Administrative Versus Judicial Reorganization of Real Estate Securities

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The widespread distribution of real estate securities which began in the early twenties was accelerated by the stock market collapse in 1929. For several years thereafter, the investing public, which had been brought to grief on the boards of the stock exchanges, turned with avidity to what was then considered the more conservative venture of holding securities backed by real estate where the interest rate was comparatively low yet deemed adequate and where, as the public had been told, the principal was secure. Was it not true that a number of these companies had been distributing real estate securities for several generations without loss to any investor! Was it not true that these securities were, many of them, guaranteed by the companies under the supervision of agencies of government! With such assurances behind them, it was easy for the supersalesmen of the mortgage companies to attract the savings of countless thousands of men and women throughout the land. The investments ran into billions.¹

There were, in the main, two types of real estate securities purchased by the public. On the one hand, there were corporate bonds secured by mortgages on real estate. These bonds were sometimes guaranteed as to principal and interest by companies organized for that purpose, and at other times

¹ Mortgage guaranty companies alone had outstanding in 1934 a grand total of more than $800,000,000 in guaranties; non-guaranty companies almost equalled this amount. Of this total, less than half was sold prior to 1929. See Report to the Governor of Moreland Commissioner Alger, pp. 8–12.
entirely unguaranteed, but sold on the reputation of the distributing company. The mortgage itself was frequently made to a trustee, often a trust company, under a trust indenture which described the powers and duties of the trustee.² Often the mortgage was simply deposited in a very informal way with a trust company as a depository. On the other hand, there were the so-called certificates of participation in which the purchaser bought an undivided interest or share in the mortgage. There was no legal precedent for this device, which originated in New York during the early twenties. The mortgage company frequently guaranteed to the holders of the participation certificates that the principal and interest would be paid on demand, if not by the owner of the property then by the guaranty company. The rights with respect to the mortgage were sometimes held by the guaranty company, sometimes by a trustee, and sometimes under an informal arrangement with a depository whose sole duty seems to have been to have physical custody of the mortgage.³

² For the legal problems involved in connection with the legal rights and obligations arising out of the trust indenture, see Posner, Liability of the Trustee Under the Corporate Indenture (1928) 42 HARV. L. REV. 198; Posner, The Trustee and the Trust Indenture: A Further Study (1937) 46 YALE L. J. 737.

³ The contract with the certificate holders was usually contained in the certificates sold to them. While these varied in minor details, a typical certificate, to which most of the others conformed, is as follows:

"UNITED STATES OF AMERICA
STATE OF NEW YORK

Series FW1
Guaranteed First Mortgage Certificate

* * * COMPANY
(hereinafter termed "The Company")

IN CONSIDERATION of the sum of

Dollars ($ ), the receipt of which is hereby acknowledged, hereby assigns to the registered holder hereof an undivided, co-ordinate interest to the extent of the aforesaid amount in the aggregate principal sum secured by the bonds and mortgages deposited (or which may hereafter be deposited) by the Company with The County Trust Company (hereinafter called the 'Depositary'), under the provisions of a certain agreement dated March 2, 1931 between the Company and such Depositary (hereinafter called 'the deposit agreement')

TOGETHER with interest on the principal sum hereof at the rate of five and one-half per centum (5 1/2%) per annum to be computed from the date of registry hereof, and payable semi-annually on the first days of and in each and every year until the maturity of this certificate, unless this certificate is sooner redeemed, surrendered, or its proceeds deposited, in which event interest is to be paid as hereinafter provided.

This certificate is one of a series of certificates of like tenor (except as to denomination, date and maturity) issued by the Company under the
It occurred to comparatively few people in those days to wonder whether the guaranty companies would be able to

provisions of the aforesaid deposit agreement and is subject to the provisions of such agreement. Said deposit agreement may be inspected by the registered holder hereof at any time during office hours at the office of either the Company, or the Depositary in the City of White Plains.

The Company hereby certifies, covenants, and agrees with the registered holder hereof as follows:

1. That the aggregate principal amount of the certificates issued, or which hereafter may be issued by it under the provisions of the aforesaid deposit agreement shall not at any time exceed the aggregate amount secured to be paid by the bonds and mortgages so deposited by it; that all certificates issued (or which may hereafter be issued by it) shall be substantially of the same tenor; that there shall be no priority in favor of any such certificate as against the other certificates, but all such certificates shall be equal and co-ordinate in lien;

2. That every mortgage deposited by the Company shall be accompanied by a policy of title insurance issued by the Company, insuring that such mortgage is a valid first lien for the amount unpaid thereon, and interest, upon the mortgaged premises, which premises shall only be real property improved for business or residence purposes and situated in Westchester County; furthermore, every such mortgage shall be accompanied by the sworn certificate of one of the expert appraisers of the Company showing the appraised value of the mortgaged premises, which valuation on the date of said mortgage shall be at least 50% greater than the amount secured by it; the recording tax imposed by the laws of the State of New York on such mortgages shall have been paid in full;

3. That the Company shall require the respective owners of the mortgaged premises to pay all taxes, assessments, water rates, and/or other public charges which may become prior liens on the mortgaged premises;

4. Every mortgage so deposited by the Company shall be accompanied either by policy or certificate of fire insurance, made payable, in case of loss or damage, to the Company, as mortgagee, and such insurance shall be kept in force by the Company until such mortgage shall have been paid.

The Company hereby guarantees to the registered holder hereof payment of the principal sum of this certificate (unless prepaid, as hereinbefore provided) ten years after the first interest day hereinafore mentioned and accrued interest thereon, at the rate herein mentioned, upon the surrender of this certificate with a proper assignment thereof to the Company.

Pre-Payment Provisions:

(A) By the Company

Three years after the first interest date, or on any interest date thereafter, the Company having given sixty days' notice in writing to the registered holder hereof of its intention so to do, shall have the right to pre-pay to the registered holder hereof the principal sum of this certificate, with the interest remaining unpaid thereon to the date of payment, and to receive from the registered holder hereof this certificate, properly assigned to the Company.

At any time within three years after the first interest date mentioned above, the Company having given sixty days' notice in writing to the registered holder hereof of its intention so to do, shall have the right to pre-pay to the registered holder the accrued interest remaining unpaid thereon to the date of payment together with ninety days' additional inter-
meet their almost astronomic obligations should general de-

est, and to receive from the registered holder hereof this certificate, properly assigned to the Company.

In either case, if such notice has been given, and this certificate is not surrendered by the holder as herein required, the Company shall have the right to deposit the amount due to the holder hereof for principal and accrued interest (and additional interest, if any) with The County Trust Company for the account of the registered holder hereof, to be paid to him on surrender of this certificate, properly assigned to the Company, and from the time of such deposit no interest shall be payable on this certificate.

(B) PRE-PAYMENT at the option of the holder

Three years after the first interest date mentioned above, and on any interest date thereafter, the registered holder of this certificate, having given sixty days' notice in writing to the Company of his intention so to do, shall have the right to require upon surrender of this certificate by him properly assigned to the Company, payment of the principal amount of this certificate, with accrued interest remaining unpaid thereon to the date of payment, out of the monies received by the Company after such notice, in payment, or on account of the principal sum secured to be paid by any of the deposited bonds and mortgages, and not required for the payment of such other certificates of this issue in respect of which notice had previously been received by the Company. The Company agrees to satisfy such demands in the order in which they are received and registered by it, and out of the first monies available for that purpose.

The Company further agrees that in the event of the death of the registered holder of this certificate, and upon the request of his legal representatives, it will repurchase this certificate at its face value plus the accrued interest remaining unpaid thereon to the date of payment.

In case the holder of this certificate is an executor, administrator, trustee, guardian, or committee, the Company agrees to re-purchase on demand this certificate at its face value plus accrued interest remaining unpaid thereon to the date of payment, whenever the fund of which this certificate may be a part is to be paid to, or to be distributed among the person or persons entitled to receive it from the holder hereof.

IN ACCEPTING THIS CERTIFICATE THE HOLDER HEREOF COVENANTS AND AGREES with the Company and the holders of the other certificates of this issue as follows:

1. The Company is hereby appointed irrevocably the agent of the holder and as such is hereby empowered, exclusively,

(a) to receive, collect, demand, and, in its own name, to sue for the interest and principal of any of the deposited bonds and mortgages, and, in its own name, to satisfy and discharge any such mortgage, when fully paid; and to retain for its own use all interest collected by it in excess of the rate to be paid hereunder to the holder hereof; (b) to collect, sue for, receive, settle, and/or compromise the fire insurance in case of loss of, or damage to any of the mortgaged premises by fire; (c) to exercise every right, option, and/or privilege in any of said bonds and mortgages contained and given to the mortgagor, including the right to receive payment of the principal or interest in advance of the due dates; to extend the time or otherwise to modify the terms of payment; (d) to withdraw from deposit any of the deposited bonds and mortgages and to substitute therefor other bonds and mortgages, provided that such substituted bonds and mortgages conform to the description mentioned above; that they are accompanied by a title insurance policy, fire insurance certificate, certificate of appraisal as mentioned above, and that the aggregate principal
fault by the owners of real property occur. An investor usually argued that since a mortgage was never larger in amount than two-thirds of the value of the real property, it was unlikely that a loss would occur since a loss would involve not only the diminution in value of the property by more than $33\frac{1}{3}\%$ but also a default by the guaranty company. Even after the 1929 experience, so vast a calamity was largely unforeseen and investors thought they were being prudent when they eschewed the glamorous possibilities of profit offered by industrial securities and relied conservatively upon the small yet satisfactory $5\frac{1}{2}\%$ return which real estate securities generally carried.

The unforeseen, however, occurred during the year 1932 when widespread unemployment, with the concomitant increase in vacant apartments, the folding up of business enterprises and the loss of income by home owners, created a widespread default in the payment of interest and taxes. Added to this was the almost complete drying up of the market for the sale of real properties and the increased frequency of the amount secured to be paid by all the deposited bonds and mortgages shall at no time be less than the aggregate principal amount of all the certificates outstanding at the time;

2. Both the Company and the Depositary may become the holder, and/or pledgee of one or more certificates issued under the terms of the deposit agreement mentioned above;

3. Only the Company may receive, demand, collect, and/or sue for interest, and/or principal of the deposited bonds and mortgages, and to give receipts or satisfactions therefor on receiving such payment;

4. The interest of the holder of this certificate shall be assignable, but no such assignment shall be binding on the Company until registered on its books.

5. Any notice to be given by the Company to the registered holder hereof shall be deemed sufficient, if made in writing, enclosed in a properly sealed and postpaid envelope, addressed to the registered holder at the last address furnished by him to the Company, and deposited in the Post Office in the City of White Plains.

This certificate is not valid unless certified by the Depositary.

IN WITNESS WHEREOF *** COMPANY has caused this certificate to be sealed with its corporate seal and to be signed by two of its officers in the City of White Plains, this day of in the year 193.

Vice-President”

* * *

4 In New York, there was no limit placed on the amount of guaranties which a company might enter into or undertake. In California and in Oregon, the law limited these guaranties to twenty times the capital of the company, but in New York, where the bulk of the business was done, there was no limit. A bill to impose such a limit was passed by the Assembly in 1927 but failed of passage in the Senate (A. 864, 1828, Int. 822).
foreclosure of mortgages on homes, apartments, business properties and farms. The calamity was almost catastrophic and the legislatures of the various states, as well as Congress, felt obliged to meet the necessities of the time by the enactment of moratoria preventing foreclosures in certain cases. This had a further depressant effect on the value of mortgages and on the marketability of real estate securities generally.

But the holders of real estate securities were not only struck with enormous force by the economic disabilities under which they labored but their legal position as well was utterly precarious. The rights which they acquired with their bonds and certificates were vague, ambiguous and difficult of enforcement.

It soon became apparent that trustees who held mortgages for bondholders were surrounded in their trust indentures by numerous safeguards in the form of exculpatory clauses which effectually insulated them against any liability to the bondholders for failure to take necessary action. But

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6 An excellent illustration is afforded by the decision of the court in Hazzard v. Chase National Bank of City of New York, 159 Misc. 55, 287 N. Y. Supp. 541 (1936), aff’d, 257 App. Div. 950, 14 N. Y. S. (2d) 147, aff’d, 282 N. Y. 652, 26 N. E. (2d) 802 (1940), in which Justice Rosenman, who wrote the opinion for the nisi prius court which was subsequently upheld by the Court of Appeals, in exonerating the trustee, had this to say:

"It is clear that if it were not for the terms of the indenture, the defendant could not escape the conclusion that it was negligent towards its bondholders. If the relationship between this so-called trustee and these plaintiffs were the ordinary common law fiduciary relationship, and if the trust instrument did not exempt the defendant from every duty of making reasonable inquiry, the acts of the trustee would be a distinct
the trustees, even had they been liable, would have been at a loss to know what to do. To foreclose the mortgages out of hand was often impossible because of the moratorium. Where the conditions of the moratorium were not met, foreclosure frequently involved great sacrifice and loss to the bondholders. There was no market for sale, and foreclosure simply involved acquiring the title to the real property. Frequently, the trust indentures gave inadequate powers to the trustees so that they felt that they were unable to become the trustees of the real property in lieu of the mortgage. Frequently, business wisdom would dictate a modification of the terms of the mortgage so that the owner of the real property might carry on and ultimately safeguard the investment of the security holders. But the trustees were without power to make such modifications. Individual bondholders did not have the facilities to act. They had no means of organizing themselves into effective units and the bond issues, often very large and distributed among a great number of people, were not by their terms of such character that an individual bondholder could take legal proceedings to protect his rights. Certainly, he could not bring a suit to foreclose the mortgage, and a suit on the bond to recover the amount from the owner of the real property was in practical effect usually wasteful effort. Moreover, most members of the bar were unfamiliar with the legal mechanisms which were created when the securities were

violation of the well-recognized obligations arising from such relationship. It is elementary that a trustee owes to its fiduciary at least the duty of exercising the same care and prudence that a reasonable man would exercise with respect to his own property. Without going into all of the details of the evidence, the conclusion is irresistible that, apart from the general and specific exculpatory clauses, the defendant was guilty of lack of reasonable care in accepting these substituted securities without further investigation, with all of the knowledge which is attributable to it through its vice president Makepeace, and through its other officers and investment files. **

"Irrespective of holdings or tendencies in other jurisdictions, it is now the well-settled doctrine of this state that so long as the trustee does not step beyond the provisions of the indenture itself, its liability is measured, not by the ordinary relationship of trustee and cestui, but by the expressed agreement between the trustee and the obligor of the trust. mortgage. Where the terms of the indenture are clear, no obligations or duties in conflict with them will be implied."

sold. Likewise, the owners of the real property themselves were in a state of uncertainty and doubt. They had no one to deal with. The mortgage companies, which had defaulted, had many of them gone into receivership or into administrative liquidation. The trustees were without power to act and the security holders were a large disorganized group with no one to speak for them. Even with the best cooperative will in the world, these legal and practical obstacles would have made the solution to the problems well nigh impossible.

But the will to cooperate, itself, was not unnaturally absent. There was a severe clash of interests between the security holders, the owners, the trustees and the erstwhile mortgage companies. The security holders had the simple desire to see their interest payments reinstated and some effort made to liquidate their principal. The trustees hoped to avoid responsibility for failure to act and had a deep interest in preserving the trusts which, in many cases, were a source of considerable income to them. The owners, who had invested large sums of money in the real property and had seen the value shrink beyond recognition, were eager to preserve their equities and to wrest from the bondholders concessions with regard to interest, amortization and even principal; and, finally, the mortgage companies and their directors were desirous of seeing the involved situation clarified in a way that would prevent, or at least make improbable, any effort to hold them responsible for the judgments they had rendered while the companies were distributing the securities and for any alleged misfeasance in office. Through the mêlée of these conflicting interests, it seemed for a while as if no light could penetrate. A Moreland investigation, which had been ordered by the Governor of the State of New York, added to the difficulties by revealing, on the part of the mortgage companies, conduct and practices which hovered unevenly in the legal balance.8

8 The Moreland Commissioner, in accordance with his instructions, furnished copies of the testimony taken before him to the Attorney General of the State and to the United States Attorney for the Southern District of New York. In commenting on this aspect of the situation, he said (p. 28):

"I refrain from further comment on this branch of the matter in order to avoid possible prejudice to the action of these public authorities. I feel that my function has been fulfilled within the proper area of my inquiry, as directed by you, by submitting, as stated above, the results of
What was needed was a forum in which these problems could be considered and a possible solution found and legal machinery by which the activities of the forum could be brought into play. One thing was perfectly clear: that the old equitable action of foreclosure, the only remedy theretofore known to the law to deal with defaults in the obligations of a mortgagor, was an anachronism as far as the modern bondholders' or certificate holders' mortgage was concerned. That action was devised in simpler days and was totally inadequate to deal with the current complicated problem. Nor was it long before Congress and the legislative bodies of the several states recognized the true state of affairs and enacted remedial legislation dealing directly with this situation. A precedent was, of course, immediately present in the minds of all lawyers in their experience while dealing with defaulted railroad mortgages. There was a field which for many years had attracted the attention of the bar. There too the old action to foreclose the mortgage was not applicable. One does not buy or sell a railroad on the auction block, and the old-fashioned equity receivership, which had been devised by the lawyers to bring about the reorganization of railroads in default, promptly came to mind as a method of dealing with large scale defaults in real estate securities generally. But the conscience of the nation had been aroused by the numerous difficulties of the old reorganization procedure in equity receivership. A popular book had brought this to the atten-

my investigation to the duly constituted public authorities having jurisdiction over criminal offenses.9

A number of prosecutions were instituted and, in a few cases, convictions obtained, but in the main no criminality under the then existing statutes was discovered.

The dominance of these proceedings by committees appointed largely through the intercession of investment bankers who had themselves sold the securities and appointed the management responsible for the default, and the enormous fees that were paid to committees and counsel, and others involved in developing plans of reorganization, had left the public aghast. A new determination appeared, to avoid in the future a repetition of these catastrophic occurrences.

Congress acted in the closing days of the Hoover administration by the enactment of an amendment to the National Bankruptcy Act, frequently referred to as Section 77B, under which the process of reorganization in the federal courts was highly regulated and an effort made to throw safeguards around the position of the security holders. This enactment was not designed solely to deal with the problems of real estate security holders but it was promptly utilized by them and afforded a legal machinery urgently needed to meet the unfortunate situation in which the owners of real property and real estate securities found themselves. The State of New York enacted a series of laws dealing with the problem: the Burchill Law, the Schackno Act and the Mortgage Commission Act. These were designed to accomplish for real estate security holders what Section 77B of the National Bankruptcy Act attempted to do for holders of defaulted securities generally.

Before embarking on a comparison of the actual operation of reorganization under these various statutes, it will be helpful, even at the risk of being redundant, briefly to describe them.

The provisions of Section 77B of the National Bankruptcy Act were simple and contained numerous safeguards to security holders. Jurisdiction was conferred on the District Courts of the United States and their process was brought into play by the filing of a petition, either by the corporate owner of the real property or by a percentage of the

10 Lowenthal, The Investor Pays (1933, Knopf).
11 See note 9, supra.
12 Ibid.
13 Ibid.
14 Ibid.
bondholders or by a percentage of the stockholders. If the court found that the petition was filed in good faith, it was approved and the court had the power to appoint a trustee to administer the property pending the proceeding, or it might, if it deemed advisable, continue the owner in possession. A plan of reorganization was the ultimate objective of the proceeding. Such a plan could be submitted by the owner, or by groups of bondholders, or even by a stranger. The plan could take almost any conceivable form, formulating the rights of the various parties. If the value of the property was in excess of the amount of the mortgage, the interests of the owner could be preserved in some form. New securities could be issued and a new corporation could be formed to own the real property and a new trustee appointed to hold the mortgage. Interest rates could be fixed and, ultimately, liquidation could be provided for. If the plan, after hearings, was found to be fair and equitable, it could be approved by the court, and if assented to in writing by the holders of two-thirds of the bonds outstanding, it became effective and bound the bondholders, the owner, and all the parties interested in the property.

Under the Burchill Law, enacted by the Legislature of the State of New York in 1933, the trustee of a mortgage held by bondholders was empowered, during the course of a foreclosure proceeding, to present to the Supreme Court a plan of reorganization. As in the case of the federal statute, the plan of reorganization contemplated the acquisition of the property at the foreclosure sale by a new corporation which would issue its securities to the bondholders and, in a proper case, to the owner, or to a stranger who had contributed cash to the preservation of the property. The plan might be filed by the trustee or by any person or persons owning 25% of the principal amount of the securities covered by the mortgage. In the case of the Burchill Law, however, it was not made necessary, in order to effectuate the plan, to procure the consent of two-thirds of the bondholders. It was sufficient if within a specified time, limited by the Act, one-third of the holders of the bonds did not in writing dissent therefrom. This, of course, rendered the effectuation of plans infinitely more expeditious. The Burchill Law, however, did not apply
to mortgages which were held by certificate holders or owners of certificates of participation but only to mortgages which secured the bonds of the owner.

To meet this latter situation, the Schackno Law was enacted, which authorized the Superintendent of Insurance to take over and administer the functions of the guaranty corporations with respect to any mortgage which had been guaranteed by any one of them and with respect to which certificates of participation had been sold, and in connection with that power he was authorized to present to the court a plan of reorganization, or such plan might be presented by the holders of 15% in amount of the outstanding certificates. The plan, as in the other statutes, might provide for the rearrangement of the rights of the certificate holders and the transfer of the mortgage to a trustee for the certificate holders, with full power to act therein, or for the formation of a new corporation to own the property and to distribute its securities among the certificate holders. In this statute, however, it was likewise required that the holders of two-thirds of the outstanding certificates should consent thereto in writing before the plan could become effective. The difficulty involved in obtaining such consent, as well as the administrative disabilities under which the Superintendent of Insurance acted led to the enactment, in 1935, of the Mortgage Commission Act, which created a special administrative tribunal to deal with the problem of guaranteed certificates and to promulgate plans for the reorganization of mortgages. The new Commission thus formed had the limited function of dealing with mortgages which were sold by guaranty companies and which were distributed in the form of guaranteed participation certificates. As in the case of the Burchill Law, plans of reorganization promulgated by the Commission or by the holders of certificates were presented to the court for approval and could become effective if the holders of more than one-third of the outstanding certificates in any mortgage did not, in writing, dissent within a limited time.

As the result of these enactments, a complete machinery was established, both in the state and in the federal courts, with which to treat the difficult problems and the conflicting interests that existed in the case of publicly held mortgages
on real property. Within a short time, the business generated by these statutes assumed huge proportions and nearly all the defaulted mortgages sooner or later came before one or the other of these tribunals for consideration and reorganization. It remains to tell how these statutory remedies operated in practice and to compare them with each other with respect to the desideratum of such legislation, namely, speed, efficiency and ultimate fairness.

Perhaps the simplest way of illustrating the procedure under each of the aforementioned statutes is to explore the process of reorganization in specific cases. Taking as our first illustration a proceeding in the federal courts under 77B of the National Bankruptcy Act, we refer to the reorganization of the mortgage on the Broadmoor Apartments. Upon this very large property, a mortgage of $2,280,000. had been placed and bonds in that amount sold to the public. On April 1, 1930, the first default occurred, but nothing was done to initiate any proceedings for reorganization until the 6th of September, 1934, when the petition in 77B was filed. The final order in reorganization was not signed until May 12, 1937, thus indicating that a period of two years and eight months elapsed in order to put through the federal court a plan of reorganization. The cost of operating the property during the period of reorganization consisted of the trustees' fee and the fee of the trustees' counsel. The former amounted to $11,900., and the latter to $7,990., or a total of $19,890. The process of reorganization involved substantial costs. There were, first of all, trustees' fees of approximately $7,000. There was a trustees' counsel's fee of $8,500.; committees for bondholders were allowed $16,800.; committees' counsel were allowed $14,700.; other counsel who had appeared for various interests were allowed $19,000.; miscellaneous reorganization expenses amounted to $4,800. The total cost was approximately $91,000., or 4% of the face amount of the bonds outstanding.

For this vast expenditure of money, the bondholders received an important advantage. The property was reduced to possession of a corporation in which the bondholders now owned stock as well as bonds. The management of the affairs of this corporation was entrusted to individuals appointed for that purpose by the federal court. It was now possible for
court-appointed trustees to exercise the necessary powers with regard to the real property. A new mortgage could be raised in a financial institution with which to pay tax arrears or to make any improvements in the property or to make a cash distribution among the bondholders. Should any purchaser appear or the market for real estate improve, the property could be sold and the bonds ultimately liquidated. Efficient management in the interests solely of the bondholders could be maintained and a time looked forward to when the full salvage value of the security could be realized by the security holders.\footnote{15}

One wonders whether so long a period of time and so high a cost of reorganization was absolutely indispensable under the circumstances. But the tradition of procedure in the federal courts rendered the result almost unavoidable. Bondholders were represented by committees and the committees employed counsel. Each of these were parties to the proceeding and made frequent appearances in court in the effort to effect the ultimate plan of reorganization. There was no tribunal such as the Mortgage Commission, which existed in the state courts, charged with the duty of formulating plans of reorganization on a large scale. There were, therefore, no stereotype plans of reorganization, and while most of the plans of reorganization closely resembled each other, they were worked out in each case anew as if the problem had no precedents. This enabled lawyers and committee-men to haggle with each other with respect to the terms of the reorganization plan, the provisions of documents like trust indentures, and voting trust agreements. Numerous conferences were held over matters of this kind, and disagreements were constantly referred to a court or special master. Since no plan of reorganization could be approved without the consent of two-thirds of the bondholders, it was necessary

\footnote{15 The actual history of this reorganization did not quite live up to the expectations of the plan. There were, in addition to the first mortgage bonds, second mortgage bonds outstanding and under the plan of reorganization the first mortgage bondholders received bonds with a 4% interest rate in addition to stock in the corporation, and the second mortgage bondholders received only stock. The interest on the new first mortgage bonds was fixed at 4%. The difficulty which developed was that the company was unable to earn enough to pay this fixed interest, with the result that in 1940 a new foreclosure was instituted and this time the property is being reorganized under the Burchill Law in the state court.}
to satisfy these committees or they would vote their bonds against the plan. The result was the delay which the instant case is a typical example of, and this delay brought with it the concomitant evil of committees' and counsel fees, and the other high costs of reorganization.\textsuperscript{16}

An even worse example, from the point of view of cost and delay, was experienced in the reorganization of the Oliver Cromwell Hotel. That building had been subjected to a mortgage of $1,750,000., against which bonds had been sold in that amount to the public generally. The default having occurred on the 15th of November, 1930, a proceeding to foreclose the mortgage in the state court was instituted by the trustee on February 21st, 1931, in the course of which plans of reorganization under the Burchill Law were filed and referred to the Special Master. An enormous amount of tax arrears had been allowed to accumulate, with the result that it looked for a while as if the interests of the bondholders were going to be wiped out completely by a tax sale. A plan of reorganization was, however, worked out but the final order was not signed until the 1st of February, 1938, almost seven years after the proceeding was initiated. Again, the intervention of committees of bondholders and their respective counsel, and endless bickering and delay due to the exchange of ideas, brought about a large cost of reorganization. In this case, although the mortgage was smaller than that in the Broadmoor case, the costs were greater; exclusive of the cost of foreclosing and the referee's fee in foreclosure, the reorganization expenses amounted to $93,000., or a little

\textsuperscript{16} Applications for allowances were filed by seventeen lawyers and committees. The total amount of time claimed in these applications to have been spent is astronomical and the total amounts asked by lawyers and committees exceeded $125,000. The court allowed them, however, only $60,786.40. These allowances are neither liberal nor conservative for similar services rendered in other reorganizations in the federal court but are far in excess of any allowances made in the state courts.

Under the provisions of Chapter 10 of the Bankruptcy Act, which became effective June 22, 1938, notice of applications for allowances must be given to the Securities and Exchange Commission, 52 Stat. 901, 11 U. S. C. A. § 647 (1938). It has been the practice of the Commission, when such notice is given, to make recommendations to the court. This, for the first time, gives the court the advantage of the judgment of an administrative agency on the important question of allowances. Of course, under Chapter 10, the Securities and Exchange Commission is an important participant in all plans of reorganization, but it does not have power to promulgate plans or to supervise the reorganization of companies.
more than 5% of the total issue. Trustees' counsel was given $3,000.; committees were awarded $30,000.; committees' counsel were awarded $16,000.; reorganization expenses of various kinds were $11,500.; miscellaneous counsel received $7,500.; the cost of foreclosure itself was $18,500., and the referee in the foreclosure proceeding, to whom the plan of reorganization was referred, was awarded $10,000.17

Here, too, as in the prior case, the net result to the bondholders was the reorganization of the property by placing it in the hands of a corporation manned and controlled by judicial appointees, serving in the interests of bondholders generally and with full power to operate, manage and sell the property for the benefit of the bondholders and for the ultimate liquidation of their investment.

A detailed analysis of the steps taken to reorganize the two properties already referred to will not reveal any waste, omission or any unusually large expenses. On the contrary, studied efforts by bondholders' committees and their counsel to bring about accord will appear at every step, but the machinery of judicial procedure is traditionally slow and traditionally costly, and without the interposition of an administrative agency with legal power to act for the class affected no short cut could be accomplished, and no substitute for the process of judicial hearings and the litigation of differences could be hoped for.

In sharp contrast is a typical proceeding for reorganization under the Schackno Law. As an example, we might take an issue held by the Bond and Mortgage Company of participation certificates amounting to $1,100,000.—BMC 212252. This property went into default on July 1, 1933, when the guaranty company was taken over by the Superintendent of Insurance, who continued to service the mortgage and to pay the interest to the certificate holders. On February 19, 1936, a plan of reorganization was filed under the Schackno Law, and was completely consummated by September 1, 1936, within six months. The total cost of the plan of reorganiza-

17 In this case, the situation was complicated by the fact that there were arrears of taxes in excess of $400,000. The plan of reorganization, therefore, provided that the trustees could borrow, on a new first mortgage, enough to pay off the arrears in taxes and distribute to the bondholders subordinate bonds and shares of stock.
tion to the certificate holders was approximately $2,000., which consisted of the trustee's fee, and was less than one-fifth of one per cent of the face value of the bonds outstanding. There were no committees of certificate holders and no committees' counsel, and no fees of any kind or description awarded to anybody. The plan was worked out by the Superintendent of Insurance and his aides, under the administrative authority conferred upon them by the Schackno Law, was presented in a brief hearing before the court and promptly approved. A trustee, to act for the certificate holders, was appointed with full power to manage and operate the property and the same values for which the bondholders in the prior instanced cases had paid 4% and 5% of the amount of their bonds and had endured the agonized waiting of years were accomplished in a few months at a practically nominal cost.18

Another instance of speedy and inexpensive reorganization is the large issue sold by the New York Title Company, known as N-60, in which certificates in the sum of $2,800,000. were sold to the public, and which was reorganized under the Mortgage Commission Law by the Mortgage Commission,

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18 Under the plan of reorganization approved in this case, an individual was appointed by the court as trustee to hold the bond and mortgage. The mortgage was extended for a period of three years from January 1, 1936. During the interim, the owner was to pay interest at the rate of 5½% and 1% on account of the principal. The trustee was vested with the following powers, in these words:

"All the rights and powers of a single absolute owner of the above bond and mortgage and property securing this series are to be vested in a Trustee, to be appointed by the Court. The Trustee will be vested with the full power to manage and liquidate the trust estate in the best interest of the certificate holders. The Trustee will also be vested with the power to enforce all claims which certificate holders, as a class may have against any persons or corporation. The manner in which the Trustee may exercise its power will be defined in a declaration of trust in substantially the form annexed hereto and marked Exhibit 'B', and made a part of this plan. This declaration of trust and the trust, may at any subsequent time, be amended or terminated with the approval of the Court when consented to by the holders of two-thirds in principal amount of the outstanding certificates."

Under this plan, the trustee was required to file an annual budget with the court. It is the general purpose of this plan for the trustee to continue to receive the interest and amortization payments and ultimately to collect the principal when the amount thereof shall be low enough to permit refinancing.

At the end of the three-year period, the trustee entered into a further extension of the mortgage with the owner whereby the rate of interest was stepped up to 5½% and the rate of amortization payment was stepped up to 1½%.
acting under the authority vested in it by the Legislature. The proceeding was instituted on June 16, 1936, and was concluded on December 31st of the same year, only six months after the petition had been filed. The total cost amounted to $18,281, or less than one-half of one per cent of the face value of the certificates outstanding. Even this cost would not have been incurred had it not been necessary to allow $7,000 to counsel for the solution of special problems that had arisen during the course of the proceeding, and again the certificate holders received for this comparatively small cost all of the values that they received in the other cases for the much larger expenditure. Here, too, a trustee was appointed with full power to act in the process of liquidating the estate and of salvaging all the values that were there.¹⁰

Of course, in the case of proceedings under the Mortgage Commission Act and under the Schackno Law, the cost of operating the Commission and of maintaining the office of the Superintendent of Insurance was, to some extent at least, absorbed by the State of New York out of public funds. But

¹⁰ In this case, the mortgage was extended by the plan of reorganization to May 1, 1941, and a rate of interest of 5½% was fixed; provision was made for the payment of specific amounts on account of the principal of the mortgage. Because of the provisions of the New York Moratorium Law preventing foreclosure of the mortgage for failure to make payments on account of the principal debt, a provision was inserted imposing a penalty upon the owner for failure to make the principal payments. The penalty consisted of an increase in the rate of interest to 6%. Again, the trustee was required to file annual budgets and was given wide powers, of the same character referred to in connection with BMC 212252 (supra note 18).

An interesting feature of this case was the determination which was made by the Court of Appeals in connection with a specific legal problem that arose therein. In this case, the guaranty company had collected 6% interest on the mortgage but had only paid to the certificate holders 5½%, in accordance with its guaranty. The liquidator of the guaranty company claimed that the differential between 5½% and 6% belonged to him as liquidator. The Mortgage Commission maintained, on behalf of certificate holders, that the differential belonged to the certificate holders in view of the default and that the most that could be recovered by the liquidator was his actual out-of-pocket expense in administering the estate. The contention of the Mortgage Commission was finally upheld by the Court of Appeals (see In re Morgan—New York Title & Mortgage Co., 277 N. Y. 203, 14 N. E. (2d) 39 (1938)).

This case illustrates the celerity and dispatch with which an administrative tribunal can move in matters of this kind, even where they involve the settlement of contested legal differences. The whole matter, as has been seen, consumed only six months and the cost was comparatively negligible, but the certificate holders secured the full benefits of reorganization and their property was concentrated in the hands of a responsible trustee, obliged by the order of his appointment to report periodically to the court, and subject to constant judicial supervision.
even adding these appropriations to the cost of reorganizing the properties and dividing them among the properties reorganized, the actual cost turned out to be much smaller than that incurred in the reorganization of similar properties under the Burchill Law or 77B in the federal court. The absence, in the latter cases, of a governmental agency charged with duties and endowed with powers to act and to bring conflicting parties into accord, and to engage the confidence of the security holders, was, of course, the primary lack in the proceedings under the Burchill Law and in the federal court.

It is much too early to tell the whole story of the reorganization of real estate securities made necessary by the economic depression of the last decade. Time must elapse before we can complete the record and indicate how much, if anything substantial, the bondholders and the certificate holders will have realized. Much depends on the progress of general economies in the country. Much depends on the efficiency of the machinery which has been created for the liquidation of these investments. One feels, in the last analysis, the integrity of the trustees and their willingness to subordinate their own interests to those of the security holders will contribute in large part to the determination of the wisdom of the plans adopted. Trustees' commissions only continue so long as there is a trust estate and it is not inconceivable that this fact will play a part in the liquidation of trust estates. The result in terms of benefits to the security holders can only be determined after the history of the next few years shall have been written.

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