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By Mr. W. M. Bond of the Denver Bar

Address recently delivered before the Law Club, Denver

FIFTEEN years ago old man Sherman Davenport and his wife got on a spree in the then customary manner which obtained in the Pea Ridge section of Eastern Carolina. They washed down handfulls of quinine with scuppernong wine, the wine drove the quinine home and the resulting effects were in all respects highly satisfactory.

About dusk as they were walking along the side road that leads from the main highway to the shore of the bay, a heated but not unusual argument arose in the course of which Sherman, without any felonious intent whatsoever, smacked his wife in the jaw. She fell backwards over a pine stump and most inconsiderately and unhappily broke her neck.

Greatly to Sherman's surprise and consternation he was brought up for trial for murder and I appeared for him.

A few days before the trial he remarked to me that he wanted to employ an old ante bellum celebrity named Colonel Sam Sprince to help me. I agreed, but stated, "Why do you want to employ old Colonel Sprince? He don't know any law." "I know that," replied Sherman, "but I'll be damned if he won't complicate things."

The analogy between the case of old Colonel Sam Sprince and your speaker today will no doubt be quite obvious. I am to confine my remarks, as far as possible, to corporate mortgages and reorganization under foreclosure.

I believe I should limit this to reorganization of corporations under foreclosure for I can pass for the purposes of this discussion the question of corporate mortgages by saying that a corporate mortgage, securing a bond issue, is a conveyance in trust by a corporation of a part or all of its properties to a trustee, usually a trust company.

This mortgage or deed of trust has through general usage become stereotyped and conventional in form. It is a most lengthy document and a rather ingenious conception; begins with a recital of the parties; describes the bonds secured by the mortgage; contains a full description of the property covered by the conveyance and then recites what shall be considered acts of default and how the default may be declared; makes provision for the exercise of the power of sale, if a foreclosure becomes necessary; and then, having disposed of such minor matters, for pages and pages, sets out the things for which the trustee shall not be held responsible—things which it shall be *conclusively* presumed not to know—and still further recitations for the trustee's protection in respect to its action if it by accident learns anything about the subject matter of the trust in its hands, with further sweeping statements in regard to the indemnification which shall be furnished it as a prerequisite to action on its part and with the final statement that the trustee shall, in no event, be responsible for the negligence of its attorneys—and, what is even more to the point, the trustee shall have a first and paramount lien against the trust property for its charges and expenses and the fees of its attorneys.

The bond issue secured by this deed of trust is executed on behalf of the corporation and passed to the trustee for certification by it, and delivery or issuance in conformity with the provisions of the deed of trust.

Sometimes this delivery by the trustee is merely a return of the bonds to the treasurer of the mortgagor corporation after they have been properly certified and listed upon the trustee's records, but, in a majority of cases, the trustee must, as a condition precedent to the delivery of the bonds, know that many provisions contained in the mortgage have been complied with, as, for instance, the filing of certificates as to earnings, appraisals of properties purchased and passing under the lien of the mortgage, and frequently the surrender for cancellation of bonds of an old maturing issue in lieu of a like amount of new bonds to be then issued.

It is rather customary now days for corporations to execute "open end mortgages", so-called, in which the amount of bonds to be issued and certified by the trustee is not specified or limited, one of the conditions of issuance being that upon filing of certain certificates as to new properties acquired, or additions to the plant, when coupled with a showing of specified earnings for twelve months last past, etc., new bonds may be forthwith certified by the trustee and delivered to the corporation, and, in this way, the amount of bonds outstanding and secured with equal priority may be increased from year to year, without in any way changing the original deed of trust or recording any further documents.

Clearly, under such a mortgage the trustee has a most responsible duty to perform.

Having provided for this financial set up of our prosperous corporation, we will now proceed to entertain the happy and pleasing thought that she goes head-foremost on the rocks, or, at least, gets into pretty stormy seas and a reorganization of its affairs is necessary.

A reorganization of a corporation is a business arrangement whereby the stock and bonds of the company are readjusted as to amount, income or priority; or the property is sold to a new corporation for new stock or bonds, or the property is sold by foreclosure of a mortgage upon it and the purchaser buys for himself and such of the stockholders and bondholders as he associates with him.

It is this last method of reorganization with which we are now concerned.

This reorganization of the affairs of a corporation whereby all security holders, as well as unsecured creditors, get something, is a modern conception and is in striking contrast with the older method of procedure, whereby the properties were sold under the first mortgage bought in for the bondholders and all other interests and creditors were completely wiped out.

The legal problems and questions involved in the foreclosure of a corporate mortgage upon the system of a transcontinental railroad and those incident to the foreclosure of a mortgage upon a house and lot go back, of course, to the same fundamental and underlying principles of equity. The handling of foreclosure suits involving the properties of large corporations and the reorganization thereof has attracted the greatest legal talent of the country and is a branch of the practice which is growing most rapidly and as the industrial and business development of the nation requires, will continue to grow. It is a most interesting subject and, of course, brings into the large law office, handling such matters, compensation of size undreamed of a generation ago. (I need

not add that I speak here only on information and belief.)

The successful handling of a corporate reorganization, the ability to get the ship off the rocks and start her on a new course with new financial machinery, requires in addition to legal training a sound financial experience and judgment and, in addition to all of this, very comprehensive and intricate plans must be perfected to carry out the details and necessary clerical routine involved in the transaction.

It would be impossible to handle the mechanical details of the foreclosure and reorganization of the properties of a large nationally owned corporation with the facilities offered by the modern trust department or trust company.

It is to this mechanical and clerical branch of the business and from the viewpoint of the Trust Company officials that my remarks are directed.

A corporation having outstanding several issues of bonds secured by deeds of trust, and having a wide distribution of its preferred and common stock, becomes unable to pay the interest due on the bonds and the dividends due to its preferred and common stockholders.

We will assume that this corporation is a public utility, and must continue to operate. Some of the holders of the various classes of outstanding securities meet. Usually at such a meeting, considerable blocks of securities are represented. Committees are selected to represent each class of securities. These committees prepare and send out to the security holders a statement of the organization of the committee or committees, a general statement of the affairs of the corporation, a showing of the necessity for combined action on the part of the bondholders and the designation of banks or trust companies in various centers who will act as depositaries, and issue certificates of deposits for, the securities which are delivered to them to be held for the Protective Committee.

These Bondholders Protective Agreements have become conventional in form. The holders of securities, wishing to act in co-operation with each other, deposit their securities with the depositary banks subject to the control and direction of the Committee and to be held for the Protective Committee. As soon as this committee becomes, in this way, the holder of a sufficient amount of bonds or securities, it calls upon the Trustee to institute such proceedings in Court as may be proper, either for the appointment of a Receiver, the foreclosure of the mortgage or such other action as the situation may require.

Usually, a Receiver is appointed to manage and control the properties pending the sale under foreclosure.

The Protective Committee considers plans of re-organization and if there are several classes of securities, each committee will attempt to keep in touch with all of the other committees, and in unison work out a plan for the financial rehabilitation of the company.

Sometimes all of the committees join in the selection of a re-organization committee.

Plans having been finally agreed upon; the committee, or committees, request the Trustee to obtain a decree of foreclosure and the re-organization committee, or protective committee, adopts and promulgates a plan and agreement of re-organization. This plan describes fully the method by which the committee hopes to reorganize the affairs of the corporation, the new classes of securities which will be issued and furnishes all other information which the security holders should have.

This plan is sent out to all of the se-

curity holders, who have deposited their securities with the committee. The depositors who have deposited their securities with the committee, are given an opportunity to withdraw from the plan and agreement, if the terms are not satisfactory to them, and usually non-depositors are afforded an opportunity to deposit their securities and come in under the plan and agreement of re-organization.

The properties are then sold under foreclosure decree and are bought in by the Re-organization Committee, pursuant to the plan and agreement of re-organization.

The old securities which have been deposited with the Committee are used to meet the purchase price bid at the foreclosure sale. A new corporation has been formed in the meantime and in exchange for the bonds and stock of the new corporation, the Re-organization Committee transfers and conveys to it all the properties which they have bought at the foreclosure sale, and then through the medium of the depositary banks delivers to each of the old security holders, in lieu of their certificates of deposit, the new bonds, stocks or securities to which they may be entitled under the plan and agreement of re-organization.

Almost always there are some bondholders who do not accept the plan and agreement of re-organization, or who refuse to deposit their bonds with the Protective Committee. Upon re-organization, they, of course, are not entitled to any part of the new securities and receive in cash their pro rata share of the sale price of the property, which may be applicable, under the foreclosure sale, to their respective classes of securities.

Usually, this minimum sale price—this up-set price—is fixed by the Court in the decree of foreclosure and is set at a figure which will pay on each non-deposited bond about ⅔rds of the average market price of the bond for the year immediately preceding the promulgation of the plan and agreement of reorganization.

The cash to meet this pro rata payment on non-deposited securities usually comes through an under-writing arranged by the Reorganization Committee. They arrange to sell through underwriters the block of the new securities which are not required to be given in exchange for old securities and with the money thus raised make the payment to the non-depositing security holders.

And thus the new corporation starts out on its career with a new name, new bonds and new stock. Its debts are wiped out, its sins forgiven and its trespasses forgotten.

It is quite an ingenious solution of a problem presented by the magnitude of modern business development. And in it final results is not unlike the statement of a colored boy for whom I once appeared down in North Carolina.

He was charged with larceny of a watch and I saw him sitting over on the prisoner's bench, forlorn and bedraggled because he was in a strange county. He was at least 30 miles from home. I asked him what his trouble was and he said he was about to be tried for stealing a watch. I asked him if he got the watch and he said he did. He was an old friend of mine, so I advised him to keep quiet and appeared for him. In the course of the trial, the loss of the watch was clearly shown at a big darky festival, but they couldn't connect Norman with the disappearance of the watch, although both he and the watch disappeared at about the same time. Finally the judge instructed the clerk of the Court to enter a verdict of not guilty because of failure of proof. "Norman," I said, "you are out of it. But you don't know how you got out,

do you?" "No suh," he said, "but it sho was neat work."

It is becoming more and more the tendency for the Reorganization Committee to act in close touch with the Court having jurisdiction over the foreclosure proceedings, and, recently, the Courts have attempted to provide for a reorganization in conjunction with the Reorganization Committees without requiring any foreclosure sale of the properties—notably the recent Chicago, Milwaukee, St. Paul R. R. reorganization.

This tendency to do away with the complicated machinery and expense of a foreclosure and the creation of an entirely new corporation is being borrowed from the British courts in respect to the reorganization of railroad companies, and this attitude of the British courts is based upon a statute expressly providing for the reorganization of railroad companies and the scaling down of the various securities with the consent of a majority of the holders of the various classes of securities.

As a matter of fact there is no such thing as a mortgage or deed of trust on properties of a Rail Road Company in England. It is prohibited by law.

Interwoven in this scheme of corporate foreclosure and reorganization is an important principle laid down by the Supreme Court of the United States in the case of Louisville, etc., Ry. v. Louisville Trust Co., 174 U. S., decided in 1899 and in the more recent decision Northern Pacific Ry. v. Boyd, 228 U. S. (1913), in which this doctrine is enunciated:

> "Insolvent corporations find it necessary to scale their debts and readjust their stock issues under a reorganization. This may be done in pursuance of a private contract between the bondholders and the stockholders, and though the corporate property is thereby transferred to a new company, having the same share holders, the transaction will be binding between the parties, but such a transfer by stockholders from themselves to themselves cannot defeat the claim of a non-assenting creditor, as against him the sale is void in equity.
>
> "The unsecured creditor must be provided for in the reorganization. His interest can be preserved by the issuance on equitable terms of income bonds or preferred stock. If he declines a fair offer he is left to protect himself as any other creditor of a judgment debtor. If, however, no such tender was made he retains the right to subject the interest of the old stockholders in the property to the payment of his debt. If their interest is valueless, he gets nothing. If it be valuable, he merely subjects that which the law had originally and continuously made liable for payment of corporate liabilities."

We Agree

"Some lawyers still seem to think they must practice, especially in the trial of cases, as though the law were some kind of game. They purposely make opposing counsel all the trouble possible, refuse reasonable stipulations, put off matters by subterfuge, and wind themselves up in so much red tape that they bring as much loss and discredit upon themselves as upon the bar. We are on the whole the greatest procrastinators in the world, and largely because of habit and following antiquated methods of handling our business. Lawyers of outstanding ability and success are always amenable to any suggestion which will bring to issue on the merits the question under consideration. The smaller minded the lawyer, the less successful he is, and, generally, the more pestiferous. Two things could accomplish much. If we could get a few of our leading lawyers to tell us rather intimately how they run their business and what we generally do that's unnecessary and foolish, a lot of us would improve our systems. And we might have a business executive, who

is acquainted with the practice of the law, tell us what the business world thinks would improve our handling of their business.

Our profession embraces some shysters, leeches who prey mostly upon the weak, needy and unfortunate. The strong hand of the law is about to strangle such practices. The battle may be strenuous, it cannot be accomplished without cost, trial and grief, but the final result is not in doubt. Some of the officers of the law are working into the hands of the attorneys who are engaged in illegal practices, and cappers, ambulance chasers, and some bail bond agents and other such ilk are working with such attorneys. Aggressive means, I believe, will be employed by the State Bar to end these practices and our Association intends to take a most active part in aiding the State Bar in this essential work. The other night I heard it well expressed by an experienced member of our Grievance Committee when he said in effect that the five per cent of the bar engaged in illegal practices brought obloquy and shame upon the whole bar."

From statement by Hubert T. Morrow, Esq., to Los Angeles Bar Assn. following his recent election as its President.

Colorado Supreme Court Decisions

(Editors Note—It is intended in each issue of the Record to print brief abstracts of the decisions of the Supreme Court. These abstracts will be printed only after the time within which a petition for rehearing may be filed has elapsed without such action being taken, or in the event that a petition for rehearing has been filed the abstract will be printed only after the petition has been disposed of).

No. 11,786

Edith Graham, Plaintiff in Error, v. Miles Francis and Bessie Francis, Defendants in Error.

Decided March 5, 1928
Judgment Affirmed

En Banc—Opinion by
MR. JUSTICE ADAMS

Adoption—Next Friend—Construction of Statute

Facts—G. is the mother of an illegitimate child born March 21, 1921. She abandoned the child, consented that it be adopted by F. and F., but later sought to withdraw this consent. In the adoption proceedings in District Court, no next friend was appointed for the child.

Holding—District Court, sitting as a court of chancery, had jurisdiction of cause and parties. By abandoning child, G. made immaterial her consent or lack of consent to the adoption. The failure to appoint a next friend (C. L. '21, Sec. 5512) cannot be assigned as error by G., because the next friend is required not for her protection but for that of the child, who is the only one who can raise the question.

No. 11,725

Edward B. Hurt, Plaintiff in Error, v. Frank Newmyer, et al, Defendants in Error.

Decided March 5, 1928
Judgment Affirmed

Dept. II—Opinion by
MR. JUSTICE ADAMS

Water Courses—Adverse Possession—Tacking

Facts—H. sued N. and others for damages and injunction to restrain them from using a ditch. Trial court found that N. was owner of the ditch and that he and his predecessors in title had been in possession for more than thirty years.