St. John's Law Review

Volume 8
Number 2 *Volume 8, May 1934, Number 2*

Article 9

June 2014

# Schackno Act and Reorganization

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in truth liberality in construction and appreciation of the fact that where a charitable intent manifests itself in a will, however vague, if possible to do so, the intent should be given effect.

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## SCHACKNO ACT AND REORGANIZATION.

As Samson sent the walls of the temple crashing about the heads of the Philistines, so has President Roosevelt sent reputedly sacred and inviolable legal precepts crashing about the heads of the "precedent" lawyers. By applying, to the fullest extent, the weight of popular support to the powerful lever of public opinion, the President has sufficiently disturbed "solid" foundations of the law so as to afford an opportunity for legal reform such as has never before been presented since the formation of the country. "Emergency" legislation passed in former times was admittedly but temporary; that which is being passed under the guidance of the present administration has for its end the permanent reformation of an apparently imperfect governmental philosophy. It may designate itself as "temporary" legislation, but, as an integral part of the New Deal, it must, of necessity, have for its ultimate purpose an effect as permanent and lasting as has the New Deal itself. Never has the adage that "a chain is as strong as its weakest link" been more forcibly illustrated.

As a part of this reform program, the Schackno Act[1] has been enacted in New York. Its validity was challenged and it was held, by Judge Frankenthaler, to be unconstitutional.[2] Such decision was reached in spite of the fact that the same statute had previously been declared constitutional by Judge Morschauser in *Schmaling* v. *Burling*,[3] and by Judge Hinkley in *Matter of Title & Mortgage Guarantee Company of Buffalo*.[4] The latter case, as well as the instant

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[1] L. 1933, c. 745.

[2] In the Matter of the Application of Abrams for an Order Restraining Van Schaick, Rehabilitator, from making payments under c. 745, L. 1933.

Such legislation may be validly enacted by Congress for the prohibition against the enactment of laws impairing the obligation of contracts is directed only against the states. Sinking Fund Cases, 99 U. S. 700, 718 (1878).

See Canada Southern Railway v. Gebhard, 109 U. S. 527, 535, 536, 3 Sup. Ct. 363 (1883), wherein the court, having reference to legislation similar in substance to that herein involved, said: "The confirmation and legalization of 'a scheme of arrangement' under such circumstances is no more than is done in bankruptcy. * * * In no just sense do such governmental regulations deprive a person of his property without due process of law. They simply require each individual to so conduct himself for the general good as not to unnecessarily injure another."

[3] 269 N. Y. Supp. 747 (1933).

[4] 149 Misc. 643, 269 N. Y. Supp. 16 (1933).

case, was appealed directly to the Court of Appeals as permitted by the Civil Practice Act,[5] and it was reached for decision first.[6] The Court, on appeal, affirmed the *Buffalo* case, thus declaring the Act constitutional.

In upholding the constitutionality of the Act, the court relied mainly upon the recent decisions of *Home Building and Loan Association* v. *Blaisdell*[7] and *People* v. *Nebbia*.[8] Quoting from the former, the court said:

> "Not only are existing laws read into contracts in order to fix obligations as between the parties, but the reservation of essential attributes of sovereign power is also read into contracts as a postulate of the legal order. The policy of protecting contracts against impairment presupposes the maintenance of a government by virtue of which contractual relations are worth while—a government which retains adequate authority to secure the peace and good order of society. * * *
>
> "This principle of harmonizing the constitutional prohibition with the necessary residuum of state power, has had progressive recognition in the decisions of this court. The economic interests of the state may justify the exercise of its continuing protective power, notwithstanding interference with contracts.
>
> "The question is not whether the legislative action affects contracts incidentally, or directly, or indirectly, but whether the legislation is addressed to a legitimate end and the measures taken are reasonable and appropriate to that end."

And even more recently, the Supreme Court of the United States, in the case of *Nebbia* v. *People*,[9] repeated the thought:

> "But neither property rights, nor contract rights, are absolute; for government cannot exist if the citizen may at will use his property to the detriment of his fellows, or exercise his freedom of contract to do them harm. Equally funda-

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[5] N. Y. CIVIL PRACTICE ACT (1933) §588, subd. 3.

[6] N. Y. L. J., April 3, 1934.

[7] 78 L. ed. 255 (1934).

[8] 262 N. Y. 259, 186 N. E. 694 (1933).

[9] N. Y. L. J., March 14, 1934.

For the effect of the declaration of an emergency, see Block v. Hirsch, 256 U. S. 135, 41 Sup. Ct. 458 (1920); Brown v. Feldman, 256 U. S. 170, 41 Sup. Ct. 465 (1920); Edgar A. Levy Leasing Co. v. Siegel, 230 N. Y. 634, 130 N. E. 923 (1921), *aff'd*, 258 U. S. 242, 42 Sup. Ct. 229 (1921); People v. LaFetra, 230 N. Y 429, 130 N. E. 601 (1921).

As indicative of the trend of the courts, see Bank v. Haskell, 219 U. S. 104, 111, 31 Sup. Ct. 186 (1911); Hough, *Due Process of Law—Today* (1919) 32 HARV. L. REV. 218, 233.

mental with the private right is that of the public to regulate it in the common interest."

It is not the intention of the writer to dwell upon the question of what constitutes a valid exercise of the police power of the state, whether such exercise is the result of an emergency or not. The same result, *i. e.*, that the enactment is constitutional, may be reached through analogy to the procedure followed by courts of equity with regard to corporate reorganizations.[10] The vagueness of the limits within which the police power may be validly exercised makes it advisable to sustain the Act upon some other grounds.

The principal objective of the Act is the simplification of the problem of reorganization for the holders of guaranteed mortgage participation certificates. That the subject is one of widespread importance is evidenced by the fact that in New York State alone an amount in excess of $1,000,000,000. worth of such certificates have been issued.[11] Its importance is further evidenced by the consideration that investment therein has not been restricted to a small capitalistic group; on the contrary, investment therein is widespread, persons of moderate means holding the great majority of the certificates.[12] When we further realize that the certificates are a legal means of investment for trustees,[13] we are constrained to increase the scope of their importance. The necessity for protection of these holders, as well as of the guaranty companies, is apparent from the acknowledgedly torpid condition of the real estate market. That by such designation we are more than flattering the actual situation is epitomized by the farce that was the Hotel Pierre foreclosure "sale." There, the property, evaluated at $10,000,000., was "sold" for $200,000. and the *only* bidder was the reorganization committee.[14]

This condition has caused a corresponding loss of income from the property. There need be no citation of authority to bear out the statement that rental values have decreased as sharply as vacancies have increased. The owners have been forced to default in payment of taxes, of interest, of principal; the guarantors' reserves

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[10] Matter of Title Guarantee & Trust Co. of Buffalo, *supra* note 6: "So, too, analogy may be found in decrees of courts of equity providing for corporate reorganizations."

[11] L. 1933, c. 745, §1; Letter, dated February 21, 1934, to Governor Lehman from George W. Alger, Moreland Commissioner.

Appellant, in his brief (p. 18), places the estimate at $3,000,000,000, thereby including guaranteed mortgages with the guaranteed mortgage participation certificates.

[12] The average investment is $3,000. Appellant's Brief, p. 18.

[13] N. Y. PERSONAL PROPERTY LAW (1933) §21.

[14] These, as well as all subsequent figures, are, unless otherwise indicated, taken from Appellant's Brief.

have been dangerously sapped; the security holders have been forced to foreclose.[15]

But foreclosure in itself brings nothing. There are no bidders and the mortgagee is forced to take the property. This necessitates a reorganization.

At best, reorganization is vexatious, and at all times it is costly. Yet it seems to be the only solution under our existent law.

"Each certificate holder has the rights of a tenant in common * * *." [16] That common interest of the participation certificate holders, both in the mortgage and in the security, effectively prevents a change in the lien by any direct means unless the consent of every holder of a certificate—no matter how minute that interest might be—is obtained.[17] "* * * and so where there is a default, the only recourse in the absence of such consent is to foreclose." [18] It is to remedy just such condition that the Schackno Act has been passed. Its most important provision permits certificate holders, in principal amount of 33⅓%,[19] to promulgate a plan of reorganization and, provided that two-thirds in principal amount [20] consent to the plan, which must have the approval of the court, it will be binding upon the remaining one-third.[21] Therefore, bearing in mind this principal objective of the Act and the speedy means offered by which an effective control of the property may be had, let us

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[15] Indicative of such is the following chart, taken bodily from Appellant's Brief. It concerns only those mortgages contained in Group Series F-1:

| | | | Arrears | | |
|---|---|---|---|---|---|
| *Classification* | *No. of Mtges.* | *Principal* | *Interest* | *Taxes* | *Amortization* |
| Owner in Possession No Arrears | 4 | $ 713,250.00 | 0 | 0 | $ 6,000.00 |
| Owner in Possession Arrears | 39† | 8,419,331.67 | $ 142,110.27 | $ 212,916.60 | 303,630.00 |
| Assignments of Rents | 34 | 9,767,050.00 | 726,757.25 | 665,173.76 | 471,000.00 |
| Under Foreclosure | 4 | 600,200.00 | 33,674.33 | 26,908.75 | 23,700.00 |
| Foreclosed | 40 | 8,390,875.00 | 275,249.15 | 165,808.40 | 164,750.00 |
| Total | 121 | $27,890,706.67 | $1,177,791.00 | $1,070,807.51* | $969,080.00 |

* Does not include second half 1933 taxes.
† Includes assignments of rents held in escrow.

[16] Instant case; Spring, *Upset Prices in Corporate Reorganizations* (1919) 32 HARV. L. REV. 489; FLETCHER, CYC. CORP. (Perm. Ed.) §7271; see Brooks v. Vermont Central R. Co., 22 Fed. 211 (C. C. Vt. 1884).

[17] FLETCHER, *loc. cit. supra* note 16.

[18] *Ibid.*

[19] *I. e.*, exclusive of those certificates held by the guarantor, L. 1933, c. 745, §3.

[20] *Ibid.*

[21] L. 1933, c. 745, §6.

examine the means which would, in the statute's absence, have to be resorted to in order to obtain such control.[22]

It has been before shown that the certificate holders cannot, by direct means, effectuate any change in lien unless there be a unanimity of consent to such modification.[23] But, the mere existence of such hindrance does not dispense with the necessity of the reorganization. Therefore, to achieve such end, it is necessary to proceed in a roundabout manner, namely, by foreclosure.[24] That this apparent contradiction in terms[25] is, in truth, not such, is revealed by the actuality that "the foreclosure sale on reorganization is more or less a formal matter; a device rather than a fact. It serves the purely formal purpose of removing the lien. * * *" [26]

Nor is the recognition of the artificiality of the foreclosure sale wherein there is involved a reorganization confined to the mere statement of a text-book writer.[27] On the contrary it has proceeded far, both in this country and in England. In the latter country, there has been passed a statute which governs reorganizations[28] and dispenses with the technicality of sale. Likewise in this country, Kentucky[29] has passed a somewhat similar law. So far has this recognition progressed that, even without the aid of statute, the formality was dispensed with in the famous *Phipps* case.[30] Simply stated,

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[22] It is the general practice that an exclusive agency be conferred upon the guarantor for the purpose of allowing it to bring any action that may be necessary. Matter of Nemerov, 149 Misc. 797, 268 N. Y. Supp. 582 (1934). Nevertheless, the assumption is here made that no such contract rights exist, for their existence only complicates the procedural aspect. Kline v. 275 Madison Avenue Corp., 149 Misc. 747, 751, 752, 268 N. Y. Supp. 588 (1934), where the court indicates that the participation certificate holder who has so contracted has open to him but two courses: (1) To proceed under the Schackno Act, or, (2) To petition "* * * to obtain a judicial decree revoking the exclusive agency previously conferred upon the guarantor and permitting the institution of foreclosure proceedings * * *" whereupon "* * * the court may, if convinced that the opposition is interposed unjustifiably and in bad faith, and *perhaps* for other reasons, grant the decree applied for."

See also WILTSIE, MORTGAGE FORECLOSURE (4th ed. 1927) §322.

[23] *Supra* note 18; see Matter of Nemerov, *supra* note 22, at 803.

[24] WILTSIE, *op. cit. supra* note 22, §321.

[25] For reorganization connotes "* * * the act or process of organizing anew." FLETCHER, *op. cit. supra* note 16, §7201.

[26] FLETCHER, *loc. cit. supra* note 16; Weiner, *Conflicting Functions of Upset Prices in Corporate Reorganizations* (1927) 27 COL. L. REV. 132, 137.

[27] Phipps v. Chicago, R. I. & Pac. Ry., *infra* note 30, at 952: "It is true that there was a judicial sale in that case (Kansas City, Southern Ry. v. Guardian Trust Co., 240 U. S. 166, 36 Sup. Ct. 334 [1916]) and that in the case in hand there has been no judicial sale; but it was not the judicial sale that made the decree and the title of the reorganized company impervious to the attacks of the creditors of the old company."

[28] RAILWAY COMPANIES ACT, 1867, 30 and 31 Vict. c. 127.

For an analysis of the Canadian system of "reconstruction," see Fraser, *Reorganization of Companies in Canada* (1927) 27 COL. L. REV. 932.

[29] See FLETCHER, *loc. cit. supra* note 16.

[30] Phipps v. Chicago, R. I. & Pac. Ry. Co., 284 Fed. 945 (C. C. A. 8th, 1922), *certiorari* granted 261 U. S. 611, 43 Sup. Ct. 363 (1923), dismissed per stipulation, 262 U. S. 762, 43 Sup. Ct. 701 (1923). The case seemingly repre-

that case made it compulsory upon the dissenting minority security holders, by enjoining them from other action on their part, to join in the plan of reorganization promulgated by the majority and approved as to fairness by the court. The only departure from the customary routine was the lack of foreclosure sale; in other features, the case is but ordinary. Yet despite the fact that such omission is its only distinguishing feature, the method followed has been frequently doubted as to soundness from the legal standpoint.[31] While it is perfectly true that the method has not been followed in subsequent decisions, it is equally true that it has not been overruled. The method, were it once approved as to form, would undoubtedly be the preferable one since it does away with many of the technicalities and consequent delays. Reason may be found for the lack of subsequent decisions of approval in the fact that corporation lawyers do not wish to take upon themselves the responsibility of advising clients as to their safety in taking new securities under such procedure when they can be certain of safety through reliance upon time tested and approved precedent.

Although there be no sound reason for not following the *Phipps* case, it is undeniably the fact that such procedure is not usual. The general practice of the courts is to adhere to the farce of foreclosure sale. It is necessary, therefore, to consider in what respects, if any, such procedure differs in result from that attained by the Schackno Act.

It has ever been the problem to get a fair price for the property foreclosed. The earliest practice was to reopen the bid upon an advance of 10% in the price bid.[32] This procedure was obviously faulty in that it resulted in uncertainty both to the bidder and to the seller as to whether or not there was a consummated sale. It was finally suggested that a minimum sale price be set below which no sale would be confirmed.[33] The suggestion was adopted and has been followed in substance ever since.

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sents a mean between the established procedure and that authorized by the Schackno Act for, by the usual procedure, except for the sale, "* * * it not only imposed on the minority creditors a plan approved by the court, but restored the property to the defendant-corporation and required non-assenting creditors to take stock for their claims, enjoining other action on their part." Rosenberg, *Phipps v. Chicago, Rock Island and Pacific Ry. Co.* (1924) 24 COL. L. REV. 266, 267.

See Chicago, R. I. & Pac. Ry. Co. v. Lincoln Horse & Mule Commission, 284 Fed. 955 (C. C. A. 8th, 1922).

For other similar cases, see American Brake Shoe & F. Co. v. Pittsburgh Ry., 296 Fed. 204 (W. D. Pa. 1918); Gates v. Boston & N. Y. Air Line R. R., 53 Conn. 333, 5 Atl. 695 (1885) (the statute making the will of the majority compulsory upon the minority existed before the making of the mortgage in controversy).

[31] SWAINE, SOME LEGAL PHASES OF CORPORATE FINANCING, REORGANIZATION AND REGULATION (1931) 133, 167 *et seq.*

[32] Weiner, *supra* note 26, at 133; TRACY, CORPORATE FORECLOSURES (1929) §240.

[33] Jervoise v. Clarke, 1 Jac. & W. 388 (1820).

But, the practice of setting an upset price has seemingly found favor only in the Federal Courts.[34] Since its first use in the *Blair* case[35] it has developed until it is now the usual practice to set a price below which no sale will be confirmed.[36]

There is no conflict of opinion as to the purpose of the upset price.[37] Its birth was the result of the endeavor to secure a fair price for the property sold. As it developed to its present form, there has always existed the acknowledgment that its purpose is the insuring of a fair price to dissenters for their holdings.[38]

Generally, the three types of persons interested in the securing of a high upset price are: (1) Dissenting bondholders; (2) unsecured creditors; (3) the guarantor, if any, of the bonds.[39] It goes almost without saying that the reorganization committee is interested in the fixing of as low a price as the court can be induced to set.

There being conflicting interests, upon what theory may the court fix the price? We have already seen that it is virtuously protested that the object of the upset price is the protection of the dissenter. However, even Professor Weiner, as well as the courts, which at various times have used all four methods, ignores that purpose when stating the theories upon which the estimate may be based. These theories are:

> Method A: A merely nominal amount over and above the expenses of reorganization and prior claims.
>
> Method B: An amount based upon the scrap value of the property.
>
> Method C: An amount which would assure to the non-participators the equivalent in cash of that which the reorganizers receive in securities.
>
> Method D: The highest figure which, in the opinion of the court, would allow success to grace the new venture.[40]

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[34] Weiner, *supra* note 26, at 137.

In the West, the prevalent practice is to regulate sale prices by means of legislation. 35 C. J. 17.

[35] Blair v. St. Louis, H. & K. Ry., 25 Fed. 232 (C. C. Mo. 1885).

[36] FLETCHER, *op. cit. supra* note 16, §§7242, 7272.

See St. Louis-San Fran. Ry. Co. v. McElvain, 253 Fed. 123 (E. D. Mo. 1918).

The setting of the upset price is not compulsory, being rather within the discretion of the court. Palmer v. Bankers Trust Co., 12 F. (2d) 747, 754 (C. C. A. 8th, 1926).

[37] Weiner, *supra* note 26, at 138.

[38] Investment Registry, Ltd. v. Chicago & M. E. Ry., 212 Fed. 594, 609 (C. C. A. 7th, 1913); *In re* Prudential Outfitting Co., 250 Fed. 504, 507 (S. D. N. Y. 1918).

For insight into the history and development, see SWAINE, *supra* note 31, at 143 *et seq.*

[39] TRACY, *op. cit. supra* note 32, §207.

[40] Weiner, *supra* note 26, at 139, 140.

Now, taking all four methods into consideration (and, so far as appears, no other methods have been suggested) where is the protection to the dissenting minority? It is, of course, non-existent. Were Method C to be adopted, there would be no reorganization; it would be to the benefit of the bondholder to dissent for he would then receive cash equivalent in amount to the securities received by the depositor under the reorganization plan and be free from the possibility of further loss, whereas the reorganizer would be forced to expend more money and, in return for his double investment, receive securities which guarantee to him only the possibility of further loss. Method B would obviously be of no more protection than Method A. In either case, the bondholder would have to join to even possess the hope of salvaging anything from the wreckage which would be commensurate with the actual value of his holdings.

And Method D affords no greater protection.[41] It is but logical for the reorganization committee to be interested in making the purchase at the lowest possible figure. It "has an idea of how much money can be raised by the plan, and inferentially how much can be spared for dissenting bondholders." [42] Therefore, to again quote Professor Weiner:

> "* * * the court is not entirely a free agent in fixing upset prices, * * *. From the very fact that no one other than the reorganization committee will bid [43] the court must eventually fix a price which the committee will pay. Fixing the upset price may therefore resolve itself into a form of bargain between the court and the committee." [44]

And as to the bargain, it requires no discerning mind to see who has the better of it. True, the court may set its price, which may be just. But if it be not agreeable to the reorganization committee, there will be no buyer and what then is there left the court to do other than to, with as much dignity as it can muster, lower the sale price? [45] Consequently, with the setting of the figure, the

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[41] Moreover, the propriety of the adoption of either Method C or Method D is questioned. FLETCHER, *op. cit. supra* note 16, §7272; Spring, *supra* note 16; SWAINE, *supra* note 31, at 167 (that concern which is the subject of sale is a "broken down machine," naturally selling at a substantially lower price than a going concern).

[42] Weiner, *supra* note 26, at 142.

[43] FLETCHER, *op. cit. supra* note 16, §§7272, 7273.

[44] Rodgers, *Rights and Duties of the Committee in Bondholders' Reorganizations* (1929) 42 HARV. L. REV. 899, 911.

[45] BYRNE, SOME LEGAL PHASES OF CORPORATE FINANCING, REORGANIZATION AND REGULATION (1930) 77, 135: "Moreover, fixing an upset price and getting it are two different things. If no one bid the amount fixed the court would have to reduce it."

See TRACY, *loc. cit. supra* note 32: "In other words, the reorganization committee will have only a certain amount of money available to pay non-

ranks of the reorganizing bondholders swell to a considerable extent.[46] The courts, fully recognizing such fact, usually make it a condition to confirmation of the sale that the dissenters be allowed to join.[47]

The result is, therefore, that the dissenter must join in the plan if he wishes to adequately protect his interest. While there can be no doubting of the dissenter's right to his *pro rata* share of the proceeds in cash,[48] it is seldom that such does happen, unless it be through inadvertence and mistake on the part of the security holder. Under the Schackno Act, such unfortunate occurrence cannot take place.

While the protection of the dissenting minority bondholder has been emphasized and is an important consideration, it is also true that the protection of the majority must be recognized as an important function of the Act. "Hold-up" minorities ofttimes instigate litigation for the sole purpose of delaying the reorganization, hoping thereby to force the majority to buy them out in order that they, the majority, might pursue a plan of reorganization which would ultimately result in profit.[49] The chances in such case of a forced settlement are extremely favorable, the more especially when the situation is such as at the present time exists with regard to the participation certificate holders. In such cases as these, reorganization is imperative and unless rushed through in the shortest possible time, the deterioration to the buildings on the property, as well as the other receivership expenses, is likely to be great enough to practically prohibit the success of any reorganization.

Moreover, it is by no means uncommon for a minority to exist hoping solely that some technical misstep be made by the proponents of the reorganization. If luck be with the minority wherein such is the situation, an inadvertent omission can result in a defeat of

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participating bondholders, and if the upset price is fixed at too high a figure, the plan will fail and the committee will not bid."

[46] Weiner, *supra* note 26, at 143: "No general statistics are available as to the results of these upset prices in practice, but even a casual study of the proportion of bondholders depositing under a plan reveals that after the upset price has been fixed * * * the minority dwindles into insignificance."

[47] Southern Pac. Ry. v. Bogert, 250 U. S. 483, 39 Sup. Ct. 533 (1919); Shaw v. Little Rock & Ft. Smith Co., 100 U. S. 605, 609, 610 (1879); Palmer v. Bankers Trust Co., *supra* note 36.

[48] FLETCHER, *loc. cit. supra* note 16; Weiner, *supra* note 26, at 137.

[49] SWAINE, *supra* note 31, at 163, 164: "Receiverships are always expensive luxuries, and once a plan of reorganization has been agreed upon by a majority of the security bondholders, its prompt consummation is imperatively desirable, in order to obtain, at the earliest possible moment, the cessation of the drain * * *, the savings presumably provided by the plan and the elimination of uncertainty in the personnel of the organization. Minority factions usually avail themselves of this value to the majority * * * to seek delay and, by their opposition, to create for their bonds * * * a maneuvering value which will secure them better terms than are given others of their class, or gain advantages for their class at the expense of other * * * participants."; TRACY, *op. cit. supra* note 32, §281.

the plan. And the majority, in order to prevent such financial calamity as may be the result, may be forced to buy out the dissenters upon the basis of 100 cents on a dollar.[50]

Flowing correlatively from the above outlined system is a situation, the importance of which to this question cannot be overemphasized. Undoubtedly, the statute does not have as its main object the protection of the guaranty companies, yet that element is specifically mentioned [51] and so cannot be disregarded in its entirety. Indeed, even though it were not so mentioned, it could well be said that such object would necessarily be read into the enactment due to the fact that the business of the guarantors is so substantially tinged with public interest.[52] Thus, the consideration of the protection of the funds of the guaranty companies must enter into the discussion. Exclusive of the statute, protection is lacking.

Making the most favorable concession for the continuance of the common law method, namely, that Method C is used in the determination of the upset price, still, in these parlous times at least, this figure would be far below the principal amount of the issue. From the very nature of things, it must be below such principal amount, for the motivating force behind foreclosure is the depreciated value of the property against which the certificates were issued. Such being the case, the situation which caused the litigation in *Equitable Trust Co. of N. Y.* v. *Western Pacific Ry.*,[53] would be recurring with alarming frequency. The facts there were, *X* Corporation had floated an issue of bonds in the principal amount of $38,000,000., which issue was guaranteed as to payment by the defendant. Unfortunately for all concerned, the *X* Corporation ran into financial difficulties and was forced to undergo reorganization. The bondholders began foreclosure proceedings and, after much litigation, an upset price of $18,000,000. was fixed and it was for such amount that the sale was consummated. Thereafter, this action was instituted on behalf of the bondholders to recover the difference between the guaranteed principal amount and the upset, or its equivalent, the sale price. Recovery was allowed, the Circuit Court saying (p. 339):

> "* * * the principal debt was the limit of liability, and that was diminished by what plaintiff's bondholders got in foreclosure."

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[50] Appellant's Brief at 36, 37.

[51] L. 1933, c. 745, §1.

[52] N. Y. INSURANCE LAW (1933) §170 *et seq.*

[53] Equitable Trust Co. of New York v. Western Pac. Ry., 244 Fed. 485 (S. D. N. Y. 1917), *aff'd sub. nom.*, Equitable Trust Co. v. Denver & R. G. R. Co., 250 Fed. 327 (C. C. A. 2d, 1918), *certiorari* denied, 246 U. S. 672, 38 Sup. Ct. 423 (1918).

And, the District Court (pp. 504, 505):

> "The sale establishes the value, and *any upset price whatever is a concession to the known uselessness of an auction in such cases.* If the upset price be too low, any creditor must protect himself by bidding.* * * That judicial sales are of small value to creditors, I cannot help; it results from applying the same procedure to the sale of a quarter section and of a system of national transportation."

There is no good reason, except a moral one, why such rule should not be applicable to cases arising hereunder. Attention, however, is called to the recently enacted laws governing foreclosure actions.[54] These provide, in substance, that no action to foreclose a mortgage shall be maintainable wherein it appears that the sole default relied upon is in the payment of principal, or of any installment thereof;[55] that, correspondingly, no action shall be maintainable upon any guarantee of payment of a mortgage unless an action to foreclose such mortgage would be permissible;[56] nor is the holder of a guaranteed mortgage participation certificate allowed to sue on the instrument as long as the rate of interest prescribed therein is paid.[57] However, it is also provided that the statute of limitations shall not run with regard to any action which would have accrued to any of the above were it not for the legislation enacted;[58] nor is the guarantor discharged by virtue of any of these provisions.[59] It is further provided that in any action against the guarantor of the mortgage to recover any of the indebtedness so secured the judgment therein shall be limited to "the fair and reasonable value of the mortgaged property less the amounts owing on prior liens and encumbrances."[60]

Assuming then that the courts will rule that the actual price, or that which in the court's estimation is the actual price, shall be the basis for the computation of any deficiency, still, it is submitted that such figure could not, based upon existing values, even approximate the face amount of the issue. That such result would be ruinous to the guaranty companies, many of which are already in the hands of the Rehabilitator, is apparent.

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[54] L. 1933, c. 793; N. Y. CIVIL PRACTICE ACT §§1077a-1077g; L. 1933, c. 794; N. Y. CIVIL PRACTICE ACT §§1083a, 1083b.

[55] N. Y. CIVIL PRACTICE ACT (1933) §1077a: "* * * a default * * * other than the non-payment of principal or an installment of principal * * * shall not be affected by this act."

[56] *Id.* §1077b.

[57] *Ibid.*

[58] *Id.* §1077f.

[59] *Supra* note 56.

New York Civil Practice Act (1933) §1077g exempts savings and loan institutions from the workings of the Act.

[60] N. Y. CIVIL PRACTICE ACT (1933) §1083b.

In effect then, what this procedure amounts to, is the setting of an upset price *after* the sale rather than before it, the purpose contemplated being the arbitrary assessment of deficiencies. It smells muchly as though the well-known practice of locking the stable after the horse has been stolen is being indulged in.

Moreover, the duration of the statutes is limited, by expressed terminology, to July 1, 1934,[61] although it does seem probable that their life will be prolonged by legislative act. In any event, however, it is seen that such statutes will but result in a short-lived delay of the natural consequences of the situation. It would be but a matter of time before another "Hotel Pierre" situation arose. Therefore, it would seem that a refusal by the court to set an upset price would not better the situation, but rather would render it the more precarious.[62] The ultimate result would be that the Reorganization Committee, usually the only bidder, would be able to compel the assent of the dissenters by offering a grossly inadequate price on the sale.[63] For these reasons, the statute should be held constitutional.

An appeal to the Supreme Court of the United States is being taken on the Schackno Act, but the writer believes that the decision

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[61] *Id.* §§1077g. 1083b.

[62] In the above-mentioned "Hotel Pierre" case, the mortgage on the property was $6,500,000. Deducting therefrom the $200,000 realized upon "sale," the obvious deficiency is $6,300,000. Equally obviously, no such deficiency could result were there an upset price fixed. Even assuming that the court, on the motion to assess the deficiency, were to set a price that would be the equivalent to the upset price, still such procedure would not be the preferable one, for while the latter would be the minimum price that could be realized for the property, the former would be the maximum.

[63] Spring, *supra* note 16, at 494, 503.

The truth of the statement is, moreover, exemplified by the actual practice. The following chart, with the figures thereon being taken from the files of the New York County Clerk, is found in Appellant's Brief (p. 35):

| *Property* | *Amount of Mortgages* | *Cents Paid to Dissenting Bondholders for Each Dollar Invested* |
|---|---|---|
| Pierre Hotel | $6,500,000.00 | .0207 |
| Central Zone Building | 2,006,000.00 | .1047 |
| 875 West End Avenue | 1,119,500.00 | .098 |
| 1133 Park Avenue | 675,000.00 | .357 |
| 910 Fifth Avenue | 1,100,000.00 | .048 |
| 522 West End Avenue | 478,500.00 | .1453 |
| Yorkshire Gardens | 750,000.00 | .154 |
| Erco Hall | 381,500.00 | .3619 |
| Cerana | 994,000.00 | .0974 |
| 827 West End Avenue | 1,119,500.00 | .1699 |
| Squibb Building | 4,500,000.00 | .0000 |

*Note:* Some of the percentages allocable to dissenting bondholders are subject to a further reduction for tax arrears.

will not be disturbed. To summarize: It is not quite in harmony with the spirit of the times to declare unconstitutional a statute, the principal fault of which is found in its outspokenness. We are gradually getting away from the antiquated formalities and fictions of the law. Today, if ever, we are in need of speedy legal processes. Foreclosure and reorganization, such as would be necessary as an alternative, is not inducive to rapid results. The Schackno Act dispenses with much of the hindering red tape. It has the further advantage of being economical, thusly resulting directly to the pecuniary advantage of the certificate holder. In that respect especially, it differs from the ordinary reorganization.[64]

Moreover, as has been shown, the latter method with all of its acknowledged legality accomplishes no more in the end than does the Schackno Act. The dissenters in a common law reorganization are compelled to join forces with the majority [65] if they are to obtain a remuneration which will compensate them for the value of the securities which they hold; the dissenters, by virtue of the mechanics of the Schackno Act, are compelled to assent to the plan due to the mandatory nature of the statute.

The enactment is not an example of the "all too ready resort of America to legislation." [66] The words of Mr. Rosenberg: "Let us leave the growth of our jurisprudence regarding this still developing subject of reorganization to the courts and the bar * * *," [67] express the exact sentiment which we must avoid. The judicial growth of the law governing reorganizations has not, in spite of the *Phipps* case,[68] been toward the simplification of the problem. What is needed to relieve the present plight of both securities holders and guaranty companies is a procedure which will make possible a speedy and economical reorganization of the security without any disturbance of the guarantee. The Schackno Act satisfies such need.[69]

WILLIAM E. SEWARD.

## A NEW IMPLIED COVENANT.

The recent case of *Kirke La Shelle Co.* v. *Armstrong Co.*,[1] directs our attention to the construction and interpretation of con-

[64] Referee's opinion, Chase National Bank v. 10 East 40th Street Corp., N. Y. L. J., Oct. 2, 1933, shows reorganization expenses in the amount of $346,640.38. Appellant's brief (p. 48) estimates the average cost of reorganization under the Schackno Act to be $3,000.

[65] Weiner, *supra* note 26, at 145: "The upset price * * * has become one of the most useful tools of the majority for forcing recalcitrants into line."

[66] Rosenberg, *supra* note 30, at 271.

[67] *Id.* at 272.

[68] *Supra* note 30.

[69] Schmaling v. Burling, *supra* note 4: "* * * the provisions of the Schackno Act are necessary in the exercise of the police power of the state to safeguard and protect the interests of the many against the few."

[1] 263 N. Y. 79, 188 N. E. 163 (1933).