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MUNICIPAL DEBT ADJUSTMENT AND THE SUPREME COURT

GEORGE H. DESSION†

Last May the Supreme Court of the United States once again entered what has been described as "a vast arena . . . filled with special interests which conflict and contradict and clamor." This is the scene of local government defaults and of the struggles and negotiations to which they give rise. Their frequency and wide geographical distribution since 1926 have become common knowledge. Our institutional unpreparedness to cope with such situations in a manner wholly compatible with the public interest has likewise been demonstrated. Not that this unpreparedness should have been news; but so few were the defaults between 1900 and 1926 that this particular field of controversy with its *sui generis* playing rules and tactics had until 1926 been but a colorful legend handed down to a relatively small group of legal and financial specialists in municipal bonds by their forbears.

It was a legend replete with stories of how local government units over-burdened with debt invoked every possible technicality against the validity of their outstanding obligations; of mandamus decrees obtained by creditors but rendered ineffective by local officials who had been elected with the understanding that they would spend their entire period of office in jail or in evading federal marshals; and of utterly fantastic state legislation enacted time and again as a last resort to bring creditors to their knees. Not a few participants emerged with the conclusion that " . . . Up to now the judicial process as applied to the settlement of the claims of the creditors of insolvent municipalities has had very little more tendency to attain a correct result than the common law trial by battle," and that such situations were "not subject to control or man-

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agement according to any known law, except the first law of nature . . . "4 But the generally—if superficially—tranquil state of municipal credit during the first quarter of the present century effectively obscured what might otherwise have been provocative experiences. Even when the Florida municipalities began to default following the collapse of the Florida land boom in 1926 it was generally agreed that "What was happening down there . . . could never happen in such regions as North Carolina, New Jersey, Ohio, Michigan, or Illinois."5

But as it became apparent that, after all, such things could happen, and were happening, not only in the states just mentioned but in a great many others, the legend speedily came to life. Experiences of the past were recapitulated and almost at once began to provoke legislative experiments in ways and means of devising more satisfactory governmental debt adjustment mechanisms. Two of these experiments have recently been involved in litigation before the Supreme Court. One elicited but a memorandum denial of certiorari of somewhat indeterminate import.6 The other, Ashton v. Cameron County Water Improvement District No. 1,7 squarely divided the Court five to four and elicited a majority opinion so forthright and sweeping in its terms that it must constitute a major premise in almost any subsequent considerations of the municipal debt adjustment problem as a whole. It is, therefore, the purpose of this article, conceived as an introductory sketch, to analyze what the Court has done and to attempt to forecast the extent to which it may be said to have narrowed or transformed the problem of ways and means.

1.

By 1932, extended negotiations between representatives of a debtor taxing district and of its creditors had already taken place in a great many situations. In not a few of them a complete plan for the readjustment and refunding of the indebtedness in question had been prepared, enabling legislation enacted, and assents to the plan obtained from a great majority of the creditors as well as of the debtor. But at this point a common obstacle to the consummation of many such plans cropped up8 and prompted the legislative experiment to which this article is addressed. With respect to the practical seriousness of this obstacle, however, and likewise the stress appropriate to be placed upon it in any

4. Id. at 42.
7. 56 Sup. Ct. 892 (1936).
8. See Hearings before a Subcommittee of the Senate Committee on the Judiciary on S. 1868 and H. R. 5950, 73rd Cong., 2nd Sess. (1934); Hearings before the House Committee on the Judiciary on H. R. 1670, etc., 73rd Cong., 1st Sess. (1933).
consideration of ways and means toward the promotion of order, fairness and economy in debt readjustment, there has been and still is a difference of opinion among specialists. The obstacle in question was the one emphasized by Mr. Justice Cardozo in his minority opinion in the Ashton case: "Experience makes it certain that generally there will be at least a small minority of creditors who will resist a composition, however fair and reasonable, if the law does not subject them to a pressure to obey the general will." The majority of the Court, possibly reflecting the difference of opinion adverted to, did not discuss the obstacle in question.

Clearing up a local government default ordinarily resolves itself in the end, as is often the case where a private debtor defaults, into a process of negotiation culminating in settlement by compromise. For, barring exceptional cases of outright repudiation by a local government unit entirely able to pay, litigation by creditors is but ancillary to this main process of extra-judicial negotiation. This is not to say that litigation is infrequent or futile. To reason thus would be to take it for granted that the debtor is always right and that the stage is always set for fair-minded and peaceable compromise. The fact is that where a debtor is disposed to question the legal validity of its obligations, proves unresponsive to negotiation, or where negotiations once entered into break down at any stage, creditors may find resort to litigation their sole weapon. In a like manner, threatened diversions of funds earmarked for debt service or resort to diverse illegal fiscal practices to the prejudice of creditors have been known to call for judicial restraint through mandamus or the injunction. Mandamus to reach a fund or to require a tax levy may also be necessary to prevent the obtaining of an unwarranted preference in fact by other creditors.

But in cases of factual insolvency as distinguished from outright repudiation, which is to say cases wherein the debtor taxing district cannot as a matter of fact raise or be made to raise funds sufficient to meet its obligations as they mature, there is no magic in mandamus or any other available judicial writ or decree which will enable the creditors as a whole to collect their due. Attachment and garnishment as methods for enforcing the payment of such claims may, save in New England,

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10. See S. E. C., op. cit. supra note 2, at 18 et seq.
11. In New England the creditor of a town or other quasi-public corporation, and in some instances of a city, enjoys a unique remedy available nowhere else in the United States, namely, the possibility of obtaining execution against the private property of inhabitants of the debtor taxing district to satisfy a judgment against the latter. Me. Rev. Stat. (1930) c. 98, § 30; id. c. 56, § 116; N. H. Pub. Laws (1926) c. 346, § 8; Vt. Pub. Laws (1934) § 2253; Beardsley v. Smith, 16 Conn. 368, 41 Am. Dec. 148 (1844); Nichols v. Ansonia, 81 Conn. 229, 70 Atl. 636 (1908); Chase v. Merrimack.
be dismissed from practical consideration except for a few exceptional situations.\textsuperscript{12} For, by specific legislative provision in some jurisdictions and by decision in others, the property of a public corporation presently devoted to a public use and appropriate to that end is exempt from such levies. Nor have either the state or federal courts acquiesced in the occasional prayers of litigants that private property within a debtor subdivision be applied to the payment of its debts on some equitable theory\textsuperscript{13} or otherwise than through the indirect and cumbersome procedure of taxation and tax collection. Both federal\textsuperscript{14} and state\textsuperscript{15} courts have, moreover, been deemed to lack power to appoint a receiver for an insolvent local political subdivision of a state in the absence of state legislation construed specifically to authorize such a course of action.\textsuperscript{16}

Whatever the atmosphere and episodes of the interim preceding the stage at which the parties affected have been brought to a settling frame of mind, the ultimate recourse of the creditors in case of insolvency, therefore, must be to negotiation of a plan of readjustment with the debtor and with one another. In some instances a general extension of outstanding maturities by indorsement may suffice. More often an exchange of new refunding securities for the old will be the method deemed most practicable, for the chances are that an insolvent taxing district will be unable to raise new money by the sale of refunding securities after default. In the case of drainage, levee, irrigation and similar special districts, however, readjustment has in some instances been accomplished through the medium of a loan from the Reconstruction Finance Corporation. The loan is employed to buy up all outstanding bonds and other obligations of the given district, usually at some discount, and such securities or an unc cancelled fraction thereof are then pledged as collateral for the loan\textsuperscript{17} and eventually exchanged for new refunding securities.

But whatever be the form of readjustment attempted its basis is contractual and voluntary. There is nothing to prevent a dissenter from retaining his old securities. Suppose that the majority were to proceed with an exchange of their old securities for refunding securities pursuant to a readjustment plan. Such a plan, if it is to be acceptable to many

\textsuperscript{12} Fordham, \textit{Methods of Enforcing Satisfaction of Obligations of Public Corporations} (1933) 33 Col. L. Rev. 28, \textit{et seq.}; Comment (1934) \textit{Yale L. J.} 924, 962 \textit{et seq.}

\textsuperscript{13} S. E. C., \textit{op. cit. supra} note 2, at 17.

\textsuperscript{14} Meriwether v. Garrett, 102 U. S. 472 (1880).

\textsuperscript{15} See S. E. C., \textit{op. cit. supra} note 2, at 104.

\textsuperscript{16} Cf. Supervisors of Lee County v. Rogers, 7 Wall. 175 (U. S. 1868); Guardian Savings and Trust Co. v. Road Improvement District, 267 U. S. 1 (1925).

\textsuperscript{17} S. E. C., \textit{op. cit. supra} note 2, at 26-27.
of the creditors, must be based upon the debtor's apparent capacity to pay, which is to say that it must be based upon the utmost in taxes and other revenues available for the purpose to the debtor. But a disserter still retaining his old securities and therefore having made none of the sacrifices presumably involved in acceptance of the plan—whether merely in the form of a postponement of maturities or an actual scaling of principal or interest—could demand payment according to the terms of his original contract and, if refused, obtain a judgment and writ of mandamus for the levy of taxes to satisfy his claim.

Should the holdings of dissenters consist of already past due or presently maturing principal in any substantial amount—even though its percentage of the total outstanding be small—their disruptive possibilities are obvious.18 To pay them might very conceivably involve a doubling or even trebling of the tax levy for debt service contemplated by the plan for a particular fiscal year. Conceivably, this might precipitate new default. Even where the dissenters' holdings are less likely in terms of amount and maturities to disrupt the new fiscal arrangements embodied in the plan their nuisance value may still be serious. Holders otherwise inclined to participate in the plan may resent the possibility of more favorable treatment for dissenters. A committee for creditors may quite naturally feel that to yield in one situation will encourage hold-outs in others in which their members or affiliates are similarly interested. The net result is that the consummation of a readjustment plan usually has to be conditioned on the participation of a very great majority, if not of substantially all, of the creditors affected.

The past few years yield numerous instances where settlements acceptable to an overwhelming majority were considerably delayed, if not upset completely, by relatively infinitesimal minorities.19 The difference of opinion with respect to the importance of minority obstruction in these cases puts in issue, therefore, not so much the existence or frequency of such obstruction as the relative appropriateness of the several views now current as to what the problem is and what should be done about it.

First of all, there is the view that "where a substantial majority agree upon a refunding, a way is usually found to bring in the dissenters",20 and there is much to support this contention—up to a point. For the non-depositing or non-participating creditor confronted with a powerfully backed committee has a rather unsatisfactory choice; competing committees are so rare as to be virtually non-existent in the municipal

19. See the instance cited in the Senate and House hearings on the Sumner-Wilcox Act, supra note 8.
field. The alternative to deposit under such circumstances is likely to mean an absence of any practicable remedy against the debtor taxing district in addition to an indefinite and unprofitable delay. Once a committee has negotiated a plan with the debtor and obtained the deposit or other participation of a substantial majority of obligations outstanding, it is safe to assume that the officials of the debtor will cooperate with the committee to bring in the needed additional participants. A variety of "bearing down" tactics and devices may be employed.

In negotiating interim agreements with the debtor, and in particular agreements for the payment over of such sums on account of interest as the debtor may have on hand from time to time, a committee naturally acts only for the benefit of creditors who have deposited or entered into participation agreements with it. Non-depositors are not given a "free ride". A pointed example of such tactics on the part of a committee with the cooperation of its debtor city is afforded in the Coral Gables, Florida, case. There the committee and the city arranged to "keep the city in the red" so that non-participants would be shut out from any revenues available for creditors in the near future. The arrangement is discussed in the following testimony before the Securities and Exchange Commission by Mayor Vincent D. Wyman of Coral Gables and Committee Chairman Edwin H. Barker:

"Q. In the minutes of your committee of July 23, 1931 page 2, it says:

"Mr. Wood advises the committee he has received confidential information to the effect that Farson, Son & Company had communicated with certain holders of bonds of the city of Coral Gables, suggesting that they pledge their coupons with them so that they might collect the same through proceedings in the court. The committee requested Mr. Wood to convey this information to Mr. Wyman, with a request the city commissioners promptly advise the committee when any funds were available so that the committee could immediately receive them and thereby minimize the effect of any such judgment."

"Do you recall that?

"Mr. Barker. I think that was the substance of it.

"Q. Did you receive such a communication from the committee, Mr. Wyman?

* * * *

"Mr. Wyman. I am not sure about the date, but correspondence of that sort was received sometime during the summer or fall, or both of 1931, and subsequently the city arranged, instead of carrying a substantial working balance, to pay over to the committee all surplus funds as soon as received, so there would be nothing available to the bondholders who commenced suit against the city, no money on hand, and made an arrangement on two or three different occa-
sions by which the bondholders committee would repurchase from
the city coupons which were paid, in case the city needed money for
operations.

"Q. Do you mean to say, Mr. Wyman, that the city was arrang-
ing with the committee to keep its cash drawer cleaned out, so to
speak?

"Mr. Wyman. Yes sir.

"Q. So as to put into the hands or possession of the committee
such funds from time to time that otherwise might possibly be
reached by non-depositors?

"Mr. Wyman. Yes sir.

"The Trial Examiner. Did the committee represent a majority
at that time?

"Mr. Wyman. They said at the time they negotiated this agree-
ment, July, 1931, that they had 51 per cent.

* * * *

"Q. Mr. Barker, I have a copy of a letter from Mr. Wyman to
you, in which he says in part, 'We are faced with a mandamus
suit to pay the Helen Hopkins judgment of approximately $13,000.
We expect that papers will be filed today and are, therefore, clean-
ing out our accounts. Unfortunately for you, the general fund does
not at this time have any money to cause us worry in a mandamus
suit.'

* * * *

"Q. Do you know, Mr. Barker, what Mr. Shaw did in the direc-
tion of cleaning out the account?

"A. I presume he sent it to us." 21

This arrangement was subsequently carried a step further, as related
in the following testimony of Messrs. Barker and Wyman:

"Q. Mr. Barker, in this letter of October 24, 1932, from Mr.
Wyman to you, he states:

"'A plan has been devised, however, which will assure protec-
tion against any bondholder securing anything by mandamus; in
other words, operating with the bank account in the 'red' at all
times. This will necessitate advances by the committee when taxes
cease to come in, these advances to be as needed for operation, and
as suggested.'

"What was that plan, Mr. Wyman, as worked out, which resulted
in keeping the bank account in the 'red' at all times?

"Mr. Wyman. Outside of sending the surplus moneys to the
committee, I think there were advance payments made on account
of operating expenses and so forth, before they became due.

21. PROCEEDINGS BEFORE THE SECURITIES AND EXCHANGE COMMISSION IN THE
MATTER OF PROTECTIVE COMMITTEES FOR BONDHOLDERS OF THE CITY OF CORAL GABLES,
FLORIDA (1935) at 634 et seq.
"Q. And that step was taken, designed to perform the function
of blocking or defeating any attempt of non-depositors to collect;
is that correct?
"Mr. Wyman. Yes, the committee said if non-depositing creditors
could collect money from the city, they would see no reason for
their depositing bonds with the committee."\textsuperscript{22}

Another practice adopted on several occasions by several other com-
mittees operating in Florida was to secure writs of so-called "continu-
ing mandamus" issued by the lower state courts, requiring cities to pay
over to the petitioners not only funds on hand and applicable to debt
service, but also any funds that might thereafter come into the possession
of the city for that purpose during the current fiscal year.\textsuperscript{23} Still a
fourth "bearing down" device has been contrived in connection with
the practice frequently resorted to by financially embarrassed taxing
districts of accepting their own bonds and coupons in payment of del-
linquent taxes and assessments. Since the practice as such may be, and
often is, opposed by creditors as illegal, a committee is in a position to
exert further pressure on non-depositors by conditioning its acquiescence
in the practice on an undertaking by the debtor to accept in payment
of taxes only certificates of deposit rather than the original (unde-
posited) obligations.\textsuperscript{24} This naturally has the effect of opening a pre-
ferred market for the certificates of deposit and thereby depressing the
market value, if any, of undeposited obligations.

These are but a few illustrations chosen from a potentially lengthy
catalogue of pressure devices which have been employed in one case
or another. Committees of course use other forms of persuasion. Non-
depositors are circularized and their unstrategic position demonstrated
to them by quotations from eminent committee counsel.\textsuperscript{25} Recalcitrants
are personally solicited through retail bond dealers with whom they are
accustomed to deal. Large institutional or wealthy individual investors
who can afford to bide their time, and prove immune to other forms
of pressure or persuasion, may be offered participation on special terms,
namely, without deposit, with a special guarantee as to their maximum
liability for committee charges, an understanding that their contribution
to the committee's expenses shall be payable only from the first interest
coupon or two of the new securities to be issued them under the pro-
posed plan, and in extreme cases without any liability whatever for
committee expenditures.

But while protective committees with substantial backing have avail-
able means for rendering difficult the position of the dissenter and for

\textsuperscript{22} Id. at 644-645.
\textsuperscript{23} S. E. C., \textit{op. cit. supra} note 2, at 100.
\textsuperscript{24} Id. at 101.
\textsuperscript{25} Instances are cited in S. E. C., \textit{op. cit. supra} note 2, at 18, 98-99.
exerting on him a variety of pressure, it cannot be said that such tactics are uniformly effective. Resort to many of these pressure devices is at best an expensive gamble, as the minute books of many a protective committee will reveal. A considerable period of months and not infrequently of years is likely to be consumed in their employment without assurance as to the outcome. The record of the hearings before Congress on the Sumners-Wilcox Municipal Bankruptcy Bill bears forcible witness to the fact that in a number of situations all the pressure which a committee was able to muster over a period of several years proved insufficient to bring in a large enough portion of the minority dissenting securities to warrant declaring a plan in effect.26

Even granting, however, that there have been a goodly number of situations wherein a substantial majority of creditors acting in concert with the debtor have been unable—at least over a considerable period of years—to find a way to buy off or coerce a sufficient number of dissenters into participation, there remains another consideration which may be treated as the second current view of the problem of the dissenting minority for purposes of this discussion. As expressed by Professor James A. McLaughlin in the hearings on the Sumners-Wilcox Bill:

"I realize you have the situation of the recalcitrant minority, but as Mr. Lashly very properly said this morning, you must not assume what so many people are assuming, that every minority is a recalcitrant minority. If you do you are putting yourself into the hands of a limited class of Wall Street attorneys, the men who are always with the "insiders", the minority that controls. The majority never controls anything, any corporation or bondholders' committee or Congress or anything else. It is the intelligent forceful aggressive minority that rules.

... If you are going to have a recalcitrant minority, it should be balanced by a provision for protecting us from an aggressive, inside minority that gets this big list signed up under the deposit agreement before they know what they are signing up."

In other words, if pressure is necessary to overcome the inertia or hostility of security holders, regulation of those in a position to exercise such pressure would seem to be necessary if pressure is not to assume the form of oppressive coercion.28 The problem of devising ways and means for dealing with minority obstruction is, in short, bound up as a matter of policy with the complementary problem of securing adequate supervision and regulation of protective committees and other similar

26. See note 8 supra.
27. Hearings before a Subcommittee of the Senate Committee on the Judiciary on S. 1868 and H. R. 9550, 73rd Cong., 2nd Sess. (1934) 126.
organizations or agencies purporting to speak for creditors—usually for majority groups of creditors.

A third current reaction finds its point of departure in the extreme complexity of the average local government default situation. For a municipality is more than a legal entity with a debt at issue; it is an extremely complicated aggregate of economic and social groups. Its creditors, even of a single class, are by no means a homogeneous group with an identity of interest. The inconvenient fact is that "every municipal default is like a drama in which there are many players. Bankers, lawyers, municipal bondholders, holders of the unfunded obligations and real estate mortgages, local officials, taxpayers, municipal employees and civic groups—all play some part."20 It is correspondingly difficult to generalize about the consequences of default—and the fairness of any given readjustment plan—even with respect to a legally or superficially homogeneous group like the holders of general bonds or any other particular class of obligations of the debtor taxing district.

Consider merely the holders of funded obligations for whom a single protective committee will ordinarily purport to speak. If one of them happens to be a banking institution located in, or having business relations with, the debtor taxing district, it may quite conceivably be in a position to profit by default. An excuse is afforded for raising interest rates on short term loans to the debtor local subdivision. If it has a hand in the refunding operations it will probably receive the customary commissions for such work. It may moreover be substantially interested in real estate mortgages on property within the debtor subdivision, junior in their lien to unpaid taxes or assessments levied on such property. It may be interested either directly or through affiliates in the buying up of other defaulted obligations of the debtor subdivision as a "hedge" or in downright speculation at bargain prices; market prices usually drop precipitately as soon as default becomes public knowledge and there are indications that the past few years have seen considerable speculation in defaulted municipals. Other types of institutional holder—notably the insurance companies and fraternal benefit organizations—and wealthy individual holders may in any given case have similarly conflicting interests.

Against this potentially complex background it is clear that the value of any given percentage of consents as a hallmark of the fairness of a readjustment plan may be extremely deceptive in the particular case, even from the point of view only of the class of obligations which the consents purport to represent. Nor is the fairness of a plan always ascertainable by scrutiny of its terms. "Normally it will be necessary to inquire into the background of the plan and the activities of the negotiators to ascen-

29. Hillhouse, supra note 1, at 428.
tain if the antecedent and collateral phases of the plan are free of over-reaching and coercion."\textsuperscript{30} This implies that any one governmental agency empowered to coerce a minority into participation in a "fair" plan of debt adjustment would have in each case to undertake a very intensive and extensive investigation into all the circumstances of the case. In the belief that extended investigations of this character could not feasibly be carried on by any court or other governmental agency—state or federal—which might conceivably be so empowered, as a matter of routine in every case brought before it, some have feared that any procedure which might be devised for the coercing of minorities would be too susceptible of misuse by special interests and irresponsible debtors to the detriment of those whose sole stake in the situation is their investment in the security.\textsuperscript{31} They conclude that the existing situation is "still the most satisfactory in the long run, in spite of the element of head-clubbing."\textsuperscript{32}

Proponents of this point of view profess to find support for this hands-off attitude in the allegedly fictitious character of any determination in advance as to the capacity of a municipality or the taxing district to pay over a long period of years. For, such capacity admittedly depends not only on assessed valuation, on the private wealth and volume of business in a community, but on many other problematical future factors. Will new overlapping special districts with power to levy taxes and incur debts be created in the debtor territory, for example; can it be guaranteed that sinking fund provisions will be observed or that tax levy and collection methods will be as efficient as a given plan may contemplate; how forecast the amount of additional interest-bearing obligations which the debtor may incur in the future through the issue of bonds for capital improvements; what assurance can there be that a public debtor's future operating expenses will be kept within the bounds of a plan?\textsuperscript{33} This phase of the problem has been emphasized by a Florida attorney who has often acted for bondholders and bondholders' committees: "By discussion with municipal officials, the creditors can nearly always arrive at some reasonably fair solution of the immediate problem of how much money should be used for current operations and

\textsuperscript{30} Douglas, \textit{The Legal Problem of Control Over Protective Committees For Municipal and Quasi-Municipal Obligations} (1936) 2 \textsl{Legal Notes on Local Government} 81, 86.

\textsuperscript{31} See statements by Lashly, \textit{op. cit. supra} note 27, at 84–99; and Bangs, \textit{id.}, at 73 \textit{et seq}.

\textsuperscript{32} See the summary of discussion by Vanderbilt of Dimock's "Legal Problems of Financially Embarrassed Municipalities" in \textit{Proceedings, Section of Municipal Law, American Bar Association, First Annual Meeting} (1935), at 26 \textit{et seq}.

\textsuperscript{33} See discussion of "The Lack of Adequate State Supervision Over Future Borrowing and Fiscal Administration of Local Units" in S. E. C., \textit{op. cit. supra} note 2, at 55–60.
how much can be raised for debt service. A permanent solution must wait for more normal times, for a settlement should not be made for the next 25 or 30 years in the midst of a period of depression." 34

Still another reaction to the minority problem, which for the purposes of this discussion may be catalogued as the fourth, although likewise preoccupied with the complexities of the problem, fails to conclude that improvement through some form of governmental intervention is either impossible or undesirable. As expressed by Edward J. Dimock, a New York bond attorney: "I confess that the old system of having the municipality and the legislature on one side, and individual creditors and astute lawyers on the other, beat each other into a state of comparatively submissive docility, has worked remarkably well, considering the handicaps involved, but I see no reason why we should not attempt to remove those handicaps and reach the goal without such a lavish expenditure of time, energy and money." 35 But the peculiar complexities inherent in local government default and the normally great diversity of the parties in interest are urged as pointing to the need for some form of centralized administrative control or an "omnibus proceeding" as distinguished from a federal judicial shortcut under the bankruptcy power.

It has already been emphasized that intensive investigation of the antecedent and collateral phases of any readjustment plan which might be submitted to a court will be necessary if its "fairness" from the point of view merely of the creditors directly affected is to be ascertained. Over and above the practical difficulties implied in the foregoing proposition from the point of view of the court and of minority creditors seeking to oppose a bankruptcy petition, it is urged that a judicial proceeding in bankruptcy would almost inevitably prove "too summary in allowing a voluntary agreement to be entered into between the taxing district on the one hand and the creditors on the other hand, ignoring the interests of people who are not creditors and who are not properly represented by the taxing district." 36 The reference is to taxpayers, non-taxpaying voting residents, employees of the taxing district, and other economic groups with a stake in the situation.

The need for some form of impartial outside management and control of insolvent taxing districts is also stressed in favor of centralized administrative supervision or the omnibus proceeding. There is no question that peaceable debt readjustment is often much delayed by the shifting political complexion of local government administrations, by the unavailability of accurate and complete financial data concerning the

35. Dimock, op. cit. supra note 3, at 55-56.
36. Statement by Sturges in Hearings, op. cit. supra note 8, at 105-106.
debtor, and by the pulling and hauling necessary to put current operating expenses on a reasonably efficient basis. Creditors are put to great expense in attempting to obtain the necessary data for themselves. Officials of the debtor are antagonized by what naturally appear to be hostile investigations of the situation conducted by non-resident representatives of creditors presumably unacquainted with the reasonableness of particular municipal expenditures and the needs of the particular community. Concrete demonstration of the debtor's potential capacity to pay is clearly not promoted. The preparation and negotiation of a plan of adjustment is delayed.

A further consideration favoring centralized administrative supervision or an omnibus proceeding is the need for a breathing spell during which concerted action on behalf of all parties in interest may be furthered and each protected through a stay of litigation against others seeking an immediate advantage. The pressure for such a breathing spell has been evidenced time and again by the many attempts—usually unsuccessful—to induce courts during previous periods of municipal depression to appoint receivers for insolvent taxing districts under their general equity jurisdiction. Legislation enacted in recent years in a few of the states authorizing central state administrative agencies to exercise supervisory and managerial powers over local subdivisions in default more or less akin to those of the equity receiver further evidence the pressure in question.

Provision for some such form of outside and impartial management and control over an insolvent local subdivision would, in the opinion of some of its sponsors, go far to eliminate much of the delay, expense and nuisance generally attributed to minority creditor obstruction in addition to facilitating orderly and equitable adjustments in other respects. To quote Messrs. Dimock and Frye: "In our opinion the absence of an omnibus proceeding [as contrasted with the absence of judicial machinery for giving binding force over all creditors to the fair and reasonable refunding] is in practice the more serious weakness. If such an omnibus proceeding were afforded, all the issues in the case would be brought to the surface. In its absence, many important and relevant problems are often concealed because the character of the litigation may be controlled either by an individual's desire to secure a preference over others who have equal rights, or by a committee's desire

37. See the discussion of particular instances in S. E. C., op. cit. supra note 2, at 46 et seq.
38. See Dimock, op. cit. supra note 3, at 44 et seq; and S. E. C., op. cit. supra note 2, at 103 et seq.
39. S. E. C., op. cit. supra note 2, at 104.
40. See Stason, State Administrative Supervision of Local Indebtedness (1932) 30 Mich. L. Rev. 833; Comment (1934) 43 Yale L. J. 924, 989 et seq.
to force all bondholders to be represented by that particular committee."^{41} Not that judicial machinery for the binding of an obdurate minority could in all cases be dispensed with; it is conceded that, "if there is no way of making the settlement binding upon all of the creditors alike it will be no settlement at all."^{42} The suggestion is, however, that if federal legislation be indeed necessary to bind dissenters to a plan it should be available only by way of a complement to administrative receivership or the omnibus proceeding.^{43}

And the main problem of affording some measure of outside management or control over the insolvent debtor by way of central administrative receivership or an omnibus proceeding is, so some contend, a matter which may most appropriately be entrusted to the states. In addition to considerations rooted in state sovereignty several arguments are adduced. The extent to which the question of capacity to pay is related in any given case to matters present and future which are solely within the control of the state legislature—the whole range of the debtor's charter powers with respect to future fiscal practices and management, the creation or abolition of overlapping taxing districts, and general state laws regulating the fiscal affairs of local subdivisions—unequivocally gives the state legislature "the inside track". The primary responsibility for the fulfillment by local political subdivisions of their valid obligations which must be implied from the sovereign control vested in the states, moreover, prompts a fear that to relieve the states of that responsibility in any manner would have an unfortunate effect on state morale in matters of municipal credit.^{44} Finally, the very complexity of municipal insolvency and the rather intensive investigations required in each case to ascertain the facts prompt the further argument that to vest a responsibility for effectively supervising and controlling all the parties to these situations, which are scattered throughout the country, in any federal instrumentality would be to ignore "the real and practical limitations upon beneficial governmental administration."^{45}

Others are less sanguine with respect to at least to state administrative control or receivership during default. Legislative provision for it has, after all, been enacted in but a few states, and even in those instances compromise with "home rule" considerations has been necessary.^{46} There

42. Dimock, op. cit. supra note 3, at 44.
43. Id., at 51 et seq.; Sturges, op. cit. supra note 36, at 107.
44. See testimony by Dimock in Proceedings Before the Securities and Exchange Commission in the Matter of the Protective Committee for Holders of Securities of the City of Asbury Park, New Jersey, and Other Municipalities and Public Instrumentalities (1935) at 747-748; and by Tooke, id. at 806.
46. See the discussion in S. E. C., op. cit. supra note 2, at 107 et seq.; and the testimony of Chairman Darby of the New Jersey Municipal Finance Commission in op. cit. supra note 44, at 541 et seq.
is the further objection that it works best when it is least needed, which is to say that in a state where a great many municipalities or other local subdivisions are in default and unable to borrow money, powers conferred on a state agency are quite likely to be either abused or not exercised. 47 A member of one such state board has been quoted by counsel to a considerable number of bondholders' protective committees as saying that "if they attempted to exercise their powers at this time, when scores of counties and municipalities of the State were in default, the control act would be repealed and that he thought it would be better to wait until most of the State had gotten out of its financial difficulties, when they might be able to proceed effectively against the few political subdivisions, which then remained in default." 48

2.

These reactions to the fact of the disproportionate leverage of minority dissent are believed to be typical. They illustrate the multiform aspects of the problem, and its intimate relationship to other major issues arising out of the business of municipal debt readjustment. They also make up the background against which the recent federal legislation addressed to the minority problem may be viewed in perspective.

Probably the first attempt to authorize federal courts to bring about compromises on municipal indebtedness was a bill introduced by Representative Joy of Missouri in 1902 49; but up to 1934 Congress had never included municipalities or other political subdivisions of a state as subjects of bankruptcy legislation. By 1933, however, the minority problem had become a compelling stimulant to bankruptcy legislation for financially embarrassed local government units and their creditors. In 1932, indeed, the Mississippi legislature had adopted an insolvency act for drainage districts—declared unconstitutional by the state supreme court in 1935. 50 In Florida numerous municipalities and the protective committees for their bondholders were experiencing difficulties at the hands of dissenting bondholders. The City of Coral Gables and its committee, for example, were agreed upon a plan to which 86% of the bondholders had assented; but it developed that there was little prospect of obtaining the assents of any of the remainder, and the plan could not be con-

47. See the discussion by Dimock, op. cit. supra note 3, at 45-46, 55; by Patterson, op. cit. supra note 34, at 27-28; and by Wood in "State Control of Municipal Finances" (address delivered before the annual meeting of the American Bar Association, Milwaukee, Aug. 27, 1934, reprinted in The Bond Buyer, Sept. 1, 1934).
48. Wood, op. cit. supra note 47.
49. H. R. 12596, unsuccessfully introduced on March 15, 1902, (1902) 19 The Bond Buyer 385.
50. MISS. CODE ANN. (Supp. 1933) § 4526 (1-26); Pryor et al., Comm'rs. of Sabougla Drainage District v. Goza, 172 Miss. 46, 159 So. 99 (1935).
summated. One idea growing out of that impasse has been related by
counsel to the protective committee:

"A. . . . Mayor Wyman and I had many conferences regarding
the necessity of getting a substantial amount of bonds deposited
under the plan, and we worked for several years and spent quite
a bit of money trying to accomplish that. Finally it looked to us
as though we never were going to be able to accomplish it. Mayor
Wyman had a lot of suggestions. I mean to say, he was very
fertile with suggestions. The first suggestion was we get an act of
the legislature of Florida enacted to condemn the outstanding bonds
at their market value. I told him I thought that was unconstitutional,
but I am informed that such a bill was actually introduced
in the legislature of Florida. I don't know that of my own knowl-
edge, but I am informed such a bill was introduced but never
passed."61

The first bills introduced in Congress during this period were in Feb-
uary of 1933. Senator Norris of Nebraska and Representative McLeod
of Michigan introduced measures designed to afford a moratorium on
principal and interest to such insolvent municipal corporations having
a population of not less than 50,000 and an indebtedness of not less
than $1,000,000, as might petition the court.62 Senator Fletcher intro-
duced a bill prompted by the Coral Gables and other similar Florida
municipal situations, and inspired by the Railroad and Corporation
Bankruptcy Acts.63 No one of these bills passed as the time for con-
sideration was short, but during the opening days of the new Congress
Representative Wilcox of Florida introduced a bill very similar to the
Fletcher bill and Representative McLeod reintroduced his moratorium
bill.64 The McLeod bill did not withstand creditor resistance, but the
Wilcox bill, subsequently modified in various particulars and thereafter
known as the Sumners-Wilcox bill, was eventually enacted on May 24,
1934, as Sections 78–80 of the National Bankruptcy Act.65

Who were the supporters, and who the opponents of this legislation?
The record66 rather discourages any facile attempt to classify the Act as "debtor-relief" at the expense of creditors or as a measure designed
to favor any one interest class unduly at the expense of the others.
Among its chief advocates were municipal officials, investment bankers,
bondholders’ protective committees and a few insurance companies.

52. S. 5699 and H. R. 14789. See also Report No. 2191 of the House Committee
on the Judiciary on H. R. 14789, 72nd Cong., 2d sess., (1934).
53. See Hearings, op. cit. supra note 2, at 117.
54. Id., at 116–117.
56. See Hearings, op. cit. supra note 8; and HILLHOUSE, op. cit. supra note 1, at
396–403.
Opposing the measure were the United States Chamber of Commerce, the American Bankers Association, and a great many insurance companies and fraternal benefit societies. Congressional support for the bill was strongest among representatives from the South and West; opposition came from the eastern and north central states.

Enacted as an emergency measure of two years duration the Act was subsequently extended to January 1, 1940. Its plan was simply to permit any local government unit which might be insolvent or unable to meet its debts as they matured, voluntarily to file a petition in bankruptcy. A saving clause provided that nothing in the Act should be construed to limit or impair the power of any state to control any political subdivision in the exercise of its political or governmental powers, including the power to require that the filing of a petition in bankruptcy and any plan of readjustment be approved by the state. In other words, the petition had to be voluntary; and, if the state law so required, it had to be accompanied by the consent of the state. The federal court, sitting in bankruptcy, would thereafter be empowered to confirm the plan, if it found it to be fair and if the required percentage of the creditors approved. Upon confirmation, the plan would be binding upon minority, as well as majority, creditors, and upon the debtor.

Several specific characteristics of this legislation deserve special notice. It did not, to begin with, purport to afford a comprehensive "omnibus proceeding." The only parties to the proceeding contemplated were creditors and the debtor taxing district. "Creditors," for all purposes of the Act, did not include salary and wage claimants; even taxpayers or non-taxpaying voters were not accorded any standing in the proceeding. The petitioning taxing district was entitled to be heard on all questions. A petition could be contested by creditors holding 5% "in amount of the bonds, notes, or certificates of indebtedness." Any creditor, upon filing a petition for leave to intervene, might be heard on such questions arising in the proceeding as the judge should determine. Any creditor might be heard on the question of confirmation.

In still another respect did the proceeding contemplated by the Act fall short of an omnibus proceeding. No petition could be filed until a definitive plan of adjustment which had been prepared and accepted by a stated percentage of creditors could be presented with the petition. A considerable period of months or years of litigation and negotiation might conceivably elapse before those conditions could be complied with and the benefit of court intervention (as by stay of other

58. 30% in the case of agricultural special districts and 51% in the case of all other taxing districts in amount of the bonds, notes, and certificates of indebtedness affected.
litigation) obtained. What the Act offered, in other words, was a "short receivership" to be employed at the end rather than at the beginning of readjustment negotiations. It did not, in consequence, purport to render unnecessary or to foreclose a state administrative receivership or "omnibus proceeding," and indeed expressly provided that "whenever there shall exist or shall hereafter be created under the law of any State any agency of such State authorized to exercise supervision or control over the fiscal affairs of all or any political subdivisions thereof, and whenever such agency has assumed such supervision or control over any political subdivision, then no petition of such political subdivision may be received hereunder unless accompanied by the written approval of such agency, and no plan of readjustment shall be put into temporary effect or finally confirmed without the written approval of such agency of such plans."

The Act also failed to provide any effective machinery for supervision and control over protective committees or other representatives of majority creditors which, as has been pointed out, is an essential complement to any machinery for the coerding of minorities and obtaining approval of readjustment plans. The Act did, to be sure, require that the protective committee or agent file a list of the creditors represented and a copy of the agreement whereunder the committee purported to act. Disclosure of all compensation to be received by the committee was also required; and the judge was empowered to allow reasonable compensation and reimbursement of necessary expenses incurred in connection with the proceeding, and payment of readjustment managers committees or other representatives of creditors, with the proviso, however, that no such compensation or reimbursements should be assessed against the taxing district except in the manner and in such sums, if any, as might be provided for in the plan. But even in cases where the Act might be invoked such provisions clearly fell short of effective supervision and control over protective committees. Up to the time when a petition was filed there would be no supervision at all, and protective committees are usually organized soon after default. The court would, therefore, acquire the very limited jurisdiction over committees contemplated by the Act only when a committee had almost reached the end of its existence and activity. 59

By the same token the proceeding contemplated under the Act was scarcely designed to afford that measure of outside management and control over the debtor advocated by those who favor administrative receivership or an omnibus proceeding. The Act did empower the judge to require a petitioning taxing district to file such schedules and submit such other information as might be necessary to disclose the conduct

of the affairs of the district and the fairness of any proposed plan. The debtor might also be required to open its books, records and files to the inspection of any creditor. Any matters might be referred to a special master "for consideration and report upon specified issues." But the opportunity for all this was, under the Act as drawn, afforded at too late a stage in the readjustment proceeding to serve its purpose.

The Act, moreover, apparently failed to confer on the court in a pending proceeding sufficiently wide and express power to make such orders as might be necessary from time to time to protect the interests of creditors barred by the stay of litigation from bringing independent actions at law or in equity. For, unless the court were empowered in its discretion to order at least as much as the creditors might themselves obtain by litigation in the absence of a stay, such a proceeding might quite conceivably be utilized by the debtor for the sole purpose of delay, once it had a sufficient number of assenting creditors to file a petition, though not enough to obtain confirmation of a plan.

3.

The short life of the Act makes it difficult to draw definite conclusions from the proceedings had under it. It is likewise difficult to estimate what influence the mere possibility of its being involved may have had in discouraging minority dissent. In any event relatively few public debtors had invoked it up to the spring of 1936. The latest check shows a total of 88 petitioners scattered throughout twenty states. Only 24 of these were incorporated cities, villages or towns, the largest of which was Corpus Christi, Texas, with a population of 27,741. North Bergen township in New Jersey was the only petitioner in the East, with an indebtedness of some $16,000,000 and a population of about

60. See criticism of the Act along these lines in S. E. C., op. cit. supra note 2, at 123.
61. Testimony of Mr. Wood, as counsel to numerous bondholders' protective committees, on this point was as follows:

"Q. Has the existence of this act, in your opinion, been a factor in averting minority interferences?

"A. Very decidedly.

"Q. When it has not been invoked?

"A. It has been a very great help to the organized creditors, even in those cases where no petition has been filed.

"For instance, some committees had proposed refunding plans. I received communications from lawyers throughout the country stating that they represented holders of 25, 50, or 100 bonds, and that they did not intend to accept the refunding plan. They wanted to know what we suggested, as counsel for the bondholders' committee, and we would reply to such a communication by sending a copy of this act, and that would usually be all we would ever hear of it. Later on their bonds would be exchanged." [Op. cit. supra note 44, at 734-735]
62. HILLHOUSE, op. cit. supra note 1, at 386 et seq.
40,000. North Bergen and the Merced Irrigation District in California, with an indebtedness also approximating $16,000,000, were the two petitioners with the largest debts involved. Irrigation and drainage districts were by far the most frequent petitioners.

Most of these petitions were still pending when the Act was declared unconstitutional, but plans had been confirmed by final order in at least 16 cases. Information available with respect to ten of these plans (7 were for special districts and 3 for small municipal corporations) shows a scaling of principal by over 40% at least in each of the special district cases save one, and of 50% in that case. Interest was reduced in all cases. Reconstruction Finance Corporation loans provided the new money for refinancing in most of the special district settlements.

Why more municipalities and taxing districts in default did not seek to file under the Act during its brief existence has occasioned considerable discussion. Some of the reasons, however, are clear. In many instances debtors were asking their creditors merely for an extension of maturity dates and perhaps for a reduction of interest over the next few years. On such terms readjustment is likely to be possible without resort to bankruptcy. In the more difficult situations to which the Act was primarily addressed it had not proved possible in many instances even by the close of 1935 for creditors and their debtor to fulfill filing requirements by arriving at a definite refunding plan, securing necessary enabling legislation and the required percentage of consents.

The particular case which ultimately came before the Supreme Court was that of the Cameron County Water Improvement District No. 1. Embracing some 43,000 acres in Texas, it was organized in 1914. The plan submitted to the bankruptcy court in 1934 called for the compromise of $800,000 face amount of bonded debt, bearing 6% interest, on a basis of forty-nine and a fraction cents on the dollar, out of funds to be borrowed from the Reconstruction Finance Corporation at 4%. Most of these bonds had been issued in 1914; the remainder in 1919. More than 30% of the bondholders had filed acceptance of the plan along with the petition. The district further alleged that holders of more than the requisite two-thirds in amount of the bonds would do so in the course of the proceeding.

This petition was contested by holders of something over 5% of the bonds outstanding. The district court dismissed the petition on the ground inter alia, that the Act was unconstitutional. The circuit court of appeals, however, held the Act a valid exercise of the bankruptcy

63. S. E. C., op. cit. supra note 2, at 122.
64. Hillhouse, op. cit. supra note 1, at 390.
65. In re Cameron County Water Improvement District No. 1, 9 F. Supp. 103 (S. D. Tex., 1934).
power and reversed the decision below.\textsuperscript{66} While the case was pending in this court, the Texas legislature adopted legislation to enable local political subdivisions, including the petitioner, to invoke the Sumners-Wilcox Act. The case then came before the Supreme Court on certiorari. The ensuing decision\textsuperscript{67} by the bare majority of that Court was disappointing to many students of the problem. Not that they were unaware that the inclination of certain members of the Court would be unfavorable to the Act; indeed, few would contend that it was in its existing form either a comprehensive answer to all the problems in this field or even that it was aptly framed to achieve its more limited declared purpose. The disappointing feature of the majority opinion consists rather in what one is tempted to term the unnecessarily, if not indiscriminately, sweeping statement of the chief ground on which the decision was based.

The majority, speaking through Mr. Justice McReynolds, assumed for purposes of the discussion that the Act was “adequately related to the general subject of bankruptcies.” The petitioner was characterized as a “political subdivision of the State, created for the local exercise of her sovereign powers,” the right to borrow money as “essential to its operations,” and the conclusion drawn that its fiscal affairs were therefore “those of the State, not subject to control or interference by the National Government, unless the right to do so is definitely accorded by the Federal Constitution.” The bankruptcy power was then considered, and, by analogy to the taxing power, deemed impliedly limited by the “necessity of preserving independence of the States.” Feeling that application of the statutory provisions in question “might materially restrict respondent’s control over its fiscal affairs” and stating that “the especial purpose of all bankruptcy legislation is to interfere with the relations between the parties concerned to change, modify or impair the obligation of their contracts”, the majority held the Act invalid.

The element of state consent, required by the Act as a condition to filing under it (and present in this case), did not in the opinion of the majority alter the situation. The preservation of the states was declared to be as much a matter of federal as of state concern. “The sovereignty of the State essential to its proper functioning under the Federal Constitution cannot be surrendered . . . ” As an additional reason for holding the Act invalid the Court stated that such state consent, if recognized as having any effect, would necessarily fall within the constitutional prohibition against state laws impairing the obligation of contracts.

As if these grounds were not broad enough, the opinion proceeds: “Our

\textsuperscript{66} Cameron County Water Improvement District No. 1 v. Ashton, 81 F. (2d) 905 (C.C.A. 5th, 1936).
\textsuperscript{67} Ashton v. Cameron County Water Improvement District No. 1, 56 Sup. Ct. 892 (1936).
special concern is with the existence of the power claimed—not merely the immediate outcome of what has already been attempted. And it is of the first importance that due attention be given to the results which might be brought about by the exercise of such a power in the future.” If the federal bankruptcy machinery could be extended to local political subdivisions like the respondent, why not to the state, the majority asked? And if voluntary proceedings could be permitted, why not involuntary ones?

The minority, in an opinion by Mr. Justice Cardozo in which the Chief Justice, Mr. Justice Brandeis and Mr. Justice Stone joined, conceived the issue presented to be much narrower than the opinion of the majority had implied.68 No attempted extension of the bankruptcy power to the states or authorization of involuntary proceedings against local subdivisions was before the Court, and should such questions ever arise, it was pointed out, the Court would presumably be equal to the task of distinguishing them from the one now in issue. The plight of local public debtors and their creditors was reviewed, prevailing doubts with respect to the constitutionality of any attempt to provide relief similar to that contemplated by the Summers-Wilcox Act through state legislation confirmed, and the conclusion reached that “if voluntary bankruptcies are anathema for governmental units, municipalities and creditors have been caught in a vise from which it is impossible to let them out.”

Even accepting the familiar limitations on the taxing power implied in the interest of state sovereignty as an analogy, nevertheless, as Justice Cardozo said, consent has been traditionally regarded in the tax field as sufficient to preserve the balance between state and national power: a state may not tax the instrumentalities of the federal government without its consent, but it may with such consent;69 similarly, consent being given, the federal government may lay a tax upon the states.70 With respect to the majority’s contention that state consent would constitute an impairment of contracts, the minority retorted: “The Act does not authorize the states to impair through their own laws the obligations of existing contracts. . . . At most what they do is to waive a personal privilege that they would be at liberty to claim. . . . If contracts are impaired, the tie is cut or loosened through the action of the court of bankruptcy. . . . ”

4.

But whatever may be thought of the majority’s decision it stands, at least for the time being, as controlling. If it is to remain in all its

68. 56 Sup. Ct. 892, 896 (1936).
breadth, it may well be that insolvent local public debtors and their creditors have been "caught in a vise from which it is impossible to let them out." Assuming for the sake of discussion that the opinion is to be taken literally, let us consider what possibilities remain.

If machinery for binding a minority to a fair and equitable plan of debt adjustment cannot be provided by Congress, have the states power so to provide? So far as indebtedness incurred prior to the enactment of any given state bankruptcy legislation is concerned, the early decision of the Supreme Court in Sturges v. Crowinshield71 has indicated that the constitutional prohibition against impairment of contracts is a bar. And so far as debts subsequently incurred are concerned, the decision rendered a few years later in Ogden v. Saunders72 has indicated that any discharge under such legislation is unavailing against a non-resident creditor who avoids participation in the proceedings. Not all students of the problem have been convinced that these questions are foreclosed, however, and it may indeed be premature so to assume.73 But both the majority and the minority in the Ashton case appear to have gone out of their way to warn us that the objections arising from these two early decisions still stand. The majority of the Court assumed as a major premise the proposition that no state could accomplish for its subdivisions the end sought by Congress in the Sumners-Wilcox Act "under the form of a bankruptcy act or otherwise." And the minority said: "Nor was there hope for relief from statutes to be enacted by the states. . . . A state insolvency act is of no avail as to obligations of the debtor incurred before its passage."74

Failing bankruptcy legislation, it has been suggested that at least a measure of the objectives of bankruptcy mechanism might be realized through a molding of the practice in connection with the issuance of writs of mandamus and mandatory injunctions. The federal courts have already exercised a discretion in certain cases, where the claim of a plaintiff was too great for a municipality to pay in one year, to provide in the mandamus order for a spreading of the amount over several years.75 There is also a possibility that the federal courts may eventually come to hold that where a taxing district cannot pay all of its creditors at once, its obligations can be enforced only ratably for the equal benefit of all.76 The decision in City of Asbury Park v. Christmas by the

71. 4 Wheat. 122 (U. S. 1819).
72. 12 Wheat. 213 (U. S. 1827).
73. See discussion on this point in Dimock, op. cit. supra note 3, at 54-55.
74. 56 Sup. Ct. 892, 897 (1936).
circuit court of appeals\textsuperscript{77} and the subsequent denial of certiorari\textsuperscript{78} may further indicate that the federal courts are vested with a discretion to withhold writs of mandamus, when issuing the writ would disrupt pending negotiations being conducted in good faith for the benefit of the creditors as a whole, or when a state agency has entered the picture in an effort to work out a fair adjustment. State courts might conceivably adopt the same attitude, although it must be recognized that many of them at the present time regard the writ of mandamus for purposes of enforcing judgments on municipal bonds as a writ of right.\textsuperscript{79}

Others feel that the same end might be achieved more speedily and with greater uniformity by state and federal legislative regulation of the practice in connection with these remedies so as to achieve: (1) some balancing off of the disproportionate leverage and nuisance value of minority dissenting groups; and (2) assurance of a ratable distribution of funds available for debt service when the debtor is unable to pay all matured claims in full.\textsuperscript{80} In order to insure against prejudice to investors through a denial of remedies in cases where either the debtor or an organized majority of creditors were not cooperating in good faith to promote a fair adjustment, however, any such legislative program should presumably be coupled with a program or programs for administrative supervision and control over those major parties to the situation.

It is not our purpose in this article to explore the various constitutional and other legal issues which naturally arise in connection with these proposals. Some of them, particularly in connection with state regulation of mandamus practice in the state courts, will suggest themselves to any lawyer. Suffice it to say that at best the objectives of bankruptcy legislation could be only partially attained. Many occasions for minority dissent would presumably be averted by working out such programs, tending as they would toward the development of an "omnibus proceeding." In any case dissent would be discouraged through the contemplated reduction of its leverage value. But so long as dissenters might choose to stand apart, a debtor unable to pay them in full would continue undischarged and "in default." It is worth noting in this connection that the probable need for a bankruptcy machinery to complement even state administrative receivership was apparently recognized by the New Jersey legislature in 1933 after several years experience with such administrative control.\textsuperscript{81}

\textsuperscript{77} 78 F. (2d) 1003 (C. C. A. 3d, 1935).
\textsuperscript{78} 296 U. S. 624 (1936).
\textsuperscript{79} State v. Lehman, 100 Fla. 1313, 131 So. 533 (1930).
\textsuperscript{80} See Douglas, \textit{op. cit. supra} note 30, at 85.
\textsuperscript{81} N. J. Laws 1933, c. 331.
Might the bankruptcy result be obtained through condemnation of a dissenter's bonds or other obligations under the state's power of eminent domain, at a valuation approximating that placed upon similar securities by the plan sought to be put into effect, or perhaps at their default market value? Putting to one side the valuation problem, questions as to the "public purpose" involved, the situs of bonds held by a non-resident and other legal complications implicit in the suggestion, it seems reasonably clear that resort to such condemnation by a state or political subdivision thereof would not fall within the prohibition of the Contracts Clause. For "a contract is property, and like any other property, may be taken under condemnation proceedings for public use. ..." And "the true view is that the condemnation proceedings do not impair the contract, do not break its obligations, but appropriate it, as they do the tangible property of the company, to the public uses." 82

5.

The sweeping and authoritative pronouncements of the majority of the Court may result at long last simply in an attainment under different doctrinal auspices of the objectives at first thought to be available under the bankruptcy power. Bankruptcy is, it is true, an ugly word. But should such prove to be the outcome it would be difficult, were one not blessed with a certain cosmic outlook, not to wonder whether the Ashton decision had not been rather wasteful in point of the time, money and energy of all the parties to municipal insolvency.

All of which leads to the question whether one may not venture to hope, should new legislation designed to afford a comprehensive mechanism for the supervision and control of municipal debt adjustment and dependent in certain of its component parts on the bankruptcy power come before the Court at some future date, that the Court will find it possible to limit its decision in the Ashton case, insofar as it dealt with the scope of the bankruptcy power, to the specific legislation as applied in that particular case. For, as observed by Mr. Justice McReynolds: "The difficulties arising out of our dual form of government and the opportunities for differing opinions concerning the relative rights of State and National Governments are many; ..." 83 And the history of the Court's decisions in this field wherein the need for protecting municipal investments has time and again measured its strength with the exigencies of state sovereignty would appear to yield a caveat against too literal an interpretation of any one opinion so sweeping in

83. 56 Sup. Ct. 892, 896 (1936).
its terms. Let us consider briefly the rôle assumed by the Court in previous periods of municipal depression.

Perhaps its most outstanding characteristic is the degree to which the Court has in the past deemed itself justified under the Constitution to interfere in and override declared state policy and control over the fiscal affairs of local political subdivisions in order to protect the interests of creditors. In the Iowa municipal railway aid bond cases, for example, although the state court, reversing an earlier decision, held that the legislature had had no power to authorize their issue and that they were utterly void, the United States Supreme Court held the bonds to be valid and enforceable against the municipalities and counties which issued them. In Mobile v. Watson there was an involved and elaborate attempt on the part of the state legislature to revoke the charter and dissolve a municipal debtor, setting up an arrangement whereby certain assets of the dissolved corporation would be applied on its debts and a settlement negotiated by a state agency with the creditors, and creating out of a major portion of the territory of the dissolved corporation an entirely new municipality, differently constituted, and without the same powers of taxation as the old. The Court did not hesitate to hold the new municipality responsible for the debts of the old, and empowered to levy such taxes as might have been levied by its predecessor for the purpose of their payment. In other cases state legislatures tried more simply to revise certain of the charter fiscal powers and practices of a debtor subdivision—as by the imposition of a new tax limitation or the revocation of power to levy any tax for debt service. Instances might be multiplied at great length, but suffice it to say that whenever such attempts were deemed by the Court substantially to impair the security of pre-existing contract obligations it did not hesitate to override such legislation, despite the circumstance that the prohibition embodied in the Constitution against state laws impairing the obligation of contracts does not specifically refer to contracts by political subdivisions of a state and might conceivably have been regarded as impliedly limited by the sovereign prerogative of the states to control the creation, organization, powers and fiscal practices of their local political subdivisions.

84. Gelpke v. Dubuque, 1 Wall. 175 (U. S. 1863); Havemeyer v. Iowa County, 3 Wall. 294 (U. S. 1865); Thomson v. Lee County, 3 Wall. 327 (U. S. 1865); Rogers v. Burlington, 3 Wall. 654 (U. S. 1865); Mitchell v. Burlington, 4 Wall. 270 (U. S. 1866); Lee County v. Rogers, 7 Wall. 181 (U. S. 1868); Butz v. Muscatine, 8 Wall. 575 (U. S. 1869).
85. 116 U. S. 289 (1886).
In another class of cases we find the Court assuming the exercise of powers and functions ordinarily exercisable only by municipal officials under the charter mandate of a state legislature. *Supervisors of Lee County v. Rogers*, for example, was a case wherein the Court affirmed a power assumed by the trial court to order a United States marshal to levy and collect a tax for county debt service.\(^87\) The alleged authority for this unprecedented\(^88\) action was found in a state statute containing no special reference to cases involving counties or other local political subdivisions, but which, prescribing the state practice in connection with mandamus generally, simply provided that the state court “besides or instead of proceeding against the defendant by attachment, may direct that the act required to be done may be done by the plaintiff or some other person appointed by the court.” In a more recent case there were involved some road district bonds secured by a mortgage on special assessments, levied by act of the legislature and payable in installments. A private banking institution was named trustee. State legislation authorizing the bond issue provided further that in the event of default for thirty days the state chancery court should appoint a receiver to collect the assessments. The Supreme Court of the United States held that the lower federal court might by virtue of the aforesaid legislation appoint its own receiver at the suit of the trustee.\(^89\)

As summed up by Judge Dillon in the 1911 edition of his treatise: “The Supreme Court . . . has upheld the rights of the holders of municipal securities with a strong hand, and has set a face of flint against repudiation, even when made on legal grounds deemed solid by the State courts, as well as by the municipalities.”\(^90\) The judicial machinery worked out by the Court during previous depressions was, as he suggests, primarily adapted to cases of what might be termed “wilful repudiation.” Today we are for the most part concerned with the quite distinct problem of local government insolvency. But the line hewed by the Court in those earlier decisions lends corroboration to the contention made by the minority that “sufficient reasons do not appear for excluding political subdivisions from the bankruptcy jurisdiction if the jurisdiction is so exerted as to maintain the equilibrium between state and national power.”\(^91\)

That Sections 78–80 of the Bankruptcy Act in the form in which they came before the Court were inadequately designed to achieve their

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\(^{87}\) 7 Wall. 175 (U. S. 1868).

\(^{88}\) Cf. Rees v. Watertown, 19 Wall. 107 (U. S. 1873).

\(^{89}\) Guardian Savings and Trust Co. v. Road Improvement District, 267 U. S. 1 (1925).

\(^{90}\) 2 Dillon, Municipal Corporation (5th ed. 1911) § 886.

\(^{91}\) 56 Sup. Ct. 892, 900 (1936).
declared objective has already been conceded. The circumstances under which readjustment negotiations were initiated and the plan prepared in the particular case which brought that legislation before the Court may well constitute an additional ground for distinguishing the Ashton decision in any future test of the validity of bankruptcy features in a more balanced and comprehensive scheme for municipal debt adjustment. It will be recalled that the debtor in the instant case sought a drastic scale-down of approximately fifty per cent. There was, moreover, a question of an R. F. C. loan to the district underlying the transaction, which is to say that the R.F.C. had, pursuant to statute\textsuperscript{92} appraised the property securing or underlying the outstanding bonds of the district and therefore had presumably arrived at this scale-down figure by its own computation. The special activities of the R.F.C. are thus another distinguishing feature of the Ashton case; the statute governing the R. F. C. provides that: \textquoteleft\textquoteleft No loan shall be made under this Section until the Reconstruction Finance Corporation (A) has caused an appraisal . . . , (B) has determined that the project of the applicant is economically sound and (C) has been satisfied that an agreement has been entered into between the applicant and holders of its outstanding bonds . . . under which the applicant will be able to purchase or refund all or a major portion of such bonds or other obligations at a price determined by the Corporation to be reasonable . . . and under which a substantial reduction will be brought about in the amount of the outstanding indebtedness of the applicant.'\textsuperscript{93} There is the further consideration that the R. F. C. was drawn into this field of special district refinancing apparently as an incident to its efforts to refinance and salvage mortgage investments on private lands within such districts and that these latter securities are as a matter of law junior in their liens.

Under all the circumstances of the case, emphasizing its facts and its background, it would surely be premature to assume that the opinion of the majority in its literal entirety, as distinguished from the narrower ambit of what was necessarily decided, is to stand from now on as a complete bar to extension of the bankruptcy power in connection with local government insolvency. This contention is of course based upon the assumption that a local government unit can be \textquoteleft\textquoteleft insolvent\textquoteright\textsuperscript{'} in such a sense as to render bankruptcy legislation conceptually applicable. It is true that states have the power to devise systems of continuing supervision and control over their political subdivisions to prevent the occurrence of such a condition. Should default threaten, it is doubtless also within their power, though scarcely their practice, for the states to guarantee or assume obligations which a political subdivision cannot

\textsuperscript{92} 48 Stat. 49, 308, 1110, 1269, 43 U. S. C. § 403 (1934).\textsuperscript{93} Ibid.
meet. In that event there would be no default, or at least no continued default, and even if federal machinery for dealing with default existed there would be no occasion for its invocation. Perhaps that is the possibility which those who refuse to concede the existence of municipal insolvency and who refuse to discuss anything but the terms of their bond have in mind. But we are referred to no legal means whereby either a municipal creditor, a debtor taxing district or a federal instrumentality could force such a course upon a sovereign state; nor to any evidence pointing toward a voluntary assumption by the states of such complete responsibility for the debts of their local political subdivisions.