MUNICIPAL DEBT ADJUSTMENTS UNDER THE BANKRUPTCY ACT

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EXPANDING SCOPE OF BANKRUPTCY LAWS

Section VIII, Clause 4 of Article I of the Constitution of the United States vests in the Congress power to "establish . . . uniform Laws on the subject of Bankruptcies throughout the United States". Section X, Clause 1 of Article I prohibits a state from passing any "Law impairing the Obligation of Contracts". By these two clauses, the authors of the Constitution intended that power to alter contract rights of creditors should be vested solely in Congress, and when exercised, should operate uniformly throughout the nation. A state may not pass an insolvency or bankruptcy law that is inconsistent with an existing national uniform Act, or that impairs existing contracts.[1]

Federal courts have frequently construed the phrase, "laws on the subject of bankruptcies". They have approved the definition given by Story in his work on Constitutional Law—a bankruptcy law is a law making provision for persons failing to pay their debts.[2] They have said that the constitutional phrase includes all Acts dealing with the relation between an insolvent or non-paying debtor and his creditors, extending to his or their relief.[3] In its narrowest sense, the phrase includes laws which provide for the distribution of a debtor's property among his creditors; in its broadest sense, laws for the discharge of a debtor from liability on his provable debts,[4] with some exceptions.[5] The scope of this power granted to Congress is not restricted by traditional concepts derived from English law, nor by the earlier American Acts, so long as the requirements of due process are observed. The limits of the power can be determined only by the gradual process of inclusion and exclusion.[6]

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1. Brown v. Smart, 145 U. S. 454 (1892).
2. Continental Ill. Nat'l Bk. & Trust Co. v. Chicago, Rock Island & Pacific Ry. Co., 294 U. S. 648, 668 (1935); 2 STORY, CONSTITUTION (9th ed. 1873) § 1111.
3. Hanover National Bank v. Moyses, 186 U. S. 181, 187 (1902); Kunzler v. Kohaus & Visser, 5 Hill 317 (N. Y. 1843).
4. Hanover v. Moyses, 186 U. S. 181 (1902); *In re* Klein, 14 Fed. Cas. 716, No. 7,865 (D. Mo. 1843).
5. 52 STAT. 851 (1938), 11 U. S. C. A. § 35 (Supp. 1941).
6. Continental Ill. Nat'l Bk. & Trust Co. v. Chicago, Rock Island & Pacific Ry. Co., 294 U. S. 648 (1935).

It is not surprising, therefore, to find that to each succeeding national Bankruptcy Act there have been added what the Court calls "liberalizing" provisions, and that later Acts, and amendments to them, have extended relief to persons and corporations not included within the scope of earlier ones.

The first national Bankruptcy Act, enacted in 1800, in the main, embodied the existing Bankruptcy Law of England, and applied to merchants, bankers, brokers, factors, underwriters and traders only. It was repealed in 1803 by the Jeffersonians, because of their opposition to aggregating power in the national government, after which there was no federal statute relating to bankruptcies until 1841. The Act of that year was applicable to the estates of all living persons (except those under guardianship) and to various kinds of corporations. For the first time, a debtor was permitted voluntarily to bring his estate into court for distribution. Like the former Act, this one was repealed within a few years. A third bankruptcy statute was passed in 1867. Its definition of bankruptcy was such that a debtor could be thrown into involuntary bankruptcy whenever he was unable to meet his obligations as they matured, but it embodied a new idea, borrowed from English law. A debtor might propose a composition that would become binding on all creditors after it had been accepted by a designated majority of creditors and approved by the court. That Act was repealed in 1878. The present law was passed in 1898. As originally enacted, it applied to all natural persons, except wage earners, farmers, and unincorporated associations, and to all corporations engaged principally in manufacturing, trading, printing, publishing or mercantile pursuits. Railroads, incorporated banks and insurance companies were expressly excluded. But in 1910, the Act was amended so as to include "any moneyed business or commercial corporation except municipal, railroad, insurance or banking corporations". For the first time, municipal corporations were mentioned, only to be expressly excluded. Railroad, insurance and banking corporations were excluded because administration of them, when insolvent, was in the hands of state officials, or, as in the case of railroads, in Federal Courts of Equity. There have been numerous other amendments, most notable of which are Sections 77 and 77 B authorizing reorganization of railroads and other corporations, and the Frazier-Lemke Amendment relating to farmers. But the limits of the power had not even then been reached.

Background for Extension to Municipal Debts

It is rather significant that municipal corporations were expressly excluded from the 1910 Act, since numerous municipalities and counties had been in financial difficulty between 1870 and 1890. Most of them were in the Middle West. Most of the defaults occurred on bonds that had been issued to aid in the construction of railroads; others resulted from extravagance in the construction of municipal improvements, while some were due to special misfortunes. But in the litigation that ensued, illegality of issue was usually given as the excuse for non-payment. More than 200 cases involving the validity of municipal bonds were decided by the Supreme Court of the United States during the term of office of Chief Justice Waite alone. In the great majority of these cases, the bonds were held valid, and settlements were voluntarily effected between creditors and debtors. In these settlements, reductions were, as a rule, made only in interest accrued, or to accrue, or both, rather than by scaling down the principal; but in some instances, it was found necessary to scale principal as well as interest. St. Clair County (Mo.), for example, which had issued $200,000 principal of bonds, remained in default for over 40 years. At the time of settlement with its creditors, the principal and interest past due amounted to over $900,000. This was compromised for 40 per cent. of the total. As a result of these settlements, municipal bonds regained their reputation and continued to be regarded as sound investments. After the World War, the market for them was widely extended and the volume of municipal bonds outstanding steadily increased.

The collapse of the Florida boom in 1928 initiated another period of defaults, but even prior to that, defaults had occurred in the bonds of drainage and irrigation districts, both in Florida and in the West. During the Florida real estate boom, millions of dollars of bonds were issued by counties to finance the construction of roads, since the Constitution prohibited the state from issuing bonds. Most Florida municipal bonds had been issued for the construction of streets, but unlimited extravagance prevailed in the construction of all types of municipal improvements. After the market crash of 1929, defaults began to occur in other states, notably in North Carolina, Texas, Arkansas and California; even in New Jersey, and in Massachusetts whose municipal debt record is probably the best of any state in the Union. The great cities of Detroit and Chicago were on the verge of financial collapse. It is said that in 1934, there were 2,019 municipalities, counties and other governmental units in default on principal or interest, or both, and that the total principal of securities involved was in excess of $1,000,000,000.

It was under these circumstances that the suggestion was made that relief for defaulting public corporations and political subdivisions and their creditors could be provided by Congress under its bankruptcy power. A bill embodying this idea was introduced by Senator Duncan U. Fletcher of Florida in 1933; but that Congress adjourned without taking any action on the bill. At the beginning of the next session, Representative J. Mark Wilcox, a newly elected member of the House of Representatives, at that time attorney for West Palm Beach, a city then hopelessly in default, introduced HR 5884, which after some changes and modifications became Section 303, Title XI, U. S. C. A.—Section 80 of the Bankruptcy Law. The bill received the support not only of representatives of defaulting communities, but also of many investment houses, and of the Administration. It appeared to furnish the only solution for a problem of national importance.

Constitutionality of First Act

Constitutionality of the Act was soon challenged in a case arising in Texas. The District Court held the Act unconstitutional;[7] the Fifth Circuit Court of Appeals reversed.[8] The Supreme Court of the United States by a divided court affirmed the decision of the District Court.[9] The majority opinion was by Justice McReynolds, that of the minority by Justice Cardozo. The majority held that under the American system of dual sovereignty, Congress has no power to interfere with a state's control over its own subdivisions, counties, municipalities, etc. The opinion did not indicate what particular provisions of the Act would interfere with the states' control; rather its conclusion seems to have been due to a fear of the consequences that might follow a decision that the Act was valid. This appears from the suggestion that Congress, in that event, might even provide for bankruptcy of states, and is particularly apparent in its statement that

> "Our 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 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." [10]

Because of the generality of the opinion, it was doubted whether any Act of similar import would be held constitutional. But the situation was so serious, and defaults were so widespread, that proponents

7. *In re* Cameron County Water Improvement Dist. No. 1, 9 F. Supp. 103 (S. D. Tex. 1934).
8. Cameron County Water Improvement Dist. No. 1 v. Ashton *et al.*, 81 F. (2d) 905 (C. C. A. 5th, 1936).
9. Ashton v. Cameron County Water Improvement Dist. No. 1, 298 U. S. 513 (1936).
10. *Id.* at 530.

of the plan determined to make another attempt to draft a valid statute. Representative Wilcox called a conference of persons interested, to consider what, if anything, could be done. After a closer study of the majority opinion, the conference concluded that an act could be drafted that would furnish the much needed relief, and that would not conflict with the principle of the decision. That conclusion was not a hasty one, but rested upon other decisions of the Supreme Court, and upon deductions therefrom.

Both majority and minority opinions in the *Ashton* case assumed that the 1934 Act was within the meaning of the constitutional phrase, "a uniform law on the subject of bankruptcies". That assumption logically followed approval of Justice Story's definition of bankruptcy, and the decisions in the *Reiman* [11] and *Klein* [12] cases. Hence, invalidity of the 1934 Act was due solely to the fact that it was in conflict with the sovereign powers of states, and not because it was not a law on the subject of bankruptcies.

Clearly, Congress could not authorize institution of an involuntary proceeding in bankruptcy against a municipality, because such a proceeding would necessarily be an interference with the state's control of its local subdivisions. It was, therefore, essential to the validity of any municipal bankruptcy Act that it should authorize voluntary proceedings only. It was even doubted that a voluntary proceeding could be instituted unless a state should authorize its subdivisions to avail themselves of the benefits of the statute. Congress has no power to confer authority upon state officials. Congress can provide a machinery which they can use if the state gives authority. The state itself cannot provide procedure in bankruptcy, since it is expressly prohibited from impairing the obligations of creditors, but it can authorize its subdivisions to avail themselves of such procedure as Congress may provide without usurping the state's powers.[13]

The fact that earlier English and American Bankruptcy statutes did not authorize municipal corporations to invoke bankruptcy, did not militate against the power of Congress to authorize such procedure. The *Rock Island* [14] and *Louisville Bank* [15] cases had pointed to the fact that bankruptcy had been repeatedly liberalized and broadened, and that the limits of Congressional power had not been exceeded thereby.

Nor did the fact that a municipal corporation could not be adjudicated a bankrupt and its property sold and distributed among its credi-

11. *In re* Reiman, 20 Fed. Cas. 490, No. 11,673 (S. D. N. Y. 1874).
12. *In re* Klein, 14 Fed. Cas. 716, No. 7,865 (D. Mo. 1843).
13. Guardian Sav. & Trust Co. v. Rd. Imp. Dist. No. 7, 276 U. S. 1 (1925).
14. Continental Ill. Nat'l Bk. & Trust Co. v. Chicago, Rock Island & Pacific Ry. Co., 294 U. S. 648 (1935).
15. Louisville Joint Stock Land Bank v. Radford, 295 U. S. 555 (1935).

tors, create an obstacle that inhibited Congress from authorizing such a corporation to propose a composition. An adjudication in bankruptcy is not a prerequisite to the jurisdiction of a Court of Bankruptcy to entertain and confirm a composition voluntarily proposed.[16]

The Fourth Circuit Court of Appeals had held that Section 77 B, providing for the reorganization of private corporations, did not violate the Fifth Amendment, even though the statute authorized approval of a plan that would modify or alter secured debts. The court said that the Act was not so arbitrary and unreasonable as to be incompatible with fundamental law.[17] The Supreme Court of the United States denied certiorari.[18]

The Supreme Court of the United States not only had defined compositions, but it had enumerated the essential characteristics of them. A composition, it had said, was in the nature of a contract or agreement between the debtor and a majority of its creditors. In a proceeding for composition, the Court is limited to a determination of the fairness of that agreement; but for this it would not be necessary for the debtor to seek the intervention of the Court. A composition, in some respects, supersedes and is outside of bankruptcy; [19] it is, in effect, nothing more than a means for securing the pro rata payment to creditors of a substantial equivalent of the value of the debtor's property, leaving the debtor in possession of its property during the pendency of the proceeding; [20] when a composition has been confirmed by the Court, jurisdiction over the debtor terminates,[21] and the debtor is discharged from his former debts.

It was, therefore, assumed that if the right of a municipality to proceed in bankruptcy should be contingent upon authority from its state to file a voluntary proceeding, and if the statute should provide for a composition only, proposed by the debtor and accepted by a designated majority of its creditors, the debtor would *ipso facto* retain its freedom of action and possession of its property; and upon confirmation of the composition, the Court's jurisdiction over the debtor would terminate, and the petitioner would be discharged from its existing debts. Such an act could not interfere with or abridge the power of the state over its municipalities and political or governmental subdivisions.

16. *In re* Reiman, 20 Fed. Cas. 490, No. 11,673 (S. D. N. Y. 1874).

17. Campbell v. Alleghany Corp., 75 F. (2d) 947 (C. C. A. 4th, 1935).

18. 296 U. S. 581 (1935).

19. Nassau Smelting & Refining Works, Ltd. v. Brightwood Bronze Foundry Co., 265 U. S. 269, 271 (1924).

20. Cumberland Glass Mfg. Co. v. De Witt, 237 U. S. 447 (1915); *In re* Lane, 125 Fed. 772 (D. Mass. 1902). *But cf.* 52 STAT. 909 (1938), 11 U. S. C. A. §§ 738, 742, 743 (1939).

21. Guaranty Trust Co. v. McCabe, 250 Fed. 699 (C. C. A. 2d, 1918), *cert. denied*, 247 U. S. 505 (1918). *But cf.* 52 STAT. 912 (1938), 11 U. S. C. A. §§ 768, 769 (1939).

CONSTITUTIONALITY OF SECOND ACT

Proceeding upon these premises, a Bill was drawn, introduced by Representative Wilcox, and passed. It is now Section 403, Title XI, U. S. C. A. In order that the Bill should be consistent with legal theories, certain changes were made from old Section 303, Title XI (Sec. 80 of the Bankruptcy Act) which had been held void.

The former Act provided for a "Plan of Adjustment", or Reorganization. The present Act provides for the confirmation of a "Plan of Composition". It not only terms the proposal of the debtor a composition, but the procedure has all the characteristics of a composition. The use of the word "composition" could not, of course, control the construction or validity of the statute, but the use of a well-defined term which had legal connotations is persuasive of the purpose and intent of the authors. What is more important, the statute utilizes the customary procedural device of requiring consent by the holders of a majority of the debts to be affected. Their consent must be secured before the petition can be filed. Thus, it more nearly conforms to the court's definition of a composition than does Section 77 or 77 B, since the proceeding rests upon a contract between the debtor and a majority of its creditors. In fact, it was necessary that the agreement be made before the petition is filed, since the court could not adjudicate a municipality bankrupt, nor sell or distribute its assets, if after the petition be filed, it should be unable to obtain consent of a majority of its creditors.

The Act does not contain any provision for setting aside preferences, though provision is made for preventing preferences after the petition is filed. The court can restrain pending actions, and the institution of new ones, against the debtor. To set aside preferences, it would have been necessary to have a trustee. The appointment of a trustee might have been regarded as an interference with the state's control of the debtor, and with the debtor's control of its own affairs.

It is a condition to confirmation of the composition that the debtor be authorized by the law of the state to carry out the plan. Section 303 had required approval of the petition by an agency of the state. But the general provision of the present act necessarily includes the provisions of the former act. Recently, the Seventh Circuit Court of Appeals held [21a] that the right of a drainage district to file a petition is not dependent upon state legislative authority, but the decision rests on the holding of the court that the officials of the district had authority, impliedly given by the general statute under which the district was created. The opinion implies that Congress can confer authority upon

21a. Buchholz v. South Beardstown D. & L. Dist., C. C. A. 7th, Dec. 12, 1941.

the district, but this reasoning is illogical. For if a state should prohibit its subdivisions from utilizing the procedure for compostion, no one would contend that Congress has the power to nullify that prohibition. Municipal corporations are mere creatures of the state, which can abolish them. Congress has no power to legislate authority to them. It is the cooperation of state and nation that has made possible the accomplishment of the desired results.

One of the most important differences between Section 303 and Section 403 is found in subdivisions (e) and (f) of the new law. The District Court, after hearing, enters an "Interlocutory Order". That order is a final decision on the equities of the plan and is appealable as in equity. But the final decree of confirmation (subdivision (f)) cannot be entered until the consideration for the composition has been deposited by the debtor with the court, or subject to its order. Under the decisions of the Supreme Court, a final decree of confirmation would terminate the Court's jurisdiction over the debtor. It was, therefore, necessary that the consideration should be in the court's possession at the time final decree is entered, so that nothing could occur that might interfere with or prevent delivery by the court to each creditor of his pro rata share of the consideration. If a final decree of composition should be entered before consideration be deposited, the court could not afterward compel the bankrupt to deliver to each creditor his pro rata share of the consideration. An order to do so would interfere with the power of the state over the debtor. Since the consideration for a municipal composition usually consists of bonds, it would not be possible for the court, after final decree, to compel the debtor to issue them. The court cannot dispose of the assets of the debtor, or distribute the proceeds from a sale of them as a penalty for contumacious acts of the debtor. If the court has no power to enforce its decree of confirmation, it is a nullity.

Section 30, Title XI, U. S. C. A. (Bankruptcy Act, Section 12), required the court to find that the plan was "for the best interests of the creditors". The draftsmen of Section 303 (Section 80), using Sections 77 and 77 B as a precedent, added a requirement that the court should also find that the plan was "fair and equitable", and "does not discriminate either for or against any creditor". Section 403 brought forward these additional requirements as conditions to confirmation. The importance of these provisions became apparent when the case of *Case v. Los Angeles* [22] was decided. There it was held that the phrase "fair and equitable" is a "term of art", and that the statute imposed upon the trial court the duty of exercising its own independent judg-

22. 308 U. S. 106 (1939).

ment in determining this fact. Consent by a majority of creditors is not alone sufficient to support a decree of confirmation. The effect of the addition of these conditions was not fully appreciated when the Act was drawn, but the Act as now construed furnishes additional protection to holders of small claims.

The Report of the Committee of the House of Representatives said that the Bill had been drawn with the "sweeping character of the holding of the Supreme Court in the *Ashton* case" in mind; that it

> "avoids *any restriction* on the powers of the States or their arms of government in the exercise of their sovereign rights and duties. No interference with the fiscal or governmental affairs of a subdivision is permitted." [23]

When the Act was attacked in the *Bekins* case,[24] the District Judge failed to recognize the differences between it and the former one, and held that he was bound by the opinion in the *Ashton* case to hold the present statute unconstitutional.[25] The Supreme Court reversed that decision. Chief Justice Hughes, speaking for eight Justices, said:

> "The Committee's [of Congress] points are well taken. . . . The statute is carefully drawn so as not to impinge upon the sovereignty of the State. The State retains control of its fiscal affairs." [26]

He held that the Act provided for a composition, which had long been recognized as an exercise of bankruptcy power; that no adjudication in bankruptcy was necessary to sustain the validation of a composition proceeding; and that the Act did not violate the Fifth Amendment to the Federal Constitution.

The decision rests also upon the fact that "the Act is limited to voluntary proceedings for the composition of debts". The opinion points out that the Constitution did not prohibit cooperation between the nation and the states through the exercise of the power of each to the advantage of their citizens which neither nation nor state, acting alone, could secure for them. It necessarily implies that the officials of the debtor shall have received authority from its creator. Otherwise there would be no cooperation.

23. H. R. REP. No. 517, 75th Cong., 1st Sess. (1937) 2. (Italics supplied.)

24. *In re* Lindsay-Strathmore Irr. Dist., 21 F. Supp. 129 (S. D. Cal. 1937).

25. "I feel compelled by this decision to hold that the new enactment . . . is constitutionally vulnerable as was the old. As a student, exercising private judgment, I agree with the conclusion of the dissenters that immunity from interference through federal bankruptcy laws, even if applicable to states, should not be extended to state instrumentalities, whether they be municipal, quasi municipal, or public corporations. However, as a judge of a lower court, I cannot exercise private judgment. . . ." *Id.* at 135.

26. United States v. Bekins, 304 U. S. 27, 51 (1938).

Four years of experience have demonstrated that the Act has not been injurious to the rights of creditors of municipalities. On the whole, it has been constructive and helpful. It has served two purposes. Specifically, it has made it possible for municipalities, with the consent of a majority of their creditors, to agree upon settlements of their debts; to provide for payment of them in the future in accordance with an orderly and feasible schedule; and has made composition settlements binding upon all creditors. The possibility of confiscatory tax levies due to large accumulated defaults has been eliminated, and municipalities have been able to carry on ordinary governmental activities, as well as to increase in population and resources. What is equally important, the mere fact that there was a statute of this kind that was constitutional has caused creditors, who otherwise would seek, by independent action, each his own advantage, to join in a serious concerted effort to reach a fair basis of settlement. Those who otherwise might have refused to cooperate, have accepted settlements, because they realized that under the statute they could ultimately be compelled to accept a fair and equitable plan.

Corporation bonds are usually secured by a deed of trust, with power in the trustee, and a duty resting upon it, to act for the protection of the interests of all holders. But, municipal bonds, as a rule have no common representative. Each holder must act for the protection of his own interest. When a default occurs on corporate bonds, the expense of litigation is borne pro rata by all holders. Municipal bonds do not even include a provision for attorney's fees to be added if suit be necessary to enforce payment. Because of these facts, holders of small blocks of municipal bonds have been more or less at the mercy of the debtor and of holders of large blocks. Under the statute as now construed, all creditors, small as well as large, whether consenting or not, receive equal protection. Their share of the consideration for the composition is delivered to them by the court. In the *Avon Park*[27] case, the Supreme Court said:

> "The Court is not merely a ministerial register of the vote of security holders. All those interested in the estate are entitled to the Court's protection."

They do not even lose their rights by failing to prove their claim within a given time. But for this protection, holders of a majority of bonds might, through an agreement with the debtor, use the statute as an instrument of oppression.

In the *Avon Park* case, more than two-thirds of the bondholders had apparently consented to the proposed plan, but nearly one-half of

27. American United Mutual Life Ins. Co. v. Avon Park, 309 U. S. 651 (1940).

the bonds so consenting were owned by a dealer that was acting as Fiscal Agent for the City. It had purchased judgments and bonds at greatly reduced prices in order to eliminate objections, or to obtain consent from the required percentage. The court held that the dealer had not made a full and complete disclosure of its interests; that its vote for acceptance of the plan could not be said to have been cast in good faith within the meaning of the statute. It, therefore, reversed the lower court's approval of the plan. It pointed out the necessity for equal treatment of all creditors. In order to do equity to all, it said, the District Court has power "to adjust the remedy to meet the needs". Such power is "not dependent on express statutory provisions. It inheres in the jurisdiction of a Court of Bankruptcy". It suggested various ways in which the District Judge might adjust the position of creditors. The duties of the District Court under this Act, are, therefore, similar to those imposed upon it by Sections 77 and 77 B.

Amendments and Limitations

Since its enactment, the statute has been twice amended. First, on June 22, 1938, when subsection (j) was added. This amendment was found necessary because of a decision by the Fifth Circuit Court of Appeals. A majority of creditors had voluntarily accepted refunding bonds in exchange for their old securities before the petition was filed. The Court of Appeals held that those who had voluntarily accepted new bonds could not be counted in determining whether the required percentage of holders had consented to the Plan of Composition.[28] The amendment was later sustained by the Fifth Circuit Court of Appeals in two cases.[29] It should be noted, however, that both cases arose upon motions to dismiss, and the Court did not determine whether a change of circumstances, or events happening since the plan was originally proposed, would result in discrimination between creditors of the same class or would produce inequity. The amendment is merely permissive. It makes it possible for a plan that has been partially carried out before the proceeding is filed to be made binding on dissenters; but if making the plan effective at a later date would render the plan unfair and inequitable, or would result in discrimination for or against creditors, or would not be for the best interests of creditors, the court must disapprove the plan, regardless of the consents of other creditors.

Another amendment was passed June 28, 1940. It permits unincorporated tax or special assessment districts and counties (which were included in the 1934 Act but omitted from the 1937 Act) to file peti-

28. *In re* City of West Palm Beach, 96 F. (2d) 85 (C. C. A. 5th, 1938).

29. American National Bank v. City of Sanford, 112 F. (2d) 435 (C. C. A. 5th, 1940); Davis v. City of Homestead, 112 F. (2d) 438 (C. C. A. 5th, 1940).

tions under the Act. Subsection (e) was also amended, possibly as a result of the then pending *Avon Park* case. The court is now required to examine all contracts, proposals and agreements with agents, attorneys and others promoting the composition, particularly those which relate to compensation, and make a separate adjudication upon their fairness. If it finds that the contract or the practices of such Fiscal Agent, attorney or other person or corporation promoting the composition, do not meet with its approval, the petition must be dismissed, unless the parties consent to a modification of the terms of their agreement in a manner satisfactory to the court.

The power of Congress to include counties was questioned by Assistant Solicitor General Weston in an opinion rendered by him at the time the 1934 Act was before the Committee of the House. Mr. Weston was of the opinion that counties, being an integral part of a state, could not be legally included. The Fifth Circuit Court of Appeals in the *Broward County Board of Public Instruction* case[30] held that that Board was not a governmental body, such as a county, and affirmed the decree of confirmation, but implied that even if the Board had been held to be a governmental body, the decision of the Court would not have been different. In many states, much of the revenue of counties is derived from the state, and federal courts cannot control the distribution of state funds.[31] If a county's revenue is derived solely from ad valorem taxes and no state funds are involved, and if the state has authorized the county to file a petition, the Act may be validly applied. But if a Plan of Composition should, in fact, produce a conflict with the power of the state, or if the Plan of Composition should itself offer to permit a Bankruptcy Court to interfere with the independence of the debtor, the proceeding would conflict with the fundamental principle of the *Ashton* case, which is still the law. It must be kept in mind that though the present statute was held constitutional, that decision was based upon the fact that it did not conflict with state and local sovereignty. Merely because the Act is constitutional, a Federal court may not invade the field of the state's power. The power of the Federal court under the Act is very different from that which it possesses in proceedings instituted by individuals, or private corporations. This limitation upon its power is necessary and applies to every step in the proceedings. The court can make no order that will even indirectly interfere with the sovereignty of the state, nor compel action by the debtor. The *Bekins* case did not reverse the principle of constitutional law announced in the *Ashton* case. It reaffirmed it.

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30. Roberts v. Board of Public Instruction for Broward County, 112 F. (2d) 459 (C. C. A. 5th, 1940).

31. Rittenoure v. Charlotte County, 109 F. (2d) 476 (C. C. A. 5th, 1940).

Some have assumed that the Interlocutory Decree may authorize the debtor to make distribution of the new securities. The Act provides otherwise. Distribution can be made only by the court in its final decree. Distribution made before final decree is at the risk of all parties. If inequity or unfairness result from distribution before a final decree of confirmation has been made, creditors who accept the new bonds will not be protected by the Interlocutory Order.

Twilight of the Act

The original Act provided that it should expire in two years, but its life has been extended to June 30, 1942. Regardless of benefits derived from its operation, and of the fact that, in the main, the Act has been satisfactory, it should not become a permanent policy of our government. The statute was the product of a condition, and was intended to serve a limited purpose. The purpose has been substantially accomplished. Unless the War should have some more or less unexpected repercussions upon municipal bonds, the Act will not be needed after June 30, 1942. If left on the statute book, it may become an instrument of injustice. Community debtors may deliberately default on their bonds in order to obtain easier terms from their creditors. Bondholders often accept compromises to avoid the expense, delay and trouble involved in legal proceedings to enforce their legal rights, and to keep their securities current. A bankruptcy statute should not be used to destroy or depreciate the value of contracts made in good faith, but human nature is such, and the temptation may be so strong, that this remedial statute could become a means for perpetrating injustice. The moral sense of obligation of a community is not as strong as that of an individual, and loss of credit is not so detrimental to a municipal corporation as it is to a private corporation. The Act should be allowed to expire. If in the future conditions should require relief, Congress can enact a similar statute, or one better adapted to the then existing situation. Meanwhile, precedents, legal and practical, have been established that will furnish guideposts for the roads that lead into the undiscovered land of the future.