \$1,000 bond and extending the balance of \$850 to 1949 with interest reduced from five per cent fixed to three per cent fixed and two per cent contingent. This will meet the principal maturity crisis and will reduce the fixed interest on the \$457,000 of bonds now outstanding from \$22,850 to \$11,653 or almost half, as well as reducing the principal amount of bonds outstanding to \$388,450.

A somewhat similar plan for the Boston and Maine Railroad Co. formulated with the assistance of the Reconstruction Finance Corporation was disclosed on November 9, 1939.⁷⁴ Under it holders of the outstanding \$103,833,000 of bonds bearing interest at from three per cent to five per cent and maturing at intervals from February 2, 1940 to September 1, 1967, all of which are issued under the Boston and Maine's sole mortgage will be asked to accept in exchange for their bonds new thirty-year four per cent income bonds for fifty per cent of their holdings and for the fifty per cent balance either cash or new twenty-year four per cent first mortgage bonds. Cash in an amount not to exceed \$26,000,000 will be furnished by the RFC which will take up to \$40,750,000 of twenty-year first mortgage bonds as security for \$14,750,000 of presently outstanding RFC loans plus such portion of the \$26,000,000 as is required. This plan, too, will both solve the problem of impending principal maturities and reduce interest charges, in this case, fixed interest, by almost \$3,000,000 per year and total fixed and contingent interest by almost \$1,000,000.⁷⁵

That the second type of plan, i.e., one involving a substantial and permanent reduction of either principal or interest or both, is limited to a comparatively small number of roads is apparent. Both of the roads

out offering any present benefit. Apparently its sponsors believe that the present level of interest rates generally and the undesirability of foreclosure proceedings will be sufficient inducement to bring in the required assets.

⁷³ ICC Finance Docket No. 12517.

⁷⁴ See Moody's Railroad Service 1295 (1939).

⁷⁵ While no specific mention of Chapter XV has been made in connection with the Boston & Maine plan, unless the creditors accept it unanimously or § 77 proceedings are initiated, the only way such plan can be made binding on all holders of the affected bonds is Chapter XV. Unless all holders are bound to the plan it will be necessary to purchase the bonds of "hold-outs" at a price far in excess of present market prices or continue to have outstanding small portions of a variety of issues bearing varying rates of interests and with varying maturities.

presently sponsoring such plans have single mortgages.⁷⁶ In this respect the Boston & Maine is unique among Class I railroads. In addition both roads either have cash or are in a position to obtain cash to be offered as a present inducement for accepting the reductions. The absence of either of the aforementioned factors greatly complicates devising a Chapter XV plan providing for substantial interest or principal reductions.

Another element of prime importance in considering the probable character of Chapter XV plans is what is familiarly known as the doctrine of the *Boyd* case.⁷⁷ Briefly stated that doctrine is "that stockholders cannot obtain through the medium of a reorganization anything of value except in subordination to the rights of creditors."⁷⁸ Whether the absolute priority rule of the *Boyd* case or a standard based on so-called composition principles governed the character of plans under Sections 77, 77B and, more recently, Chapter X of the Bankruptcy Act has heretofore been an unsettled question.⁷⁹

In the present term of the Supreme Court, however, that question has been determined. The Court, by Mr. Justice Douglas, has held that a plan of reorganization of a debtor clearly insolvent in both the equity and bankruptcy senses and with assets admittedly worth less than twenty-five per cent of the claims of bondholders is not "fair and equitable" within the language of Section 77B (f) of the Bankruptcy Act⁸⁰ if the plan allocates an interest in the securities of the reorganized corporation to stockholders of the insolvent one.⁸¹ That holders of 92.81 per cent of the face amount of the bonds had assented to the plan as well as holders of 99.75 per cent of the Class A stock, and ninety per cent of the Class B stock was held to be immaterial for, in the language of the Court, "the fact that the vast majority of the security holders have approved the plan is not the test of whether the plan is a fair and equitable one."⁸²

While the corporation involved in the *Los Angeles* case was admittedly insolvent in both the equity and the bankruptcy sense, the Court in

⁷⁶ See Moody's Manual of Investments, Railroads Securities 61, 515 (1939).

⁷⁷ Northern Pac. R. Co. v. Boyd, 228 U.S. 482 (1913). The Boyd case merely reaffirmed principles enunciated in both Chicago R. I. & Pac. R. Co. v. Howard, 74 U.S. 392 (1868) and Louisville Trust Co. v. Louisville, New Albany & Chicago R. Co., 174 U.S. 674 (1899).

⁷⁸ McCutcheon, An Examination of Devices Employed to Obviate the Embarrassments to Reorganizations Created by the Boyd Case, 8 Some Legal Phases of Corporate Financing Reorganization and Regulation 35 (1931).

⁷⁹ See Levi, Corporate Reorganization and a Ministry of Justice, 23 Minn. L. Rev. 3 (1938) and Spaeth & Winks, The Boyd Case and Section 77, 32 Ill. L. Rev. 769 (1938).

⁸⁰ 11 U.S.C.A. § 207 (f) (1937).

⁸¹ Case et al. v. Los Angeles Lumber Products Co., 60 S. Ct. 1 (1939).

⁸² Ibid., at 7.

adopting the sweeping language of the earlier full or absolute priority cases⁸³ made it quite clear that the rule was applicable regardless of the precise financial condition of the corporation involved.

Inasmuch as Section 77 (e),⁸⁴ Section 221 of Chapter X,⁸⁵ and Section 366 of Chapter XI,⁸⁶ of the Bankruptcy Act all apply the same standard of "fair and equitable," the decision means that reorganization plans under these sections henceforth must recognize that "to the extent of their debts creditors are entitled to priority over stockholders against all the property of an insolvent corporation"⁸⁷ and must accord "the creditor his full right of priority against the corporate assets."⁸⁸ Section 472 of Chapter XII⁸⁹ and Section 656 of Chapter XIII,⁹⁰ which also apply the "fair and equitable" standard, are, by analogy, also subject to the doctrine of the decision.

The effect of the *Boyd* and *Los Angeles* cases on Chapter XV plans presents an interesting question. In this connection it is first to be noted that while the other statutes referred to employ the words "fair and equitable,"⁹¹ Chapter XV requires that the plan be "fair and equitable as an adjustment."⁹² Any implication that Congress intended by the altered language to make the doctrine of the priority cases inapplicable, however, would appear to be negated by the subsequent provision that the plan is to be approved only if it "affords due recognition to the rights of each class of creditors and stockholders and fair consideration to each class thereof adversely affected, and will conform to the law of the land regarding the participation of the various classes of creditors and stockholders."⁹³ In addition, both Senate and House Committee reports on the bill⁹⁴ specifically state that the principles of the *Boyd* case apply and the Senate report in explaining why the words "as an adjustment" were

⁸³ See *Chicago R.I. & Pac. R. Co. v. Howard*, 74 U.S. 392 (1868); *Louisville Trust Co. v. Louisville, New Albany & Chicago R. Co.*, 174 U.S. 674 (1899); *Northern Pac. R. Co. v. Boyd*, 228 U.S. 482 (1913); *Kansas City Terminal R. Co. v. Central Union Trust Co.*, 271 U.S. 445 (1926).

⁸⁴ 11 U.S.C.A. § 205 (e) (1937).

⁸⁵ 52 Stat. 885 (1938), 11 U.S.C.A. § 521 (Supp. 1938).

⁸⁶ 52 Stat. 911 (1938), 11 U.S.C.A. § 766 (Supp. 1938).

⁸⁷ *Kansas City Terminal R. Co. v. Central Union Trust Co.*, 271 U.S. 445, 455 (1926).

⁸⁸ *Ibid.*, at 456.

⁸⁹ 52 Stat. 923 (1938), 11 U.S.C.A. § 872 (Supp. 1938).

⁹⁰ 52 Stat. 935 (1938), 11 U.S.C.A. § 1056 (Supp. 1938).

⁹¹ Notes 84-6, 89, and 90 *supra*.

⁹² § 725 (3).

⁹³ *Ibid.*

⁹⁴ S. Rep. 489, 76th Cong. 1st Sess., at 7 (1939), and H.R. Rep. 358, 76th Cong. 1st Sess., at 3 (1939).

added expressly negatives any implication that they were added to make the *Boyd* case inapplicable.⁹⁵

Assuming, then, that the principles of the *Boyd* and *Los Angeles* cases are applicable, what constitutes a "fair" Chapter XV plan within those principles? It would seem quite clear that a plan which reduced interest or principal claims of secured creditors without any present compensation therefor and did not touch the interests of unsecured creditors or stockholders would not be a fair plan. This was the conclusion of the legislative committee of the Interstate Commerce Commission expressed in the letter from its Chairman, Commissioner Eastman, to Congressman Sumners.⁹⁶

A closer question arises in connection with the deferment plans. Whether extending principal maturities of secured creditors and making the payment of their interest contingent on earnings, while not altering the rights of unsecured creditors or stockholders, is according to secured creditors that priority required by the *Boyd* and *Los Angeles* cases is open to serious doubt. The commission, in the letter previously referred to, expressed the opinion that deferment plans were the only type which a court could approve under Chapter XV, thus implying that such plans would satisfy the rule of the strict priority cases.⁹⁷ This statement was made, it should be noted, prior to the decision in the *Los Angeles* case which so vigorously affirms the principles of the *Boyd* case.⁹⁸

An open question too is whether the cash-reduction-deferment plans are adequate under the priority rule. If the plans providing no present payment meet the requirements, those providing for part payment of principal and deferment of the balance certainly should. As an indication of how little creditors are really receiving even in these most favorable plans, however, it is necessary only to compare the orthodox contract principle under which part payment in cash is no consideration for the extension of a matured claim.⁹⁹

If the Supreme Court should decide that neither straight deferment nor cash-reduction-deferment plans which leave unaltered the interests of unsecured creditors or stockholders meet the standards of the priority rule, Chapter XV in its present form would as a practical matter be a

⁹⁵ Ibid.

⁹⁶ Hearings, op. cit. supra note 21, at 83. In the light of this conclusion cf. the plan of the Chicago, Memphis & Gulf R. Co. outlined in note 72 supra.

⁹⁷ Ibid.

⁹⁸ Case et al. v. Los Angeles Lumber Products Co., 60 S. Ct. 1 (1939).

⁹⁹ See 1 Williston, Contracts § 120 (rev. ed. 1936).

nullity. The legal and practical limitations would make it virtually impossible to put through any plan under its provisions.

Since, however, in addition to the commission's abstract opinion, a three-judge court has found that one plan involving principally deferments satisfies the requirements of the *Boyd* case,¹⁰⁰ we may assume that until an adverse Supreme Court decision on the subject, deferment plans will continue to be proposed.

MISCELLANEOUS PROVISIONS

In addition to the basic provisions of the act heretofore discussed, there are a number of additional provisions which deserve comment.

The first of these is the provision that "nothing herein contained shall be construed to authorize the court to appoint any trustee or receiver for said properties or any part thereof, or otherwise take possession of such properties or control the operation or administration thereof."¹⁰¹ This provision is in direct contrast with the recent trend in reorganization legislation toward strengthening the jurisdiction of the court and requiring competent and disinterested trustees.¹⁰² If no trustee is appointed there necessarily will be no investigation into the past acts of the management which in some instances may be directly responsible for the insolvent condition of the corporation. Prohibition of the court's appointing a trustee or taking any control of or administering the property strengthens the conclusion that the court's function is intended to be limited to approving the management plan as presented.

Another indication of the non-stop character of the Chapter XV proceeding is that it apparently contemplates no organization of affected security holders into independent committees. This conclusion is apparent first, because in sharp contrast to other recent reorganization legislation,¹⁰³ no provisions with respect to such committees are included, and second, because the provision controlling the payment of fees relates only to "amounts or consideration, directly or indirectly paid or to be

¹⁰⁰ *In re B & O. R. Co.*, 29 F. Supp. 608 (Md. 1939), cert. den. by the Supreme Court January 29, 1940. The petitioner's brief surprisingly did not question the fairness of the B. & O. plan, however, so the denial of the petition casts little light on what constitutes a "fair" Chapter XV plan.

¹⁰¹ § 715.

¹⁰² Cf. § 77 (c) of the Bankruptcy Act, 11 U.S.C.A. § 205 (c) (1937) which requires the appointment of a trustee, and §§ 111-21, 156-8 of Chapter X, 11 U.S.C.A. §§ 511-21, 556-8 (Supp. 1938) requiring the appointment of one or more disinterested trustees in all corporate reorganizations involving liabilities in excess of \$250,000.

¹⁰³ Cf. §§ 209-13 of Chapter X, 52 Stat. 895 (1938), 11 U.S.C.A. §§ 609-13 (Supp. 1938).

paid by or for the petitioner for expenses, etc.”¹⁰⁴ If there is no possibility of compensation there will, as a practical matter, be no effective independent committees. While the history of protective committees has been unfortunate in many respects,¹⁰⁵ the solution of that problem is not their abolition but rather better regulation of their activities,¹⁰⁶ for it is certainly not desirable that the management monopolize security representation in reorganization proceedings.

A provision important to the carrying out of the *fait accompli* procedure is that requiring the railroad during the proceedings before the court to make the reduced interest payments contemplated by the plan.¹⁰⁷ From the point of view of the creditor whose acceptance of the plan is solicited, the plan may as well be consummated so far as the interest he receives is concerned. Further, he is told that in all likelihood, unless he accepts the plan, he may receive no payments for a considerable length of time. So he accepts and thereby facilitates the *fait accompli*.

CONCLUSIONS

Now, granting that the conclusions heretofore reached are correct and that Chapter XV plans by and large will be moratoria plans over which neither the Interstate Commerce Commission nor the court will have any effective jurisdiction, it may be asked what harm other perhaps than that resulting from inequities in the degrees of deferment as between various classes of creditors, can result from plans which do not permanently reduce creditors' claims in any way. It is obvious that the answer to this question will vary between different railroads. The present condition and future prospects of the roads vary widely. It will be impracticable at this time to attempt any individual analysis of the possible application of Chapter XV to any one railroad. It is practicable, however, to examine briefly the position of the railroad industry as a whole and its probable future.

Implicit in the desirability of a moratorium statute is the assumption that the obligation due is not an overburdening one and that the inability to meet it is the result of an extraordinary business situation. Moratoria

¹⁰⁴ § 725 (6) (italics added).

¹⁰⁵ See Securities and Exchange Commission Reports on the Study and Investigation of the Work, Activities, Personnel, and Functions of Protective and Reorganization Committees, especially pts. I and II (1936-8).

¹⁰⁶ This is the conclusion reached by the Securities and Exchange Commission (Pt. II *ibid.*, at 528 et seq.) and is reflected in the provisions of Chapter X (§§ 209-13, 11 U.S.C.A. §§ 609-13 (Supp. 1938)) relating to such committees.

¹⁰⁷ § 728.

legislation is justifiable only if the payments extended could reasonably be made under normal conditions.

What, then, is the present condition of the railroads and what are their future prospects? In April of this year, 109 roads operating almost 78,000 miles, representing nearly one-third of the country's mileage and having outstanding almost the same percentage of the unmatured funded railroad debt were in receivership or reorganization.¹⁰⁸ Another third of the roads are marginal producers in such weakened condition that they continually have difficulty meeting their fixed charges and probably could not survive prolonged depression conditions.¹⁰⁹ The remaining third of the roads are in reasonably strong financial condition.

Since under the act, carriers now in the custody of the courts or which have been in receivership or Section 77 proceedings within the past ten years are prohibited from proposing plans,¹¹⁰ Chapter XV will be applicable principally to the marginal companies comprising the middle third of the roads.

Many of these roads, in an effort to cut transportation expenses, have reduced operating staffs to a minimum and have deferred maintenance to a maximum. In February, 1938, only about half as many persons were on the railroad pay rolls as there were in 1923-5. The so-called "Committee of Three" Interstate Commerce Commissioners estimated in the spring of 1938 that, on a volume of traffic comparable to that of 1937, the railroads had deferred maintenance of not less than a half billion dollars.¹¹¹ In addition much of the equipment is old, e.g. 74.1 per cent of all freight locomotives in use as of December 31, 1937, were at least seventeen years old.¹¹² The replacement of old rail and equipment would make for reduced operating costs and increased efficiency.

This, then, is the present condition of the borderline carriers. The roads comprising this group, which include approximately twenty-one carriers, have been unable in almost half the years from 1930-7 to meet their fixed charges and of the least successful ten, an average of less than four each year have met these charges. Even in 1937, the best railroad year since 1930, only three of the ten earned fixed charges and the most successful of the three did so by only 1.11 per cent.¹¹³ As one railroad observer has

¹⁰⁸ See Clay, *op. cit. supra* note 3, at 4; Moody's Manual, *op. cit. supra* note 71, at a3.

¹⁰⁹ *Ibid.* ¹¹⁰ § 710.

¹¹¹ H. Doc. 583, 75th Cong. 3d Sess., at 28 (1938).

¹¹² Clay, *op. cit. supra* note 3, at 5.

¹¹³ See The Rehabilitation of Railroad Credit, Railway Business Ass'n Series 1939, No. 7, at 27 (Table No. 4).

well said, "The railroads not only need more business—they need relief from archaic capital structures."¹¹⁴ The recent history of the intermediate group for whose use, according to its sponsors Chapter XV was intended,¹¹⁵ is not encouraging. What is likely to be the future of this group if no permanent reductions in funded debt or fixed charges are made but present maturities are merely deferred?

The earnings prospects of the marginal carriers, in the absence of unique considerations applicable to individual roads, can be no better than those of the industry as a whole¹¹⁶ and those of the industry as a whole do not appear very bright. The revenue trends of the entire industry since 1899 are revealing. They show that from 1899 through 1920 railroad tonnage and revenues advanced at a faster rate than business activity generally.¹¹⁷ While total tonnage continued to grow larger from 1920 to 1929, it did so at a lower rate than that of general business expansion. The railroads were not holding their own though the generally prosperous business conditions existing from 1923-9 served to obscure this fact.¹¹⁸

This decline of railroad tonnage and revenue in relation to industrial production has continued to the present time. In 1937, the best railroad year since 1930, though the Federal Reserve Board Index of Industrial Production averaged 110 as against 111 for 1928, railroad freight tonnage was 21.1 per cent and freight revenue 28.2 per cent below 1928. Total revenues, incidentally, were 31.9 per cent below 1928.¹¹⁹

While an improvement in business conditions generally will, of course, be reflected in improved railroad operations it is doubtful whether the relative position of the railroads will improve. Unless the use of trucks, buses, motor cars, airplanes, pipe-lines, inland water carriers and high tension transmission lines decreases, though all indications are the other way, railroad passenger and freight traffic will continue for some time to

¹¹⁴ Clay, *op. cit.* supra note 3, at 5.

¹¹⁵ See Hearings, *op. cit.* supra note 21, at 23.

¹¹⁶ As a matter of fact, since the fixed charges per dollar of revenue of these carriers average from 14% to 31% more than those of the financially strong carriers, the prospects of the marginal carriers may possibly be worse than those of the industry as a whole. See *op. cit.* supra note 113, at 6 (Table I).

¹¹⁷ In 1899, railroads as a whole originated 13.4 tons of freight and had revenues of \$24.40 per unit of industrial production. By 1920 these figures had increased to 16.5 tons and \$53.45 respectively, the greater rise in revenues being due to sharply higher freight rates. See Moody's Manual, *op. cit.* supra note 71, at a3.

¹¹⁸ For a more detailed discussion of these trends see Moody's Manual, *op. cit.* supra note 71, at a3 et seq.

¹¹⁹ Moody's Manual, *op. cit.* supra note 71, at a4. There are also listed on p. a4 nine of the principal reasons for the relative decline of the railroads.

decline in relation to business activity generally. A declining industry is not likely to benefit by a moratorium. Until the railroads reach a more stable level of operations, it is desirable that their fixed charges be reduced as much as possible. While the intermediate group of roads are not over-capitalized if we look only to the cost or reproduction value of their property, it is quite apparent that looking at the earning capacity of these roads, they are over-capitalized.¹²⁰

Deferment of charges of these roads is no real favor to their creditors, for, as has been previously pointed out, they operate less efficiently and earn less per dollar of revenue. Much of this operating inefficiency is the result of insufficient or inadequate equipment, old light rail, winding road-beds, and manifold grade crossings, all of which slow down traffic and require excessive maintenance. Still another cause of inefficient operation is antiquated shop facilities. All these are drains on revenues which the straitened financial conditions of many of the roads makes it difficult to overcome. Further, the constant contest to meet over-burdening charges tends always to induce deferment of desirable maintenance with resulting depreciation of the property. These considerations, coupled with the declining condition of the industry generally, make it unlikely indeed that any of the marginal carriers will find deferments of principal and interest maturities without permanent reductions therein of any real benefit.

Because there may be a few carriers who will be able to effect necessary reductions without the lengthy proceedings now characteristic of Section 77 reorganizations or equity receiverships, it may be desirable to provide some machinery for carrying out such plans. For reasons discussed earlier, the number of these roads will be small, so small in fact that it is open to question whether any real need for such machinery exists. If such a method is to be provided, however, certain important safe-guards not present in Chapter XV must also be provided. First, the procedure should be removed from under the influences attendant upon a *fait accompli*. One necessary step in this direction would be to require commission and court consideration of the plan before any solicitation of assents thereto.

Further, no plan should be acceptable which does not provide for substantial reductions of both principal and interest maturities. In addition, the commission, as well as the court, should be required to pass on the fairness of the plan. While other desirable provisions will be apparent

¹²⁰ See Clay, *op. cit.* supra note 3, at 42 et seq.; note 113 supra.

from the observations heretofore made concerning other provisions of Chapter XV, these are essential.

In reflecting upon these necessary and desirable provisions, one is struck by the fact that all but one are now included in Section 77¹²¹ and that with comparatively moderate amendment that section might be made to serve most admirably.

Whatever the form of the alteration, however, Chapter XV in its present form should not be continued, for, rather than assisting the borderline carriers and the railroads generally, it will result in the accumulation of an insurmountable debt burden which will make the ultimate readjustment the more painful.¹²² A marginal operator in a declining industry is best served, not by deferment of fixed charges and principal maturities, but by their reduction or elimination.

¹²¹ § 77 does not now require that a plan provide for a reduction of fixed charges and maturities.

¹²² In the words of Chairman Eastman of the ICC: "such a plan only defers the evil day and makes it worse when it finally arrives." Hearings, *op. cit.* supra note 21, at 83.