PROCEDURAL DELAYS IN RECENT AMENDMENTS TO THE RAILROAD BANKRUPTCY ACT

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It has often been observed that enactments directed to amend existing statutory laws are best made after the statute has been in effect long enough to have been exposed to analysis arising out of litigation. Whenever a leading court decision construes some statute which soon thereafter is amended by the legislature, it is commonly assumed that the function of the amendment was intended to meet the demonstrated need for change; and that the amendment was effected in view of such decision.

While the sequence of events following the enactment of the Railroad Bankruptcy Act of 1933[1] include an interpretation of that statute by the federal Supreme Court in the *Rock Island* case[2] and an amendment of that Act by the Congress during its 74th session[3] nothing warrants the inference that new matter in the Act of 1935 was added because of any judicial criticism of the Act of 1933. On the contrary the mandate for expeditious legal procedure contained in the *Rock Island* case is still the law of the case for each step of the procedure prescribed by the Act of 1935 as well as the Act of 1933 which this decision construes.

The Act of 1933 through Section 77 added to the commonly recognized bankruptcy jurisdiction of the federal courts, a new system of procedure for the relief of railroad corporations in need of reorganization and financing.

Because of the public interest in railroads the necessity for dispatch in the pace of these reorganization proceedings was vital. The Act of 1933 enacted by the 72nd Congress met these demands for a simplified procedure for reorganizations with particular force and afforded a smoothly working, comprehensive code with few defects. The Act was drafted to avoid recognized defects involved in the former method of reorganizations through the equity receivership and the foreclosure sale. It has often been shown that the clumsiness of the equity procedure was easily appropriated by those desiring postponement from ultimate lia-

[1] Act of March 3, 1933, C. 204, 47 Stat. 1467.
[2] Cont. Ill. Bank & Tr. Co. v. C. R. I. & P. R. R. Co. (1935) 294 U. S. 648.
[3] Act of Aug. 27, 1935, Pub. No. 381—74th Congress.

bility and delay for their selfish ends; and that the cost of the relief through this procedure was wasteful.

These practices largely contributed to the demand for the new code of procedure contained in Act of 1933 and applied to railroads through Section 77 of that Act. But the spirit of change in these times created new demands in this regard and the code contained in the Act of 1933 has been displaced by a still newer code covering this same field.

The first decision by the Supreme Court construing the Act of 1933 was rendered in the *Rock Island* case[4] on April 1, 1935. The occasion of this decision was accidentally timed to the program of amending the Act of 1933 undertaken by the Federal Coordinator of Transportation; and I believe it may be truthfully asserted that the Act of 1935 was not intended to overrule the Supreme Court as to any part of the decision in the *Rock Island* case.

Section 77 of the Act of 1935 was intended as an entirely new code of procedure to revamp, and not merely to correct, features of the Act of 1933 which had been found cumbersome in execution.

While the Act of 1935 adopted many features of the proceedings under the Act of 1933, it did not constitute merely a textual correction of the former statute relating to details of practice. The new act contains over a dozen new subsections different from those in Section 77 of the former statute, and not one-half of that number of amended subsections which have been recast from the contents of old subsections.

In the *Rock Island* case the court found that Section 77 of the Act of 1933 was properly within the field of valid bankruptcy legislation under Article I, Sec. 8, cl. 4 of the Constitution. The court said Sec. 77 "advances another step in the direction of liberalizing the law on the subject of bankruptcies" and stated that equity receiverships were found an unsatisfactory method for reorganizing railroad corporations.

After emphasizing the scope of the equity powers of the trial court to "make such orders, issue such process and enter such judgments in addition to those specifically provided for as may be necessary for the enforcement of the provisions of the Act [U. S. C. title 11, sec. 2 (15)]," the court sustained the authority

[4] Supra, note 2.

of the lower court to enjoin the sale of collateral held by a creditor and justified its finding with convincing reasons.

The direction for a speedy handling of all reorganizations under the 1933 Act was laid down as a general rule of procedure; and this as applied to Section 77 of the Act of 1935, as well as to the former statute, becomes the rule of action which will go far to implement the present law as a satisfactory method for railroad reorganizations if it is found otherwise workable.

In this *Rock Island* decision the court warned that all such proceedings should go forward without delay or suffer the penalty of being dismissed by the trial court.

In discussing the issues raised by the petitioners in the case the court through Mr. Justice Sutherland said:

> "Finally, petitioners insist with much force that the injunction, granted in November, 1933, and still operative, is likely, if continued, to result in irreparable injury . . . It is true that no plan has yet been consummated; and, so far as the record shows, none has been prepared or is in the course of preparation. If this long delay were without adequate excuse, the retention of the injunction for a long period which has intervened since it was granted could not be justified. But the delay is obviously due to the many doubts and uncertainties arising from the present litigation. Until they are finally resolved the consummation or even the preparation, of any definite plan is plainly impracticable. With these doubts and uncertainties now removed the proceeding should go forward to completion without further delay, or be dismissed.
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> "The delay and expense incident to railroad receiverships and foreclosure sales constituted probably, the chief reasons which induced the passage of Section 77; and to permit the perpetuation of either of these evils under this new legislation would be subversive of the spirit in which it was conceived and adopted. Not only are those who institute the proceeding and those who carry it forward bound to exercise the highest degree of diligence, but it is the duty of the court and of the Interstate Commerce Commission to see that they do. Proceedings of this character, involving public and private interests of such magnitude, should, so far as practicable, be given the right of way both by the court and by the Commission to the end that they may be speedily determined."

This rule of the Supreme Court requiring speed in carrying forward all reorganization proceedings has not been changed by

any intendment which can be read into the Act of 1935. On the other hand the practical result of the many checks between the trial judge and the Interstate Commerce Commission created in the new procedure under this Act will tend definitely to retard all proceedings of reorganization, and prevent both the courts and the Commission from attaining the same speed in disposal of cases as was generally possible under the former statute.

Numerous features of the earlier act have been cited as weaknesses which tended towards unreasonable delays. These include the difficulty sometimes experienced in the reorganization of the larger western railroad systems where the great number of classes of creditors made it difficult to procure a full ⅔ consent of interested parties.

To critics of the earlier statute this experience justifies a change carried out in the Act of 1935 requiring a ⅔ consent merely of those voting on the plan of reorganization, instead of the former requirement of consents of ⅔ of all of each class of creditors and stockholders. In practice it may be just as difficult to meet the present requirements of the 1935 Act in this regard as it proved to be in the unusual case under the 1933 Act.

The change seems to mark a distinction with little practical difference; but a fuller discussion of changes effected by the 1935 Act to facilitate the procedure will be noted in detail in later paragraphs.

From a general comparison of the two statutes it has been calculated that under the Act of 1933 in an uncontested case a final decree of confirmation of a plan of reorganization could be entered within 60 days from the time of filing the copy of the plan with the court; but that under the Act of 1935 a minimum of 390 days would be required before all of the necessary steps could be taken and such decree entered notwithstanding no unreasonable delays are experienced in the presentation of the case.

This estimation of the delays possible under the new procedure places in a new light the importance of the rule of the *Rock Island* case in regard to carrying through with dispatch all pending reorganization proceedings. But conceding the importance of this decision and its salutary effect upon proceedings under the Act, it can not muster an effect which will overcome the delays which will be occasioned by the multiplicity of steps required by the Act for the preparation and confirmation of the plan of re-

organization. In this regard it appears that the authors of the Act of 1935 may have lost sight of the desired object and become too intent upon details of the instrumentality through which the results are to be gained.

It is not intended to condemn many of the new features of the Act as undesirable, but whatever gains have been made in that regard are at the expense of loss of dispatch in procedure to such a degree that it may be forcibly stated that the whole remedy afforded by the Act has fallen into that evil so often exposed as poor economy and bad legal practice—the proverbial delays in legal procedure.

A cursory examination of the steps required in an ordinary reorganization proceeding under the new Act and a few contrasts with the Act of 1933 will serve to illustrate these conclusions.

Under both acts all proceedings are started in a federal court according to jurisdictional requirements by the filing of a petition alleging the "debtor" corporation insolvent or unable to pay its debts as they mature and that the "debtor" desires to effect a reorganization under Section 77.

Both acts provide for the court to take jurisdiction, when the petition is approved by the judge, over the subject of action, the *res* and over the person of all interested parties wherever located.

Certain subsidiaries and affiliates of a parent "debtor" may join or be joined with it in the same original proceedings for reorganization.

Plans of reorganization are required to include proposals to modify and alter the rights of "creditors" (the meaning of this term being given a wide scope), either through the issue of new securities or otherwise; and to include adequate means for carrying into effect all provisions of the plan.

Parties in interest included in the meaning of the term "creditors" and stockholders of the debtor corporation must submit to the jurisdiction of the trial court notwithstanding they are not residents of the judicial district of the trial court.

None are denied their day in court, but it is to the court taking jurisdiction, after approving the petition filed in the case, that these creditors and stockholders must look for relief.

In many details the Acts are similar; but they differ radically regarding necessary requirements relating to the building of the plan and the supervision thereof by the Commission.

For example, the Commission now has a broad discretion in regard to its right to disapprove a plan of reorganization without a reciprocal obligation to formulate or approve a substitute plan.[5] This was not possible under the Act of 1933 which required the Commission to report and recommend some plan of reorganization within a reasonable time.[6]

While subsection (d) of the Act of 1935 requires the Commission to report and state fully the reasons for its conclusions in refusing to approve any plan, there is no judicial procedure provided for reviewing this action of the Commission, and the Act affords no rules or standards for the proper conduct of the Commission in this regard.

The importance of this power in the Commission to withhold approval from a plan of reorganization lies in the fact that no plan may be approved by the trial judge under the 1935 Act unless the plan has first been approved by the Commission.[7]

While the Commission might be justified in its action in refusing to approve any plan of reorganization there could be a wide difference of opinion in that regard; and such situation would bring the proceedings to a standstill, for which there appears to be no remedy. Valuable as is the rule of the *Rock Island* case to keep proceedings moving, its force can not be applied in this regard to the Act of 1935 because of the difference of its provisions from the Act of 1933 which provided an obligation on the part of the Commission to report and recommend some plan of reorganization within a reasonable time.

Another example of departure from simplified procedure resulting from provisions of the present statute is included in the requirement that the trial judge must hear all parties in interest in support of, and in opposition to, objections to the plan and claims for equitable treatment.[8]

It would seem that a hearing de novo required in this connection is unnecessarily wide in scope considering the fact that the plan submitted to this hearing must already have been subjected to a hearing before the Commission and must be reported to the

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[5] Act approved Aug. 27, 1935, Subsection (d).
[6] Act of March 3, 1933, C. 204, Sec. 1, Subsection (d); U. S. C. title 11, sec. 205, Subsection (d).
[7] Act approved Aug. 27, 1935, subsection (d).
[8] Act of Aug. 27, 1935, subsection (e).

trial court as approved before further action may be taken upon it. The hearing on the plan at this stage should be limited to specific objections relevant to vital features of the plan and should be extended to no other persons except those who would have had such a right prior to the time the railroads passed into the hands of the court for administration; otherwise, the trial court will be involved unnecessarily in retracing steps already covered by the Commission.

Unfortunately the text of the act is clearly susceptible of a direction requiring that the function of the hearing extend to general features of every claim or objection involved in the question whether equitable treatment has been given to parties in interest. The scope of such hearings would extend to questions relating to the business management of the road during reorganization—a field in which the trial judge should be permitted to rely upon the representatives appointed by him alone.

For the trial court to be required to hear all parties interested in this regard, in support of and in opposition to objections to the plan of reorganization and its administration, the result will be that the door will be opened to a variety of issues which must finally be settled before the court validly can follow the canons of the Act and take the next step of weighing the plan in the light of the standards set up by subsection (e).

Arbitrary action on the part of the trial judge to limit these hearings might afford grounds upon which plausible exceptions could be made against the final order of confirmation of the plan of reorganization. In this provision the procedure directed by the 1935 Act for a hearing de novo before the trial court appears unnecessarily elaborate and much slower in action than the provisions of the Act of 1933 covering similar functions to be followed for the approval of the plan.

Another feature of practice under the present act which will slow up the procedure is the requirement that the trial judge may approve the plan and transmit it to the Commission for creditors' and stockholders' action in regard thereto, only after the judge has found that it includes several elements necessary to all plans of reorganization.[9]

These elements are somewhat similar to the fundamentals re-

[9] Act approved Aug. 27, 1935, subsection (b).

quired under similar circumstances by the Act of 1933, but there is a new feature included in the present law which gives rise to much conjecture and affords a very considerable obstacle to speedy court action in the hard case, although its purpose manifestly is to expedite the procedure connected with obtaining necessary consents to the plan.

Before the proceedings go farther, both the Commission and the trial judge must have found that the plan is fair and equitable; affords due recognition to the rights of each class of creditors and stockholders; does not discriminate unfairly in favor of any class of creditors or stockholders and *will conform to the requirements of the law of the land regarding the participation* of the various classes of creditors and stockholders (italics supplied);[10] that all expenses of the reorganization have been disclosed and are reasonable within the limits fixed by the Commission; and that adequate provisions have been made for the payment of costs and allowances.

This finding by the Commission and by the trial judge that the plan will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders was not essential prior to the Act of 1935.

According to the House debate on the hill known as H. R. 8587 (Public #381, 74th Congress) this requirement was inserted to insure certain features of the Act from invalidation by the courts.

In this regard Representatives Sumners and Biermann are reported in the Congressional Record as follows:

> Mr. Sumners of Texas. The most important change is that whereas under the present law there is required the consent of two-thirds of each class, it is made possible for the Commission and the court, after consideration of the plan—and they may modify the plan—if it is a fair and just plan and meets the constitutional requirements, it is possible to have a plan effectuated which has not been approved by two-thirds of each class . . .
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> Mr. Biermann. It now takes two-thirds and under your plan it states no definite number?
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> Mr. Sumners. That is right; and we feel that we have protected the constitutionality of the bill by providing that the plan must meet with—I have not the exact language of

[10] Idem., subsection (e) clause (1).

the bill in my mind—but it must comply with the law of the land.[11]

From the report of this debate it is manifest that the drafters of the Act of 1935 considered the provisions included in Subsection (e) as vital in order to validate the power of the trial judge to confirm a plan already rejected by stockholders and/or creditors of the debtor corporation.

This power of the trial judge is expressed in a proviso following directions concerning the confirmation of the plan by the judge, when satisfied it has been accepted by or on behalf of creditors of each class to which submission is required who hold more than two-thirds in amount of the total of allowed claims of such class which have been reported as voting on the plan; and similarly by or on behalf of stockholders.

The proviso in question reads as follows:

> Provided, That, if the plan has not been accepted by the creditors and stockholders, the judge may nevertheless confirm the plan if he is satisfied and finds, after hearing, that it makes adequate provision for fair and equitable treatment for interests or claims of those rejecting it; that such rejection is not reasonably justified in the light of the respective rights and interests of those rejecting it and all the relevant facts; and that the plan conforms to the requirements of clauses (1) to (3), inclusive of the first paragraph of this subsection (e).[12]

One can not refrain from observing that the clause in question gives little help to the trial judge by setting up guides or standards as a rule of conduct in the hard case, but passes entire responsibility upon the trial judge to apply the remedy properly in the given case. This situation will probably give rise to many exceptions, should the court override dissentors to the plan; and also it will contribute little towards facilitating these proceedings by speeding up procedure.

It may be objected that my criticism will apply only to the occasional case and that ordinarily no issue will arise to put the proviso to a test. Granting the truth of this, there still remains the question of the usefulness of the proviso. In considering our convictions are we not to resolve the matter by admitting that the

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[11] Congressional Record, August 15, 1936, page 13770.
[12] Act of August 27, 1935, subsection (e), paragraph 3.

only safe procedure will be to rely on obtaining the ⅔ consents of stockholders and creditors to the plan, and that the Act of 1935 offers in this regard little improvement for speed of procedure over the provisions of the earlier act.

In this discussion it has been the purpose of the writer to analyze the changes in the practice in the light of their effect upon the facilitating the speed of reorganizations.

While other additions to the Act of 1933 serve purposes proper for the full control by the court and by the Commission of conduct of stockholders' and creditors' committees, as well as of trustees appointed by the court, none of these additions are of such nature that they could not also have been added to the former equity practice as extensions of the jurisdiction of the court and the Commission.

These additions are in line with the policy of centralization of control of the nation's transportation and communications' facilities which policy can be heartily endorsed. They are only subject to criticism in so far as the procedure in the given case through accumulation of many steps necessarily results in delaying the procedure to a degree that the means seems to defeat the object of its consummation.

Among valuable improvements of the Act of 1935, I call attention to provisions which relate to the valuation of the debtors' property by the Commission;[13] the discretion given to the court to restrain the foreclosure of the debtors' property;[14] authorization of options or participations under the plan to safeguard interests of creditors or stockholders who can not presently avail themselves of the opportunity to take part in the plan at the price of the sacrifice of their respective interests;[15] the supervision of creditors' committees and the regulation by the Commission of fees and allowances;[16] the duty of trustees to file a list of bond holders and creditors with the court for public information and a report disclosing the conduct of the management of the debtors' affairs;[17] the right to authorize trustees' certificates similar to the issue of receivers' certificate under the equity practice;[18] the

[13] Act of Aug. 27, 1935, subsection (e).
[14] Act of Aug. 27, 1935, subsection (j).
[15] Act of Aug. 27, 1935, subsection (p).
[16] Act of Aug. 27, 1935, subsection (c) (12).
[17] Act of Aug. 27, 1935, subsection (c) (4).
[18] Act of Aug. 27, 1935, subsection (c) (3).

method to be employed in order to sell secondary railroad lines unprofitable to the parent corporation and to annul executory contracts and leases binding the debtor corporation;[19] and regulations requiring the appointment of trustees independent of the railroad management where the annual operating revenues of the debtor corporation exceed one million dollars.[20]

It will be noted in this connection that the aggregate effect of those provisions of the Act of 1935 is to extend the supervisory authority of the Interstate Commerce Commission, an end salutary, perhaps, but yielding the immediate result of delay in the progress otherwise possible under less elaborate reorganization proceedings.

This enlargement of the supervisory power of the Commission may be indispensable in the case of the reorganization of the great railroad lines, but it is to be remarked that the elaborate system of checks between the court and the Commission which accompanies these provisions under the act seem needlessly to require the retracing of steps already intrusted to a dependable authority.

The present statute shows a spirit conscious of the delays which are entailed in its elaborate system of supervision over the building of the final plan. The Act provides against this by requiring that a plan of reorganization must be filed by the debtor whether six months from the entry of the order by the judge of the trial court approving the filing of a petition for reorganization under the Act, among other things; but the trial judge may extend the time for filing the plan from time to time, no single extension to be for more than 6 months.

The present act like the Act of 1933 includes the provision that when, in the light of all of the circumstances, there is undue delay in a reorganization proceeding, the trial judge, after hearing and a consideration of the recommendation of the Commission in that connection, may dismiss the proceedings and return the property to the debtors' management or as the court may direct.[21]

The rule supplied by the Supreme Court in the *Rock Island* case will apply with renewed force to reorganizations under the

[19] Act of Aug. 27, 1935, subsection (o).
[20] Act of Aug. 27, 1935, subsection (e).
[21] Act of Aug. 27, 1935, subsection (g).

present act. Its warning that reorganizations must be expeditiously pressed still holds good.

"The delay and expense incident to railroad receivership and foreclosure sales constituted, probably, the chief reasons which induced the passage of Section 77; and to permit the perpetuation of these evils under this new legislation would be subversive of the spirit in which it was conceived and adopted. Not only are those who institute the proceeding and those who carry it forward bound to exercise the highest degree of diligence, but it is the duty of the court and of the Interstate Commerce Commission to see that they do."[22]

Undoubtedly the courts and the Commission reasonably will do their part in expediting these proceedings in so far as the Act of 1935 permits, but it is also necessary that parties to the proceedings will be constantly alert to keep the procedure in motion so that it will be saved from the stigma of delay which the investing public attributes to most litigation.

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[22] Cent. Ill. B. & T. Co. v. C. R. I. & P. R. R. Co. (1935) 294 U. S. 648.