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CORPORATIONS - REORGANIZATION UNDER SECTION 77 B - RIGHT OF MORTGAGE TRUSTEE TO VOTE TO EXCLUSION OF BONDHOLDERS

CORPORATIONS — REORGANIZATION UNDER SECTION 77B — RIGHT OF MORTGAGE TRUSTEE TO VOTE TO EXCLUSION OF BONDHOLDERS — The trustee under a mortgage bond issue which was in default with foreclosure pending, sought to vote to the exclusion of the bondholders on a proposed plan for reorganization in a voluntary proceeding by the corporation debtor pursuant to Section 77B of the Bankruptcy Act.[1] The trust indenture authorized the trustee on default to enforce the security by appropriate proceedings, and the individual bondholders were specifically forbidden to sue. The indenture also gave a majority in interest of the bondholders power by an instrument in writing to direct the procedure of the trustee or to remove him. There was no express provision as to the power claimed. *Held*, the trustee cannot exercise such power; it is unnecessary to decide whether the trustee should be permitted to vote for bondholders not joining a committee or individually voting, since more than two-thirds in amount have in fact joined a committee and thus the trustee could not affect the result of the voting under Section 77B.[2] *In re Allied Owners Corp.*, (C. C. A. 2d, 1934) 74 F. (2d) 201.

There is now general agreement on the broad proposition that bondholders are represented by the trustee to the extent that ordinarily, in the absence of fraud, breach of trust, or collusion, preservation or enforcement of the security is to be effected exclusively by the trustee, and the bondholders are bound by his acts.[3] Nevertheless, it is clear that all powers of the trustee are inevitably derived from the trust instrument itself and authority to represent the bondholders in any given act must necessarily be found there either expressly or by implication.[4] It would be doing violence to the instrument to construe the provision against action by individual bondholders, designed to guard against obstructionists and to prevent a multiplicity of suits,[5] so as to deprive the bondholders of their right to vote on a plan of reorganization. And such a construction seems flatly inconsistent with reservation of the powers of removal of the trustee and directive control. In none of the cases frequently relied on as authority for denying intervention by the bondholders was such intervention denied against the will of a majority of the bondholders.[6] Moreover, there is even distinguished

[1] 48 Stat. 912, 11 U. S. C. tit. 11, sec. 207 (1934).

[2] 77B (e) (1), 48 Stat. 912, 11 U. S. C. tit. 11, sec. 207 (e) (1934).

[3] 4 THOMPSON, CORPORATIONS, 3rd ed., sec. 2673 (1927).

[4] Lebeck v. Fort Payne Bank, 115 Ala. 447, 22 So. 75 (1896); Appeal of Harrisburg, etc. R. R. Co., 1 Mon. (Pa. Sup.) 692, 15 Atl. 459 (1888); Woods v. Woodson, (C. C. A. 8th, 1900) 100 Fed. 515.

[5] 27 COL. L. REV. 579 at 582 (1927).

[6] Palmer v. Bankers' Trust Co., (C. C. A. 8th, 1926) 12 F. (2d) 747; Farmers' Loan & Trust Co. v. Northern Pac. R. R., (C. C. S. D. N. Y. 1895) 70 Fed. 423 (dictum); Guaranty Trust Co. v. Chicago, etc. Ry., (D. C. N. D. Ill. 1926) 15 F.

authority *per contra* for allowing intervention by minorities in appropriate situations.[7] The recent cases authorizing the trustee to file proof of claim in bankruptcy for all the bondholders [8] afford no basis for supporting the trustee's claim in the principal case. The sound policy in enabling the trustee to act so as to avoid a total loss to the bondholders [9] is not present in the matter of voting on reorganization plans in the benefits of which an absent bondholder shares automatically without voting. The provisions of Section 77B, far from supporting the position of the trustee, actually militate against it. A procedure is outlined by which the trustee can be compelled to effectuate an approved plan.[10] Obviously such a provision is inconsistent with exclusive voting power in the trustee. Again, it is provided that a plan may be put into effect on approval by two-thirds in amount of each class of creditors.[11] Such a stipulation would be idle if the trustee's claim were sound. In conclusion, the court properly points out that the last mentioned provision renders it unnecessary to decide whether the trustee should be permitted to vote for absent bondholders since more than two-thirds had in fact joined a committee.[12]

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(2d) 434, aff'd, Jameson v. Guaranty Trust Co., (C. C. A. 7th, 1927) 20 F. (2d) 808, cert. denied, 275 U. S. 569, 48 Sup. Ct. 141 (1927).

[7] Guaranty Trust Co. v. Mo. Pac. Ry., (D. C. E. D. Mo. 1916) 238 Fed. 812, 816; Chase Nat. Bank v. 10 East 40th Street Corp., 238 App. Div. 370, 264 N. Y. S. 882 (1933).

[8] In re International Match Corp., (D. C. S. D. N. Y. 1932) 3 F. Supp. 445; In re Paramount Publix Corp., (C. C. A. 2d, 1934) 72 F. (2d) 219; In re United Cigar Stores Co., (C. C. A. 2d, 1934) 68 F. (2d) 895.

[9] 46 HARV. L. REV. 309 (1932).

[10] 77B (h), 48 Stat. 912, 11 U. S. C. tit. 11, sec. 207 (h) (1934).

[11] 77B (e) (1), 48 Stat. 912, 11 U. S. C. tit. 11, sec. 207 (e) (1934).

[12] Coercion of dissenters into a plan adopted by two-thirds in amount of each class of creditors and sanctioned by the court is one of the marked innovations in the new legislation. Swaine, "Corporate Reorganization under the Federal Bankruptcy Power," 19 VA. L. REV. 317 at 324 (1933).