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Proposed New Form of Security for the Senior Debt of Our Airlines and Railroads: Floating Charges

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THE PURPOSE of this paper is to propose for our airlines and railroads a new form of senior debt security developed from the floating charges used by English and Canadian companies to secure their debt. This form of debt could be instituted by amendments to the Civil Aeronautics Act and the Interstate Commerce Act, authorizing our airlines and railroads to enter into agreements creating such floating charges to secure debt and providing that purported conveyances made, or liens created by the obligor, in violation of any restrictive covenants entered into to protect such floating charges would be void. (Suggested drafts of such amendments are attached hereto as Appendices A and B.)

Although the factors that could make this new form of security desirable in the case of airlines are different from the factors that could make it desirable in the case of the railroads, it is because of the peculiar federal status of those two transportation industries that the proposal made in this paper takes the form of proposed federal statutes. Similar statutes could, of course, be adopted by any state with respect to property subject to the legislative jurisdiction of that state. Of course, state legislation would have to be drafted with an eye toward the provisions of the Bankruptcy Act, a concern not required in the case of a federal statute that would have the effect of superseding inconsistent provisions of the Bankruptcy Act.

SENIOR DEBT Financing by OUR RAILROADS, SHIPPING ENTERPRISES AND AIRLINES

Before considering the proposals it seems desirable to briefly relate some of the history of the development of the security instruments used by our transportation industries to finance senior debt.

Railroads

When the construction of canals and railroads in the United States began about 1830, the necessary money was raised by state aid and by sale of stock. Soon, however, those sources proved inadequate, and from about 1840, up to the present time, the greater part of railroad capital has been raised by the sale of bonds secured by mortgages on the railroads. In the early construction period such bonds were frequently issued to, or guaranteed by, states or municipalities interested in having a railroad constructed. While there have been a number of railroad collateral trust obligations secured by pledge of bonds of the issuing railroad or of stocks and bonds of subsidiaries, and some issues by railroads of unsecured debentures, in general, except for equipment trust obligations and conditional sale arrangements entered into in connection with purchases of equipment, the great bulk of senior railroad debt has consisted of bonds secured by mortgages on the railroad.

The corporate mortgage as it exists in American financial practice is primarily an American creation that was developed in the railroad field. It is not commonly found in England or elsewhere in Europe, although it is used by some industrial companies in Canada. The railroad mortgage and the remedies available to bondholders thereunder were not the result of legislative action but were adapted by lawyers from the mortgage an individual puts on his land to secure repayment of a loan, and the remedies provided in a railroad mortgage are substantially those available at common law to a person holding such a mortgage.

Specific legislative authority for railroads to borrow money was not necessary, because the power to borrow was held to be a necessary incident to the power to construct and operate a railroad. Even the power to mortgage the line of railroad probably existed as an implied power without express legislative authority. However, the franchise to operate a railroad could not be effectively mortgaged or sold on execution or foreclosure sale without express state legislative authority. Accordingly, most statutes authorizing the construction and operation of the pioneer railroads, either initially or by early amendment, expressly authorized the incurring of debt and the mortgaging of the property and franchises to secure repayment of the debt.

The first period of the development of our railroad mortgages is from about 1830, the time of the first construction of railroads in the United States, up to the end of the Civil War. The second period, from 1866 to 1890, was the period of expansion and consolidation into large systems in the East, and, in the West, of the construction of the lines which now make up the great transcontinental and southwestern systems. That period ended with the depression of the 1890's, when many of the railroads were forced into receivership. In the third period, from 1890 to 1910, railroad mortgages were materially expanded and improved, both in form and substance, through the influence of the group of expert railroad reorganizers (bankers and lawyers), who worked on those reorganizations. The fourth period, from 1910 to 1930, covers the wave of railroad receiverships and reorganizations (particularly of railroads operating west of the Mississippi) which preceded World War I, as well as the railroad financing of the 1920's. The final period, from 1930 to the present, covers the reorganizations resulting from the depression of the 1930's (mostly under section 77 of the Bankruptcy Act) and the few mortgages created by railroads with excellent credit to refund outstanding bonds at lower interest rates. Most mortgages executed after 1930 contain protective provisions reflecting the requirements of the large insurance companies and savings banks which, because they were large holders of the defaulted bonds of the bankrupt railroads, participated actively in the reorganizations of that period. Their views as to appropriate provisions in railroad mortgage are given great weight by solvent railroads also, because institutional investors are large purchasers of the new issues of railroad bonds.

Shipping Enterprises

Until 1920, senior debt financing by American shipping enterprises was largely unknown. That was due to the fact that the vessels of those enterprises, their principal assets available to secure borrowings, were liable for claims resulting from voyages of the vessel. Those claims could result in maritime liens in substantial amounts and having priority over any debt secured by a mortgage on the vessel. Until enactment of the Ship Mortgage Act of 1920, a mortgage on a ship was not enforceable in the United States in admiralty. While it was enforceable in equity, it was subject to those many prior maritime liens which were enforceable in in rem proceedings in admiralty. This situation was such that a congressional report of 1920 could
state “mortgage security on ships [now is] . . . practically worthless.”

Congress took a truly revolutionary step in 1920 when, in order to have American people and capital interested in shipping and shipping securities, it passed the Federal Ship Mortgage Act. That act established a procedure for creating a preferred ship mortgage, based on federal rather than state law, enforceable in the federal courts and assured of a priority in those courts over all but a limited number of maritime liens specified in the act.

That action of Congress, which flew squarely in the face of our admiralty law, not only assured that in the disposition by the United States Government of hundreds of war-surplus vessels it would receive a security instrument that would adequately secure the purchase price payable to the United States, but provided a vehicle for senior debt financing by our still struggling Merchant Marine.

Airlines

The Ship Mortgage Act of 1920 contributed to the enactment of federal legislation that aided in the financing of our airlines, but not to any significant degree prior to the end of World War II. It has been estimated that up to the end of World War II the second debt financing of American airlines never exceeded $10 million at any one time. Subsequent to 1938 the airlines could use chattel mortgages on their aircraft to secure their debt. That was because section 503 of the Civil Aeronautics Act, enacted in 1938 largely through the inspiration of the Ship Mortgage Act of 1920, provided for the maintenance by the Civil Aeronautics Administration of a system for recording conveyances (including conditional sale contracts and mortgages) affecting the title to, or an interest in, civil aircraft of the United States. Section 503 operated on a nation-wide basis and made it necessary to comply with state filing or recording laws, regardless of whether or not the aircraft was used in interstate commerce. In view of the wide scope of operations of the larger airlines and the geographical limits of state recording statutes, secured airline financing was extremely burdensome without federal recording. Even with federal recording, the problem for airlines operating into foreign countries is, of course, not completely solved, because in most foreign jurisdictions the chattel mortgage is unknown or ineffective and the recording provisions of the Civil Aeronautics Act do not operate abroad. A conditional sale agreement pertaining to aircraft had similar infirmities abroad.

Until 1948 secured transactions relating to aircraft were not satisfactory because a lessor, conditional vendor or assignee was exposed to the danger that as owner he could be absolutely liable under state law, regardless of negligence, for damage to persons or property. So far as this country is concerned, that rule was reversed by a federal statute in 1948. That pros-

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2 Ibid.
4 The act reversed Bogart v. The John Jay, 17 How. 399 (1854), where it was held that a ship mortgage could not be foreclosed in admiralty, but must be foreclosed in equity. In Detroit Trust Co. v. The Barlum, 293 U. S. 21 (1934), involving a mortgage created under the Federal Ship Mortgage Act to secure sums not applied to the mortgaged vessel, the act was upheld notwithstanding the fact that traditionally a loan unrelated to service to a vessel could not be the basis of a valid maritime lien. See Morrison, The Constitutionality of the Ship Mortgage Act of 1920, 44 Yale L. J. 1 (1934); Canfield, Ship Mortgage Act of 1920, 22 Mich. L. Rev. 10 (1923).
5 Rodgers, Ship Construction Financing, XII Business Lawyer 142, 154-6 (1957).
6 52 Stat. 1006 (1938).
pective liability of owners of interests in aircraft contributed to the fact that until 1948 only two or three aircraft equipment trusts were ever created. In any event, up until 1948, what little senior secured debt the airlines had incurred was in the form of chattel mortgages, but probably never exceeded $10 million at any one time.

On the urging of those who were concerned with financing the very substantial postwar increases in our airline fleets, Congress in 1948 amended section 503 so that federal recording would also be applicable to any lease, mortgage, equipment trust, conditional sale agreement or other security instrument, affecting title to, or an interest in (a) any specifically identified aircraft engine or (b) propellers and appliances maintained by or on behalf of a certified air carrier for use in aircraft maintained by or on behalf of such carrier. This extension of the recording system was to provide the airlines with a security instrument that, among other things, would enable them to borrow against the very substantial investment in spare engines and spare parts kept for installation in aircraft during normal operations. But for this “basket lien” statute, spare parts could not be readily subjected to a lien by any existing security device. However, as is hereinafter indicated the possibility of the application of the doctrine of Benedict v. Ratner has limited the use of liens on floating stocks of spare parts.

Just as the provisions of the Ship Mortgage Act of 1920 contributed to the enactment of section 503 of the Civil Aeronautics Act in 1938, section 503, in turn, contributed to the enactment by Congress in 1952 of section 20c of the Interstate Commerce Act which authorized security instruments pertaining to railroad equipment financing to be filed with the I. C. C., and provided that, when so deposited, they were to be valid and enforceable against all persons. This eliminated the necessity for depositing, filing, registering or recording such documents under the provisions of state laws.

Proposed Federal Floating Charge Statutes

For Our Airlines and Railroads

Federal Status of Our Airlines and Railroads

The special status given to our transportation industries and their properties by federal law furnishes the basis for suggesting legislation of the kind referred to herein. For more than a century a “vessel of the United States” (i.e., one registered under our laws) has had a special status. In 1868 the Supreme Court upheld an 1850 statute declaring that a chattel mortgage on a vessel of the United States would not be valid against third persons without notice unless recorded with the Collector of United States Customs at the port where the vessel was registered. In holding that this federal statute accorded to a chattel mortgage that was so recorded a priority over one recorded under a state statute, the Supreme Court wrote:

Ships or vessels of the United States are the creations of the legislation of Congress. None can be denominated such, or be entitled to the benefits or privileges thereof, except those registered or enrolled according to the act. ... Ships or vessels not brought within these provisions of the acts of Congress, and not entitled to the benefits thereunto belonging, are of no more value as American vessels than the wood and iron out of which they are constructed. Their substantial

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11 268 U. S. 353 (1925).
13 White’s Bank v. Smith, 7 Wall. 466 (1868).
14 Id. at 655-6.
if not entire value consists in their right to the character of national vessels, and to have the protection of the national flag floating at their mast's head.

Congress having created, as it were, this species of property, and conferred upon it its chief value under the power given in the Constitution to regulate commerce, we perceive no reason for entertaining any serious doubt but that this power may be extended to the security and protection of the rights and title of all persons dealing therein.

By the Ship Mortgage Act of 1920 Congress as a matter of federal law authorized the creation of mortgages on vessels of the United States that would be enforceable in admiralty, even though the creation of the mortgage might be contrary to the principles of admiralty.15

The Civil Aeronautics Act gives a special status to “civil aircraft of the United States,” including the right to create liens on them under section 503 of that act. It also gives a special status to appliances and spare parts maintained for use by certified air carriers by enabling them to create liens enforceable against third parties.

The federal status of interstate railroads was recognized long ago when the Supreme Court indicated that Congress could grant them franchises in addition to those granted them by their states of incorporation.16 That was referred to by the Supreme Court in one case when it described the effect of the Transportation Act of 1920 in the following words:17

... Transportation Act, 1929, introduced into the federal legislation a new railroad policy seeking to insure an adequate transportation service. To attain that end, new rights, new obligations, new machinery, were created .... It is a primary aim of that policy to secure the avoidance of waste. That avoidance, as well as the maintenance of service, is viewed as a direct concern of the public.

... [Appellant] urges that in the course of the passage of Transportation Act, 1920, a provision for federal incorporation of railroads was struck out. But while railroad corporations were left under state charters, they were still instrumentalities of interstate commerce, and, as such, were subject to the paramount federal obligation to render the efficient and economical service required in the maintenance of an adequate system of interstate transportation. (Emphasis added.)

More recently, in a case where the Court held that the I. C. C. could free a railroad corporation incorporated in Virginia from complying with those provisions of the South Carolina Constitution and statute requiring incorporation in South Carolina, the Court wrote:18

Congress has long made the maintenance and development of an economical and efficient railroad system a matter of primary national concern. Its legislation must be read with this purpose in mind. .... Since [1934] ... Congress has given additional proof of its purpose to grant adequate power to the Commission to override state laws which interfere with efficient and economical railroad operation. ... Although the [language of Section 5(11) of the Interstate Commerce Act] ... bars creation of a federal corporation, it clearly authorizes a railroad corporation to exercise the powers therein granted and above those bestowed upon it by the state of its creation. These federally conferred powers can be exercised in the same manner as though they had been granted to a federally created corporation.... Here, just as a federally created railroad corporation could for federal purposes operate in South Carolina, so can this Virginia corporation exercise its federally granted power to operate in that state. (Emphasis added.)

15 Detroit Trust Co. v. Barlum, supra note 4.
From these decisions it is clear that interstate carriers have a unique status in our law, in that they may be accorded by federal law rights that are in addition to, and, on occasion, in conflict with, rights given under state law. In addition to those instances referred to earlier, in section 77 of the Bankruptcy Act, Congress operates to stay the exercise of rights given to security holders under state law, such as the right to carry out foreclosure proceedings under a corporate indenture, or the right to sell collateral pledged to secure loans. Somewhat similarly, in federal equity receiverships the federal courts traditionally granted priorities to so-called "six-month" claimants and to receivership expenses over railroad and public utility mortgages.

Another instance of the exercise of this power to alter state-created rights in connection with the financial difficulties of interstate railroads is section 20b of the Interstate Commerce Act, enacted in 1948. Reduced to simple terms, section 20b enables an interstate railroad to alter or modify the provisions of a security (other than an equipment trust obligation), and to alter or modify the provisions of mortgages, indentures or charters pursuant to which such a security was issued. To be so empowered, the road first proposes the plan to the I. C. C., which, following a hearing after notice to security holders, may make findings prescribed by the statute. The proposal is then submitted to holders of the affected securities and, if 75 per cent of each affected class assents, the I. C. C. enters an order approving and authorizing the proposal and fixing the time when it is to become binding on all affected security holders. The statute spells out its far-reaching effect—in carrying out a plan under the statute a carrier is "relieved from the operation of all restraints, limitations, and prohibitions of law, federal, state or municipal, in so far as may be necessary to enable [it] to make and carry into effect the alteration or modification so approved and authorized.... Any power granted by this section to any carrier shall be deemed to be in addition to and in modification of its powers under its corporate charter or under the laws of any state."20

These instances of the use of federal law to add to or to alter the state-created rights of interstate carriers are the basis for suggesting the possibility of congressional enactments creating a new type of senior debt security to enable the airlines and the railroads to utilize floating charges.

Floating Charges as Security for Senior Debt

In commencing a discussion of floating charges it might be well to refer to two descriptions given by Lord Macnaghten:

A specific charge, I think, is one that without more fastens on ascertained and definite property or property capable of being ascertained and defined; a floating charge, on the other hand, is ambulatory and shifting in its nature, hovering over and so to speak floating with the property which it is intended to affect until some event occurs or some act is done which causes it to settle and fasten on the subject of the charge within its reach and grasp.22

A floating security is an equitable charge on the assets for the time being of a going concern. It attaches to the subject charged in the varying condition in which it happens to be from time to time. It is of the essence of such a charge that it remains dormant until the

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20 See 20b(5).
21 As to floating charges in general see: Gower, Modern Company Law c. 19 (1954); Waldock, The Law of Mortgages c. 7 (2d ed. 1950); 3 Palmer, Company Precedents c. 7 (16th ed. 1952); Fraser, Reorganization of Companies in Canada, 27 Colum. L. Rev. 932, 934-6 (1927); Note, The Availability of the Floating Charge as a Security Device in the United States, 28 Colum. L. Rev. 300 (1928); Curtis, The Theory of the Floating Charge, 4 U. Toronto L. J. 131 (1941).
undertaking charged ceases to be a going concern, or until the person
in whose favor the charge is created intervenes. His right to intervene
may of course be suspended by agreement. But if there is no agree-
ment for suspension, he may exercise his right whenever he pleases
after default.\(^2\)

Just as the American railroad mortgage and the remedies available to bond-
holders thereunder are not the result of legislative action but the develop-
ment of extremely able and imaginative lawyers, so is the floating charge in
England. The validity of floating charges there was not established until
1870, in a case involving such a charge created by a company with extensive
shipping operations. There the court held that debenture holders secured
by the floating charge were entitled to the proceeds of the sale of ships in
priority to general creditors.\(^2\)

Floating charges have now developed to the point where a writer on the
English practice can state, "There can be scarcely a company which has not
granted such a [floating] charge to its bank to secure its current overdraft
and, in many cases, there will be a further floating charge to secure an issue
of bonds;"\(^2\) and a writer on the Canadian practice to observe, "It is the
almost invariable practice to include in a well drawn Canadian bond mort-
gage a floating charge upon the assets and undertaking of the company.
Most bond mortgages contain a specific charge of a company's real estate
and buildings or other fixed assets in addition to the floating charge, although
sometimes there is no fixed charge and the floating charge is the only security
for the bonds."\(^2\)

The spirit that moved English solicitors to develop the floating charge to
a high state was portrayed half a century ago by the author of the then
leading text on English debentures:\(^2\)

The "law merchant," as Chief Justice Cockburn pointed out in his
instructive judgment in Goodwin v. Roberts, is not fixed and stereo-
typed, but a living law, capable of expansion and enlargement to meet
the requirements of trade in the varying circumstances of commerce;
and no more striking object-lesson in illustration of this truth could
be found than debentures and debenture stock. Almost untouched by
legislation—springing out of mercantile usage, this branch of our
commercial system has grown with the marvellous growth of the com-
pany, and strengthened with its strength. The needs of the business-
man, the experience and acumen of the City solicitor, the art of the
Lincoln's Inn draftsman, each has played its part in bringing deben-
tures and debenture stock to their present state of elaboration . . .

Perhaps the most controversial matter in connection with deben-
tures and debenture stock is the floating charge. This floating charge
is something sui generis and peculiar to English law. Neither the law
of France, nor of Germany, nor of Scotland permits such a form of
security—permits, that is to say, a company to give a valid charge on
its property (other than immovable) while it remains in possession—the
ostensible owner. It may be said in defense of the charge that,
now there is a public register of mortgages and charges, every person
dealing with a company knows, or had the means of knowing, that the
company has charged its property; and if, notwithstanding such
knowledge or notice, he chooses to give credit to the company he must
take the consequences, as in the case of a registered bill of sale.

Since that was written vast improvements have been made in such security
instruments and today they hold a high position in England and in Canada.

\(^2\) The Governments Stock and Other Securities Investment Co. v. Manila Ry.
[1897] A. C. 81, 86.
\(^2\) In re Panama, New Zealand and Australian Royal Mail Company, L. R. 5
Ch. 318 (1870).
\(^2\) Gower, Some Contrasts Between British and American Corporation Law,
\(^2\) Fraser Reorganization of Companies in Canada, 27 Colum. L. Rev. 932, 934
(1927).
\(^2\) Manson, Debentures and Debenture Stock of Trading and Other Companies
v-vi (1910).
Professor L. C. B. Gower of the University of London, recently visiting Professor of Law at Harvard Law School, contrasted the use of the floating charge in England with our practices in the following words:28

As in America, a charge which leaves the borrower free to deal with the property charged is normally not feasible. The reason for this result in England is not the rule in Benedict v. Ratner, which precludes it in America but is unknown in England; instead the reason is the "reputed ownership" clause of the English Bankruptcy Act, and certain provisions of the Bills of Sale Acts of 1878 and 1882. These provisions do not apply to incorporated companies which can therefore charge their property in this way. Accordingly it is almost universal practice for companies to raise some of the funds which they require by floating charges over all their assets both present and future. This leaves them free to deal with their assets in the ordinary course of business, until the charges crystallize upon insolvency or the appointment of a receiver. There can be scarcely a company which has not granted such a charge to its bank to secure its current overdraft and, in many cases, there will be a further floating charge to secure an issue of bonds.29 It is, indeed, quite common for a business to be converted into an incorporated company solely because of the greater facilities for borrowing which flow from the ability to grant an effective floating charge.

In his volume on company law Professor Gower elaborated on some of the important attributes of floating charges:30

...floating charges ... are equitable charges on some or all of the present and future property of a company, subject to the company's power to deal with such property in the ordinary course of business. ... The charge remains floating and the property liquid until some default is made and the debenture-holder takes steps to enforce his security, or until winding up commences. When that occurs the charge "crystallizes" and is converted into a normal fixed charge on the assets of the company at the time of crystallization. Default alone will not suffice to crystallize the charge, the debenture-holders must intervene to determine the license to the company to deal with the property, normally by appointing a receiver or by applying to the court to do so.

No particular form of words is necessary in order to create a floating charge; it suffices that the intention is shown, (a) to impose a charge on property present and future, and (b) to allow the company to continue to deal with that property in the ordinary course of business. ...

... As a floating charge is necessarily equitable, it will clearly be postponed to a later legal mortgage if that mortgagee had no notice of it. But this is of little importance for, as we shall see, the floating charge will be invalid unless registered at the Companies' Registry and registered with notice. What makes the floating charge so vulnerable is not so much that it is equitable as the fact that the debenture-holders have impliedly authorized the company to continue to deal with its assets notwithstanding the charge. ...

The debenture itself may, however, restrict the company's power to raise further charges in priority to or pari passu with it. Such restrictions, which are quite common but strictly construed, limit the company's actual authority to deal with its assets and accordingly remove the basis on which floating charges are postponed to later equities.

There is one reported American case involving a floating charge created by an English company.31 The case held that the instrument created an equitable mortgage on land in Minnesota enforceable between the parties. Since the question was presented on demurrer, the court did not decide the validity of the charge as against creditors and subsequent purchasers but

28 Gower, Some Contrasts Between British and American Corporation Law, 69 Harv. L. Rev. 1369, 1396-7 (1956) (some footnotes have been omitted).
29 Often coupled with a fixed charge over specified real estate.
indicated that as between the company and the debenture holders the language of the debenture under consideration, which expressed a present purpose to pledge all of the company's property (including that in Minnesota) for payment of the debentures, was sufficient to create a valid lien without describing the property with particularity. Of course, among the questions that would probably have been raised by creditors and subsequent purchasers would be those relating to failure to comply with the Minnesota recording statutes and the effect of rules such as those expounded in Benedict v. Ratner, if applicable to the transaction.

A contemporary writer on the subject of security in England has expressed a strong belief that the development in England of debentures and floating charges may well continue to the point that mortgages may completely disappear in that country as instruments securing corporate securities. He likens that movement to the transition that took place in the Roman law from the fideicommis (a transfer of title on condition that it be retransferred at a future date) to the hypotheca (a right of a creditor to compel a sale of assets of the debtor to realize on his claim). One point made by that writer is that the problems of conveyancing inherent in a mortgage transaction (where the real objective is security, not title) are needlessly complex so long as adequate procedures are available to bring about in the event of default the appointment of a trustee and sale of the assets of the debtor to secure payment of the creditor's claim.

That point has special significance in the case of railroad mortgages in the United States, where it is not uncommon for the mortgaged property to be in as many as ten different states and as many as three hundred different recording districts. In creating a railroad mortgage in this country it is conventional to consider the laws of each of the states where the mortgaged property is located and to comply as closely as possible with the laws of those several states with respect to the substantive provisions of the mortgage as well as with their recording requirements. The reason for this is that our railroad mortgage is a direct descendant of the mortgage given by an individual land owner. In the case of a railroad mortgage the problem becomes extremely complex because of the many jurisdictions involved and the vast amount of time counsel must spend to resolve these problems. More than half a century ago Canada, realizing the inordinate problems and expense imposed on its railroads in recording their mortgages in the various provinces and counties, enacted a statute dispensing with local recording where the mortgage was recorded with the Secretary of State of Canada.

The airlines of the United States do not have a problem of comparable complexity. Although they may have real property located in more states than many railroads, the real property in a single state of even the largest trunk airline is at one or more terminals and can be readily described by metes and bounds—something which is impossible in the case of a large

82 "The company hereby charges with such payment its undertaking [and] all its property whatsoever and wheresoever, both present and future. . . . The debentures . . . are all to rank pari passu as a first charge upon the property hereby charged . . . ; and such charge is to be a floating security, but so that the company is not to be at liberty to create any mortgage or charge in priority to the said debenture." Id. at 897. More modern forms of floating charge clauses appear in Fraser, Reorganization of Companies in Canada, 27 Colum. L. Rev. 932, 935 (1927); Jacob, The Effect of Provision for Ratable Protection of Debenture Holders in Case of Subsequent Mortgage, 52 Harv. L. Rev. 77, 127 (1938).

83 Waldock, The Law of Mortgages 16, 19, n. 1 (2d ed. 1950). Cf. Corey, Direct Placement of Corporate Securities 117 (1951): "In the choice between debentures and mortgage bonds, institutional investors follow the capital market's preference for the former. The general experience with mortgage bonds during the depression left the impression that this type of security frequently was not a great deal more satisfactory in the event of bankruptcy or liquidation than were debentures."

railroad system. Each individual piece of property can be subjected to a separate mortgage to be pledged as collateral with a single trustee—each mortgage complying with the laws of the particular jurisdiction, thereby making it unnecessary to draft, as in the case of a railroad mortgage, a single document which simultaneously complies with the applicable laws of a great many states.

Since our airlines have been able to finance the acquisition of large fleets of four-engine aircraft for domestic and foreign operation, the financing vehicles presently available to the airlines must be deemed to be reasonably satisfactory. A large part of such financing has been done with the use of chattel mortgages entered into and recorded with the C.A.A. under the authority of section 503, but another large part has been done by the sale of unsecured debentures, principally to institutions and to a lesser extent to the public. Commitments, aggregating more than $2 billion, have been entered into, largely with institutional investors, to finance the acquisition of jet fleets by our trunk airlines. Some of these commitments contemplate the giving of security in the form of chattel mortgages on the aircraft fleet. An equally large number contemplate the issuance of unsecured debentures with appropriate protective clauses. It is expected that such financing and the use of retained earnings will be adequate for the reequipment programs and that recourse to public debt financing will not be necessary.

Notwithstanding these enviable signs of successful solution by the trunk airlines of their financing problems, it seems essential that the airlines develop, just as the railroads did a century ago, a debt security device which can appeal to large numbers of investors. Neither section 503 nor the medium of unsecured debenture financing may be fully adequate for that purpose. In terms of section 503, there has been no very satisfactory resolution of the problem of obtaining a first and prior lien on unidentifiable spare parts located at many places around the country. Counsel are concerned as to the possible effect of the doctrine of Benedict v. Ratner, their concern stemming from the fact that while section 503(a)(3) appears to authorize a chattel mortgage affecting unidentified spare parts, propellers or engines, when such articles are installed in or removed from aircraft at many terminals here and abroad, or are exchanged between the airlines themselves or with operators of privately operated central repair bases where substantial amounts of commercial aircraft maintenance and overhaul is carried out (all of which is done in practice, and necessarily so), the mortgagor and others may be deemed to have been exercising such dominion over the supposedly mortgaged spare parts, propellers and engines as to raise a question as to the validity of the mortgage. If this dealing with purportedly mortgaged assets is of the type that is within the doctrine of Benedict v. Ratner, and if the doctrine of that case should be applicable to the transaction, the mortgage itself may be invalid. Rather than run that risk, some

35 In Benedict v. Ratner, the Court recognized that a state statute could authorize the creation of a floating charge and make inapplicable the rule that retention of possession by a mortgagor with power of sale for his own benefit is fraudulent to creditors (see 268 U. S. 361, n. 11). The Court cited as just such a statute the then section 45 of the New York Personal Property Law, which authorized the creation of a general lien on a stock of merchandise, including after-acquired chattels, and upon accounts receivable arising from such merchandise.

The congressional reports on the 1948 amendments to section 503, supra, note 10, seem to acknowledge that the revised section 503 was intended to create a floating charge on unidentified spare parts, propellers or engines. That appears from the following statements in both reports:

"Subsection (a)(3) provides for the establishment and maintenance of a system for the recordation of the designated liens upon spare parts, aircraft engines, and propellers. It would be unnecessary under these provisions to identify each item individually. Only a general description of the type of property covered and a designation of its location would be necessary. Such descriptions of property together
airline chattel mortgages have deliberately omitted any purported lien on spare parts or unidentified accessories and engines.

Except for such recognition to security interests created under section 503 as may be accorded abroad because of the Convention on the International Recognition of Rights in Aircraft (which has received the unqualified ratification of only Brazil, Norway, Pakistan and the United States of America), there is no great assurance that section 503 will be held to be effective other than in the United States, its territories and possessions. Therefore, an airline that must depend on giving security in its financings may find that it derives little borrowing power from anything other than that portion of its fleet, and perhaps spare engines and parts, utilized in operations within the United States. Our airlines have very sizable amounts of other assets that might well be availed of as security to increase their borrowing power—such as operating assets not embraced within the terms of section 503, office equipment, maintenance shops, passenger and cargo loading equipment, underground fueling systems and accounts receivable. As our airlines acquire larger and more expensive operating equipment, the amount of their assets not within the present terms of section 503 will increase and the desirability of a security device to effectively borrow against them will likewise increase.

Even though the airlines may now feel they can foresee the successful financing of their re-equipment programs, fairness to their stockholders (who, because of the use airlines have made of retained earnings for new equipment, have long gone with little or nothing in the way of dividends) should impel the airlines to seek long-term financing acceptable not only to the large institutional investors capable of carefully following the activities of their borrowers, but to the smaller investors. The large institutional investors may themselves desire that there be available to the airlines a security device that may make possible the refunding of securities held by institutions by securities that may have greater attraction to the public.

The attached drafts of amendments to the Civil Aeronautics Act and the Interstate Commerce Act have been prepared with the objective of providing statutory authority for the creation by our airlines and railroads of floating charges to secure debt. If statutes such as these are enacted, the provisions of the indenture setting forth the terms and other conditions of the indebtedness will be of considerable importance. It is reasonable to expect that such

with designations of locality have been accepted as adequate descriptions in liens by Federal and State courts. See Murphy Hotels Corp. v. Central National Bank Savings & Trust Co. (18 F. (2d) 719 (1927), cert. den. 275 U. S. 534) [chattel mortgage covering all property placed in a leased hotel by the mortgagor held to be 'neither vague, indefinite nor insufficient, but, on the contrary, specifically covered all the furniture and equipment in this billiard parlor on the day the mortgage lien attached']; Hartford Accident & Indemnity Co. v. Coggin (78 F. (2d) 471 (1935), cert. den. 296 U. S. 620) ['North Carolina courts apply the general rule that a description in a mortgage is sufficient if it points out the subject-matter with such particularity as to enable it to be identified']; Latta v. Bell (122 N. C. 641, 30 S. E. 15) [chattel mortgage on 'all personal property' in 'Hotel Bar' and 'Hotel Billiard Room' held not to cover personal property in adjoining cellar]; Lee County Sav. Bank v. Snodgrass Bros. (166 N. W. 680, 182 Iowa 1387) [mortgage of 'livestock, including steers, cows, calves, bulls, hogs and sheep' held to also cover horses and mules]."

The Uniform Commercial Code abrogates the doctrine of Benedict v. Ratner by providing that a "security interest is not valid or fraudulent against creditors by reason of liberty in the debtor to use or dispose of all or part of the collateral..." 12A Pa. Stat. Ann. (Purdon), sec. 9-205 (1954).

an indenture would contain, among other provisions, clauses restricting the creation of indebtedness ranking prior to or on a parity with indebtedness secured by the floating charge, restricting the creation of mortgages and prohibiting or limiting the sale of disposition of certain assets unless the proceeds are applied for the benefit of secured debt. Drafting of indentures with such clauses has reached a high state of development in contemporary debt financing, and those precedents would be further developed and refined.

APPENDIX A

SUGGESTED NEW SECTION 505 OF THE CIVIL AERONAUTICS ACT

SECTION 505. (a) It shall be lawful for an air carrier certified under section 604(b) of this act to create and issue (any provision contained in any corporate charter or any provision of state law to the contrary notwithstanding, except any such provision requiring the consent of shareholders to such action) indebtedness secured by a mortgage, lien or charge on all, or any part of its real and personal property, franchises and certificates of public convenience and necessity, then or thereafter owned, with power reserved to the carrier to deal with such property and franchises, subject to any restrictions on such power contained in the instrument executed by the carrier to create or secure such indebtedness, although such mortgage, lien or charge may take effect as a specific encumbrance or crystallize only upon the declaration, as provided in the instrument executed by the carrier to create or secure such indebtedness, of a default in any term or condition contained in such instrument. Purported conveyances made, or liens created, by the carrier in violation of any restrictive covenant contained in any such instrument shall be void.

(b) Every such instrument shall describe the property, franchises and certificates to be subject to such mortgage, lien or charge (such description may be by classes of property, franchises and certificates) and shall be executed by the parties thereto, and acknowledged or verified in accordance with such requirements as the administrator shall prescribe, and recorded in a recording system which shall be established for such purpose by the administrator; and any such instrument so recorded shall, from and after the time so recorded, constitute notice to, and shall be valid in accordance with its terms against, any person who subsequently acquires from the carrier or its successors or assigns, in any manner whatsoever, an interest in the property, assets or undertaking which shall be affected by such instrument, including, without limitation any purchaser from or mortgagee, pledgee, creditor, receiver, or trustee in bankruptcy of, the carrier or its successors or assigns; and any such instrument so recorded need not be otherwise filed, deposited, registered or recorded under the provisions of any other law of the United States of America or of any state or political subdivision thereof, territory, district or possession thereof, respecting the filing, depositing, registration or recordation of such instrument, but shall be valid and enforceable in any such state or political subdivision thereof, territory, district or possession thereof, as if duly filed, deposited, registered or recorded in accordance with any such law of such state or political subdivision thereof, territory, district or possession thereof, whether or not so filed, deposited, registered or recorded. The administrator shall establish and maintain a system for the recording of each such instrument which shall be submitted for recording pursuant to the provisions of this section, and shall cause to be marked, or stamped upon such instrument, a consecutive number, as well as the date and hour of such recording, and shall maintain an index of all such instruments, including any assignment, amendment, release, discharge or satisfac-

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37 Corey, Direct Placement of Corporate Securities 115-125 (1951).
tion thereof, and notice of any declaration of default thereunder, and shall list in such index the names and addresses of the principal debtors, trustees, guarantors and other parties thereto, as well as such other facts as the administrator, in its discretion, may consider will facilitate the determination of the rights of the parties to such transactions. All records and indices maintained by the administrator pursuant to this section shall be open to public inspection at reasonable hours. In all suits or proceeding in any court, at law or in equity, a copy of each instrument recorded in accordance with the requirements of this section, certified by the administrator to have been so recorded, shall be received as evidence thereof.

(c) Upon the default in any term or condition of an instrument executed by a carrier, the mortgage, lien or charge created therein may be enforced by judicial proceedings. The several United States district courts shall have original jurisdiction of any action or proceeding to enforce the mortgage, lien or charge contained in any such instrument and to prevent and restrain violations of the provisions thereof. Any power granted by this section to any carrier shall be deemed to be in addition to and in modification of its powers under its corporate charter or under the laws of any state. As used in this section, the term “instrument” shall mean any deed of trust, indenture, mortgage or other document executed by a carrier to create or secure indebtedness created and issued pursuant to the provisions of this section, and any release, partial release, discharge or satisfaction thereof, or supplement thereto.

APPENDIX B

SUGGESTED AMENDMENT TO SECTION 20a OF THE INTERSTATE COMMERCE ACT

(13) (a) It shall be lawful for a carrier to create and issue (any provision contained in any corporate charter or any provision of state law to the contrary notwithstanding, except any such provision requiring the consent of shareholders to such action) indebtedness secured by a mortgage, lien or charge on all, or any part of, its real and personal property, franchises and certificates of public convenience and necessity, then or thereafter owned, with power reserved to the carrier to deal with such property and franchises, subject to any restrictions on such power contained in the instrument executed by the carrier to create or secure such indebtedness although such mortgage, lien or charge may take effect as a specific encumbrance or crystallize only upon the declaration, as provided in the instrument executed by the carrier to create or secure such indebtedness, of a default in any term or condition contained in such instrument. Purported conveyances made, or liens created, by the carrier in violation of any restrictive covenant contained in any such instrument shall be void.

(b) Every such instrument shall describe the property, franchises and certificates to be subject to such mortgage, lien or charge (such description may be by classes of property, franchises and certificates) and shall be executed by the parties thereto, and acknowledged or verified in accordance with such requirements as the Commission shall prescribe, and recorded in a recording system which shall be established for such purpose by the Commission; and any such instrument so recorded shall, from and after the time so recorded, constitute notice to, and shall be valid in accordance with its terms against, any person who subsequently acquires from the carrier or its successors or assigns, in any manner whatsoever, an interest in the property, assets or undertaking which shall be affected by such instrument, including, without limitation, any purchaser from, or mortgagee, pledgee, creditor, receiver, or trustee in bankruptcy of, the carrier or its successors or assigns; and any such instrument so recorded need not be otherwise filed, deposited, registered or recorded under the provisions of any other law of the United
States of America or of any state of political subdivision thereof, territory, district or possession thereof, respecting the filing, depositing, registration or recordation of such instrument, but shall be valid and enforceable in any such state or political subdivision thereof, territory, district or possession thereof, as if duly filed, deposited, registered or recorded in accordance with any such law of such state or political subdivision thereof, territory, district or possession thereof, whether or not so filed, deposited, registered or recorded. The Commission shall establish and maintain a system for the recording of each instrument which shall be submitted for recording pursuant to the provisions of this paragraph, and shall cause to be marked, or stamped upon such instrument, a consecutive number, as well as the date and hour of such recording, and shall maintain an index of all such instruments, including any assignment, amendment, release, discharge or satisfaction thereof, and notice of any declaration of default thereunder, and shall list in such index the names and addresses of the principal debtors, trustees, guarantors and other parties thereto, as well as such other facts as the Commission, in its discretion, may consider will facilitate the determination of the rights of the parties to such transactions. All records and indices maintained by the Commission pursuant to this paragraph shall be open to public inspection at reasonable hours. In all suits or proceedings in any court, at law or in equity, a copy of each instrument recorded in accordance with the requirements of this paragraph, certified by the secretary or an assistant secretary of the Commission to have been so recorded, shall be received as evidence thereof.

(c) Upon the default in any term or condition of an instrument executed by a carrier, the mortgage, lien or charge created therein may be enforced by judicial proceedings. The several United States district courts shall have original jurisdiction of any action or proceeding to enforce the mortgage lien or charge contained in any such instrument and to prevent and restrain violations of the provisions thereof. Any power granted by this paragraph to any carrier shall be deemed to be in addition to and in modification of its powers under its corporate charter or under the laws of any state. As used in this paragraph, the term "instrument" shall mean any deed of trust, indenture, mortgage or other document executed by a carrier to create or secure indebtedness created and issued pursuant to the provisions of this paragraph, and any release, partial release, discharge or satisfaction thereof, or supplement thereto.