ADDRESS

of

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CORPORATE REORGANIZATIONS AND THE HOLDING COMPANY ACT

The resourcefulness of our profession in discovering statutory holes through which we, like adroit quarterbacks, can direct our clients, is proverbial. It is rivaled only by the ingenuity of our profession in drafting apparently hole-proof legislation. I once heard an alleged leader of the reorganization bar deliver himself of a tirade against reorganization legislation sponsored by the Securities and Exchange Commission, and when he had concluded, he said: "We'll find a way to operate anyhow."

This, gentlemen, has been the gallant slogan of our reorganization bar. Equity receiverships gave way to 77B; 77B is now being superseded by chapter X of the Chandler Act; and, in the public utility field, there have come the controls exercised by the Interstate Commerce Commission and the Securities and Exchange Commission. But some members of our profession are persuaded that they can still operate in the grand old way.

At least in the portion of the public utility field which is subject to the Holding Company Act, it is my conviction that civilization has at last extended its rule to corporate reorganizations. Congress has rolled back a frontier of the law; and in this new domain of law and order, brigandry will hardly be possible.

I need not describe to you the reorganization practice of the past. I need not relate how corporate reorganization was regarded as a sort of state of nature in the Hobbesian sense: where substantive rules of law were virtually suspended; where, if certain ritualistic procedures were observed, contract rights might be freely violated; and where diplomacy was devious, covenants secret and the rights of thousands of ordinary citizens disposed of by and for their ruling minorities. These were the actualities in hundreds of cases; if the contrast between the actualities and the forms makes you sceptical of this description, I invite you to consult the available sources and to review the records of reorganizations in your own jurisdiction.

I propose, in this paper, to describe the powers of the Securities and Exchange Commission under the Holding Company Act over corporate reorganizations. I shall include not only reorganizations under the Bankruptcy Act, but also the so-called "voluntary" reorganizations. I shall also relate my own conclusions with respect to the principles which have guided and will guide the exercise of these powers, and I shall comment upon certain practical aspects of their administration. You will realize, I am sure, that nothing I say here has been officially approved by the Commission. I am going to talk quite frankly, and on any and all points the Commission may disagree with my analysis or views of policy. Our statute is still in its infancy, and in large part what I say is based upon my own interpretation and not upon decisions of the Commission.

Companies and persons which control electric or gas utilities must register under the Holding Company Act, with some exceptions. Once they have registered, a great many of the activities of the holding companies and their subsidiaries are subject to the Act. Reorganizations may be affected by many sections of the Act, depending upon their nature; but in order that what I say shall not be too disorganized, I shall limit myself to the operation and effect of sections 11(f), 11(g), 6(a)(1)

and 6(a)(2) of the Act. I shall not deal with the administration of section 11(b) (the miscalled "death sentence"), although this section involves many of the customary problems of corporate reorganization.

Let me first describe the provisions of the Act which directly affect reorganizations in a court of the United States -- whether they be receiverships or 77B. The Holding Company Act does not require that a trustee be appointed in 77B proceedings. On the other hand, as you know, the Chandler Act provides that if the fixed, non-contingent indebtedness of the debtor is $250,000 or over, the Judge is required to appoint one or more trustees. At least one of these trustees must be a disinterested person; the other may be a director, officer or employee of the debtor, but the powers of this second type of trustee are limited to siding in the operation of the business and management of the property. The result of this provision is that in all substantial utility reorganizations which take place after the provisions of the Chandler Act become effective, at least one trustee will be appointed.

By virtue of provisions in the Holding Company Act, a 77B Court cannot validly appoint a trustee for the estate of a registered holding company or a subsidiary thereof unless the Securities and Exchange Commission has been notified and given an opportunity to be heard. The court may, if the Commission consents, appoint the Commission itself as receiver or trustee.

The Commission itself may, if it so desires, propose a reorganization plan; and no plan (by whomsoever proposed) may become effective unless it has been approved by the Commission prior to its submission to the court. These are powers which will not be affected by the provisions of the Chandler Act requiring the Judge, where a corporation's indebtedness exceeds $3,000,000, merely to submit the plans he deems worthy of consideration to the Commission for its examination and its advisory report thereon, and which in smaller cases give the Judge the privilege to submit such plans to the Commission.

The powers which the Commission possesses under the Holding Company Act, over the appointment of a trustee or receiver and over the plan of reorganization are, to my mind, given substance and meaning by the broad powers in that Act to regulate the solicitation of proxies, deposits, consents or dissents in respect of reorganization plans. Consents to or dissents from a reorganization plan may be solicited only if each solicitation is accompanied or preceded by a report of the Commission on the reorganization plan. In addition, the Commission has power to regulate fees, expenses and remuneration, to whomsoever paid, in connection with any reorganization of a registered holding company or a subsidiary thereof. This provision, it is safe to assume, is of particular interest to lawyers.

I want to emphasize that what I have said is in the nature of a hop, skip and jump over some of the provisions of the Act. I shall hereinafter comment upon some of the elaborate and complex rules which the Commission has adopted pursuant to the statutory provisions. Any of you who are or become engaged in a reorganization subject to the Act will undoubtedly fret and fume over the complexity of these rules. But, in the first place, the Commission staff offers you free and sympathetic legal aid that is, counsel as to the interpretation of these provisions; and, in the second place, I think that once you have mastered these provisions, you will find that they are intelligible parts of an intelligent regulatory scheme.

Let me state to you my notion of the basic theories underlying these controls over reorganizations. There is a tremendous public interest involved in holding company systems. It has been estimated that about $10,000,000,000, face amount, of public utility operating and holding company securities are outstanding; and it is estimated that there are about 23,000,000 customers of electricity and gas companies in this country. The interests of both investors and consumers are involved in the reorganization of constituents of a holding company system. The investors' interest is obvious -- to a substantial extent, a holding company system is a group of units organically connected and financially interrelated. The consumer interested in reorganization derives from the fact that efficient service and low rates are, in large part, the results of stable, conservative capitalization and able, effective management. Both of these factors are directly affected by reorganization.

Without adequate regulation of reorganizations, therefore, the scheme for control of holding company systems embraced in the Act would be vitally deficient. And of this control scheme, a right to be heard concerning appointment of trustees or receivers; a veto power on plans plus the privilege to propose plans; and regulatory jurisdiction over protective committees and solicitation practices, are all important parts.

Some of you are undoubtedly familiar with the Commission's position on trustees in 77B proceedings. As I understand it, the Commission believes that in every large estate, an independent trustee should be appointed. A trustee who is independent of affiliation with the management or any other interest in the company can provide the sort of reappraisal of the company's management and its operating and financial policies which is highly important to its successful reorganization. He can exercise an objective scrutiny over claims, and he is in a position to ascertain and prosecute causes of action which will benefit the estate, without regard to the persons against whom such causes of action exist. In addition, he can perform the great service of formulating and assisting others to formulate beneficial plans of reorganization, freed from the influence of and suspicion sometimes generated by personal interest. As I have stated, however, this philosophy is not wholly embodied in the Holding Company Act. That Act merely allows the Commission to be heard on the qualifications of the person to be appointed trustee; it does not require the court to appoint a trustee.

Nevertheless, in one major reorganization under the Holding Company Act, the Commission successfully urged that a trustee be appointed for a company in 77B proceedings. In the 77B proceedings of Utilities Power and Light Corporation, in the Northern District of Illinois, an order had been entered continuing the debtor in possession. This order was entered at the time the company filed its petition in 77B.

The facts were such as to lead the Commission to believe that it was particularly necessary in this case that an independent trustee be appointed. Utilities Power and Light Corporation is a registered holding company with electric, gas and various non-utility subsidiaries scattered over this country and Canada. The system had been built up by Harley Clarke. Mr. Clarke had been virtually eliminated from the company shortly before institution of the 77B proceedings. Nevertheless, he still asserted an interest.

The two major interests in the company were the Atlas Corporation and the Associated Gas and Electric Company. The Atlas Corporation owned approximately half of the entire outstanding debenture issue; and Associated owned some debentures and a considerable amount of the B and common stock of Utilities Power and Light.

Herley Clarke, Atlas and Associated were engaged in bitter controversies. Charges of mismanagement had been made by presumably reliable persons, against Clarke; and charges had been made that the Atlas Corporation was attempting to enforce certain claims which were subject to attack.

It was generally recognized that the books and records of the company were in deplorable shape, and that the management of its subsidiaries was not all that it might be.

There was no president of the company. The company's affairs were in the hands of a Board, which represented the various conflicting interests and this Board was headed by an executive vice-president whose powers were substantially circumscribed.

Because of these facts and others which it would take too long to relate, the Commission felt that an effective reorganization which would realize as much as possible for investors could not be affected under the leadership of the company's Board. Counsel for the Commission therefore appeared as a friend of the court and urged the appointment of an independent trustee. Substantially all of the interested parties were opposed to the Commission's suggestions, for one reason or another. After prolonged hearings, however, the court appointed an independent trustee and administration of the estate under a trustee has since proceeded.

As I said above, under the Chandler Act, this result will obtain as a matter of course. I have already mentioned the requirement of that Act that an independent trustee be appointed in all cases of substantial size. The Act also requires that a disinterested attorney for the trustee must be appointed. The trustee is directed, if the Judge so orders, to investigate the past acts and conduct of the debtor and to report upon them to the Judge; he is authorized to examine the directors and officers of the debtor and any other witnesses concerning such matters, if the Judge so directs; and he is required to report to the Judge any facts ascertained by him, relating to fraud, misconduct, mismanagement and irregularities, and any causes of action available to the estate. In every case he is required to assemble the essential information relating to the property, liabilities and financial condition of the debtor, the operation of its business, and the desirability of its continuance. These provisions in effect vitalize the office of trustee, in general accordance with the theory of his office which I have stated above. The trustee's functions are further vitalized by provisions authorizing and directing the trustee to prepare and file a plan of reorganization.

After the Judge has approved a plan, the trustee is required by the Chandler Act to transmit to all creditors and stockholders affected by the plan, a copy of the plan together with the opinion of the Judge, if any, and the report of the Securities and Exchange Commission, if any has been filed in the proceedings. The Chandler Act forbids solicitation of any

acceptance of a plan until it has been approved and transmitted to creditors and stockholders, and unless the specific consent of the court has been obtained prior to the solicitation. The Act also requires that disclosure be made concerning the interests of any person or committee who appears in the proceedings representing more than twelve creditors and stockholders; and there is an exceedingly important provision requiring the disclosure of lists of security holders upon direction of the court.

It is my belief that these controls over solicitation practices are not in themselves adequate to assure honesty and democracy in the reorganization process, although they are a great advance over the practice which has heretofore prevailed. As I have mentioned, provisions in the Holding Company Act and in rules adopted pursuant to the Act provide additional controls over solicitation in respect of the reorganization of a registered holding company or any of its subsidiaries.

I have already indicated my view that controls over reorganization plans are only partially effective if they are not coupled with comprehensive regulation of protective committees and solicitation practices. For example, students of reorganizations have often pointed out that under the old procedure, the equity court had no real choice but to approve the reorganization plan agreed upon by the dominant protective committees. Customarily, these committees had on deposit with them a majority of the securities affected by the reorganization. Disapproval of a plan proposed by the committees did not reinfranchise the security holders. It merely required the various committees to renegotiate and rebargain, and the results of such renegotiation were not likely to be radically different from the plan originally submitted to the court. In addition, and perhaps more fundamentally, the practice of soliciting deposits or proxies which constituted a blanket power of attorney to the protective committee was a violation of basic notions of decency and fairness in a democratic society. In effect, it was a mock plebiscite at which the constituents of the protective committees had only one alternative -- to vote Ja.

The rules of the Securities and Exchange Commission, pursuant to the authority of the statute, are designed to accomplish the following things, generally speaking: To prevent solicitation of consents to reorganization plans which are not yet in being -- that is to say, to prevent protective committees or others from soliciting blanket powers of attorney to draft unspecified kinds of reorganization plans and to cast the vote of security holders for unspecified and undefined plans, selected at the absolute discretion of the committee; to prevent solicitation of consents to any plan unless such solicitation is accompanied by an analysis of the plan by the Commission; to prevent protective committees or others from obtaining deposit of securities unless it can be demonstrated that deposit is necessary for purposes which cannot adequately be served by proxies; and to permit solicitation in any event only after disclosure has been made of the interests and affiliations of the persons who are soliciting or are causing the solicitation to be made.

On the other hand, we have recognized the practical desirability of permitting a group of interested persons to act in the role of financial and legal representatives of security holders in connection with the negotiation of reorganization plans and to appear before governmental bodies in respect

of the reorganization. Subject only to the requirement that disclosure of their affiliations and interests be made, we have permitted solicitation of powers of attorney for this restricted purpose. We have also exempted from the requirements of our rules solicitation of authorizations from groups of not more than twenty-five persons. In effect, this provision is a rough and ready definition of solicitation, in the sense that it recognizes that proxies may be obtained from a small group of individuals without the consequences of a general, broadside solicitation. Our solicitation rules, therefore, are basically merely an application of certain democratic principles to the field of reorganization. No one in a democratic society should be required to vote for a reorganization plan as to which he is not given adequate information; and no one should be required to deposit his property subject to another's dominion except for specific, defined and necessary purposes.

Similarly, in passing upon the merits of reorganization plans, the Commission has insisted and will continue to insist upon adherence to another basic democratic principle -- namely, the sancity of contracts. You will recall that before the *Boyd* case was decided by the Supreme Court in 1913, lawyers generally believed that the equity reorganization process furnished machinery whereby contract rights of security holders might be disregarded. This was so despite the Supreme Court's earlier warnings in the *Monon* case. But the *Boyd* case was a message to the profession that the assets in an estate must be divided, as far as they would go, among security holders in accordance with their contract rights and priorities -- in short, that the doctrine of the sancitity of contracts is not abrogated by the equity reorganization procedure.

To members of the reorganization bar twenty years ago, the *Boyd* case was a "perpetual spectre" and "a veritable demon incarnate". By 1928, however, the demon had become "reasonably domesticated". Today, many of our best citizens regard it as a mere household pet. Many lawyers and many courts have refused to take the warning of the Boyd case seriously. Some have strictly construed the strict principle of the Boyd case - applying it only to situations falling nicely within the facts of the *Boyd* case; and there are even instances in the records where the narrow holding of the Boyd case has been disregarded in lower courts. Indeed, it has been said that the cases in which a liberal construction of the Boyd principle has been applied are distinctly in the minority.

The advent of section 77B renewed the controversy as to whether or not sacred contracts are even theoretically sacred in reorganizations. I shall not recapitulate the differing opinions on this subject. You know that some lower courts have gone so far as to deny the applicability of the Boyd principle to 77B reorganizations. Others have merely given it lip service.

So far as the Securities and Exchange Commission is concerned, I think certain generalizations can be safely indulged. In its opinion in the *Genesee Valley Gas Company* case, the Commission placed itself squarely alongside those courts which have insisted upon a liberal application of the Boyd principle to 77B reorganizations. The Genesee Valley Gas Company is an intermediate holding company organized and operating in New York State. It is itself a subsidiary of two holding companies. As of January 10, 1936, it had outstanding $733,000 of 1st Lien 6% Bonds; $283,500 of Ten-Year Debenture Bonds; about $107,000 of secured notes; and preferred and common stock. Genesee's assets consisted almost entirely of common stock and obligations of its subsidiaries. All of these assets were pledged as collateral for the company's own obligations.

The company's 77B proceedings were precipitated by its inability to meet the maturity of its debentures and certain short-term loans. A plan of reorganization was formulated by various interests in the company and filed with the Securities and Exchange Commission. I shall not trouble you with the details of this plan. Suffice it to say that the $733,000 of 1st Lien Bonds were to be undisturbed; the remainder of the new capital structure was to consist entirely of common stock. To the debenture holders and general creditors, common stock was to be issued; and common stock was also to be issued in exchange for the secured notes. The plan also provided for alloting to the old common and preferred stock an aggregate of 739 shares of new common.

The Commission disapproved the plan for a variety of reasons. I think it will illustrate the Commission's operations in connection with reorganization plans, if I briefly recapitulate some of these reasons, with as little detail as possible. I shall not even mention all of the factors which led to disapproval. In the first place, the Commission pointed out that Genesee's income was largely derived from one subsidiary, Pavilion Natural Gas Company. Pavilion had transferred $196,000 from its depreciation reserve to its earned surplus account, where it was available for the payment of dividends to Genesee. This transfer had been made without the approval of the New York State Commission and, accordingly, violated the uniform system of accounts prescribed by that Commission. The Securities and Exchange Commission concluded that if the New York State Commission reversed this transfer or required the company to restore the amount transferred out of earnings, Genesee would be in a position where it could not meet its interest requirements on its lien bonds. This factor introduced an element of doubt with regard to the earnings of Genesee and its financial condition so serious as to make it impossible to approve the plan.

The Commission further concluded that there was no value in the company for the stock either on an assets or earnings basis. The Commission did not go so far as to hold that allocation of the small interest contemplated by the plan to this stock would of itself vitiate the plan; such was unnecessary to its decision in the matter. It pointed out, however, that in the particular circumstances, the stock alloted to the old stockholders was sufficient to vest the old management group with voting control. This factor, coupled with the lack of any equity for this stock, prevented a finding that the plan was fair.

The Commission's opinion did not rest with the refusal to approve the plan which had been filed with it. It proceeded to make further suggestions with respect to a new plan. The first suggestion was that Genesee and the holding company on top of it should be dissolved or liquidated. The next was that the New York State operating companies of Genesee should be merged or consolidated into a single operating company. The last suggestion related to the creation of a sound structure for the reorganized company.

I think that a careful study of this opinion will disclose a great deal concerning the Commission's technique in dealing with reorganization plans under the Holding Company Act. Let me summarize the Commission's approach, as I understand it: In order to test the fairness of a reorganization plan,

it is first necessary to arrive at an estimate of value of the property. The primary factor in arriving at this estimate is a capitalization of "reasonable prospective earnings". This "value" is then to be divided among the various classes of security holders and claimants in the order of their priority. Each class must obtain a "completely compensatory" allotment of securities in the reorganized company before any participation can be allowed to a junior class.

Some people have called this the logical or mathematical theory of reorganization. I think it can better be referred to as the constitutional theory. It is based upon a regard for the rights embodied in contracts. It insists that to each shall be accorded participation in a reorganization plan in accordance with his legal claim.

You will note that the basis of this theory is a determination of value. It is at this point that the mathematical character of the theory which I have described becomes lost. Value cannot be determined simply by the application of mathematical formulae. On the other hand, it is not simply a matter of guess work, as some people would like to have us believe. There are certain fairly definite financial standards to be applied in order to ascertain the value of a property. As I have said, I believe that the important criterion for reorganization purposes is earnings. So far as investors are concerned, a property is not worth more than it can earn.

But even a determination of earnings is not easy, particularly in respect of a holding company. All that glitters is not gold; and all that appears on the books of a company as earnings cannot always be confidently accepted as such. In addition, there is ever present the problem of determining which earnings figures to take as the basis for a determination of value. Figures for the last available twelve months may not give a dependable answer; nor can one always accept an average of the earnings of several years as the appropriate figure. Reorganizers, and particularly those who are interested in the equity, are always confident that better times lie ahead. It is curious that regardless of their pessimism about the state of the Nation for other purposes, they are always optimistic about the value of their business for reorganization purposes.

I think that it is only fair to permit a moderate amount of optimism to influence judgments as to earnings for this purpose. That is to say, reasonably prospective earnings are the criterion; and in my experience, reasonably prospective earnings are always established at a higher rate than the past record of the company would indicate. But here again, there is not unlimited latitude. "Reasonably prospective earnings" does not mean unreasonably possible earnings, although if you look at the forecasts of earnings supplied by a company in a reorganization, you will believe that the two things are synonymous.

In the case of a public utility operating company, subject to the control of a State commission, another perplexing factor enters into the determination of earnings as a basis for valuation. Let us assume that an appraisal of the physical properties of a company indicates that it is earning 10% upon the figure which should properly be allowed as its rate base. The State commission has not caught up with the company, and there are no proceedings pending to require a reduction of the company's rights. The question which this state of facts obviously presents is whether earnings, of themselves, furnish a reliable basis for valuation. You can

see that in such case, there is a great deal of danger that the earnings of the past will not continue; that they are likely to be reduced materially by action of the State commission. In a situation of this sort, fairness to the senior security holders may very well demand that the earnings of the past should be discounted before they are used as a basis for arriving at the value of the property. What this means, in effect, is that in the case of a public utility operating company, its true rate base places a ceiling upon its value; and that earnings by themselves are not a reliable criterion.

All of this may sound very complicated, and it is indeed involved, both in theory and in practice. To the Securities and Exchange Commission, it means that a thorough analysis of earnings must be made in connection with every reorganization plan; that the appropriate rate of capitalizing those earnings must be arrived at; that a reliable appraisal of physical properties must be had; and that these factors must be equated on a scientific basis to arrive at a figure as to values. Once this is done, the logical problem of determining the participation of various classes of security holders is comparatively simple; although the human and strategic problem of consummating the plan will still be most difficult. You see, as I have heretofore stated, there are still many lawyers and financial people who do not believe in the sanctity of contracts in the reorganization process; and who are unwilling to accept the results of a logical process incorporating such recognition, when it is applied to a reorganization in which they are interested.

It is the practice of the Commission when passing upon reorganization plans, to approve at the same time the issuance of securities under the plan, pursuant to section 7 of the Holding Company Act. The usual procedure is for the persons filing a reorganization plan to file simultaneously the information required under section 7 with respect to the new securities called for by the plan. If a reorganization plan meets the standards which I have discussed above, it will probably comply automatically with the standards of section 7. In the main, section 7 requires that the security be reasonably adapted to the security structure of the company, and to its earning power. There are other standards in section 7; but the ones which I have mentioned are particularly applicable for present purposes. Because of the provisions of section 7, then, the Commission has a double check upon reorganization plans. It has broad and general power under section 11 to approve or disapprove the plan; and under Section 7 it has power to permit or refuse to permit the issuance of the new securities under the plan.

A somewhat similar situation exists with respect to voluntary reorganization plans. Section 11(g) of the Holding Company Act, as I have stated above, forbids solicitation of consents in respect of any reorganization plan of a registered holding company or a subsidiary thereof unless the solicitation is accompanied or preceded by a copy of the report on the plan made by the Commission, and unless the solicitation complies with rules of the Commission for the protection of investors, which I have heretofore described.

By virtue of this section, therefore, the Commission after a hearing, must formulate a report on every voluntary reorganization plan. But virtually every voluntary reorganization plan involves either the issuance of new securities or an alteration of priorities, preferences or other rights of outstanding securities. Under sections 6 and 7 of the Act, the Commission has power to permit or refuse to permit the issuance of new securities or the alteration of rights of security holders.

Consequently, the Commission's power with respect to voluntary reorganization plans is double barrelled. In the International Paper and Power case, which was a voluntary reorganization, the Commission announced that in passing upon the issuance of new securities pursuant to a voluntary reorganization plan it would consider the fairness of that plan. Its powers over voluntary plans are therefore almost precisely the same as its controls over plans under 77B. In effect, it has the power to disapprove a voluntary plan on the grounds that it is unfair. And it also has the power, as I have stated, to regulate solicitation methods.

I think it is correct to say that at the present time voluntary reorganizations of registered holding companies and their subsidiaries present a problem of greater magnitude and importance than 77B reorganizations. There are many companies the earnings of which are adequate to avoid any prospect of default on their outstanding debt; but which, at the same time, are badly in need of reorganization. This need for reorganization is frequently manifested by huge accumulations of unpaid dividends on preferred stocks. As of January 1, 1938, out of 158 holding companies having outstanding preferred stocks with a par or liquidating value of $2,413,255,930, there were 48 companies with outstanding preferred stocks of $1,330,616,237 which were in arrears as to dividends to the extent of $336,657,749.

The arrearages represent an average accumulation of 25.3% of the par or liquidating value of the stocks, or more than 4 years' dividends. It will also be noted that more than half of the par value of the outstanding preferred stocks of these holding companies have accumulated arrearages.

Turning now to the operating subsidiaries of registered holding companies, there were 224 companies with preferred stocks in the hands of the public amounting to $1,447,460,196 par value. Of these, 70 companies, having $442,976,005 par value of preferred stock, were in arrears to the extent of $95,745,276. Thus over 30% of the par value of the subsidiaries' preferred stocks held by the public are in arrears. The amount of arrears averages 21.61% or over three years' dividends.

It is not hard to find the explanation for this condition. For the most part, it is directly traceable to the roaring 20s -- to the days when securities were issued by holding companies not on the basis of values, earning power or real need, but simply on a market test -- whatever the market would absorb. We are today faced with the necessity of correcting the situation brought about by these practices. Excessive capitalization must be eliminated and water must be squeezed out of public utility systems. It is my belief that the Commission will insist that correction of this situation be effected in accordance with principles of law and decency. This means to me that the same theory of adjudicating the fairness of a plan of reorganization which is applied to 77B proceedings will also be applied to voluntary reorganizations. That is to say, there will be insistence upon the sanctity of contracts; the rights and priorities of various classes of securities will be maintained. Common stock holders will not be permitted to reorganize on a so-called voluntary basis in such a fashion as to preserve an interest for themselves at the expense of preferred stock holders. They will not be permitted to give themselves participation in the company as reorganized if there is no value in the enterprise for them.

You see, it is my belief that the strict principle of the Boyd case, liberally applied, is not applicable only to reorganizations in equity or under the Bankruptcy Act. In my opinion, it is merely a specific application of the constitutional theory of due process. It is, so to speak, an articulation of the principle that a person having a contractual right against certain assets must receive satisfaction of his claim, in accordance with its terms, to the limit of those assets. I fail to see any reason why this principle is not just as applicable to so-called voluntary reorganizations as it is to those effected pursuant to judicial or statutory schemes for reorganization. Indeed, it seems to me to be even more clearly applicable to the former, for dialectical considerations with which I shall not burden you at this time. Certainly it is my feeling that a governmental agency which has jurisdiction over voluntary reorganizations is not justified in sanctioning ruthless disregard of contract rights; it is my belief and conviction that any governmental agency, whether it be court or commission, must insist upon the maintenance of the relative rights and priorities of security holders, in accordance with their contracts.

Application of this principle to voluntary reorganizations means that the procedural and substantive problems are substantially the same as they are in connection with 77B reorganizations. The same problems of valuation exist; and application of the same principles to determine the existence of a real interest for each class of security involved is necessary in much the same way. But the successful application of this theory to voluntary reorganizations perhaps involves difficulties even greater than those encountered in 77B reorganizations. The resistance of lawyers and financial people to the rule of law and constitutional right to voluntary reorganizations is even greater than it is in respect of 77B reorganizations. In part, this is because of the absence of statutory standards for voluntary reorganizations. There is no statute requiring that plans of voluntary reorganizations shall be fair and equitable. In part, it is because voluntary reorganizations, even more than equity or 77B reorganizations, are cast in the form of an agreement among security holders to alter their rights. Of course, there is no real agreement, generally speaking; and of course, generally speaking large numbers of security holders are bound even if they do not consent. I shall not pause to argue this point; you can find it spelled out in detail in part seven of the Protective Committee Study reports of the Securities and Exchange Commission.

But to a very substantial extent, this resistance to the application of principles of law and justice to voluntary reorganizations is the result of history and custom. The unconstitutional invasion of priorities which has taken place in reorganizations in equity and under the Bankruptcy Act is mild and unobjectionable as compared with the rape of contract rights which has characterized the history of voluntary reorganizations. Customarily, the management and the common stockholders have held all the cards; and they have dictated the terms of the plan with the result that preferred stockholders have taken an appalling beating. Particularly before the decision of the Delaware court in *Keller against Wilson*, preferred stock holders were ruthlessly stripped of their rights resulting from accumulated arrearages on preferred stock. Both before and since the Keller decision, the interests of preferred stock holders have been drastically slashed, although common stock holders have not taken a proportionate cut.

The public utilities industry is presently confronted with an exceedingly grave situation because of the inability of many companies to support their capitalizations, as I have already discussed. Voluntary reorganizations are needed on a large scale so that the industry may put itself in shape to meet the future. These voluntary reorganizations can be speedily effected so far as the Holding Company Act is concerned, if they are formulated upon sound legal and equitable principles. It is my hope that common stock holders, encouraged by the Commission, will abandon the pattern of the past and will devise plans which give to each class of stock the rights to which it is entitled. If, however, the managements of holding companies and their subsidiaries do not come forward with fair and effective plans, it may be that the first move towards effecting voluntary reorganizations will have to be taken under section 11(b) of the statute. This section, in part, requires the Commission to take steps to insure that the corporate structure of any company in a holding company system does not unfairly and inequitably distribute voting power among security holders. If this section is invoked, it will mean that voting power will be redistributed in accordance with the real interest of security holders in the company. In some cases, this redistribution might mean that at least the balance of voting control would shift from the common stock holders to the preferred. Voluntary reorganization might then be possible in a way that would be fair to all classes of security holders and at the same time would place the corporation in a sound financial condition. Chairman Douglas of the Commission has recently discussed this problem and he has expressed the hope of the Commission that the managements and common stock holders of public utility companies in need of recapitalization will voluntarily propose plans which are sound and equitable, and he has promised the cooperation of the Commission to this end.

In conclusion, let me briefly discuss an aspect of our procedure in connection with reorganizations which I think is of paramount importance.

We have adopted a procedure for dealing with reorganizations under the Holding Company Act which I believe is extremely helpful to all concerned. Before approving any plan, we must, of course, hold a fairly elaborate hearing, after giving notice. But we have not exercised our powers in a formal fashion. We have not merely received the filings of plans, held hearings upon them, and entered an order approving or disapproving them. We have felt that the essence of good administration is ability and willingness to cooperate informally — the round-table method, as Chairman Douglas calls it. This means that the staff of the Commission is always available to analyze and discuss reorganization plans - even in advance of their being reduced to writing or being filed with the Commission. In these informal conferences, the staff, after study of the plan, criticizes it in view of what the staff believes to be sound principles of law, finance and management, and attempts to iron out any difficulties by offering affirmative suggestions.

If I may digress a moment, I should like to discuss some general aspects of this procedure.

The round-table method, with respect to reorganizations, is the hard way of exercising our powers under the statute. The easy way is to consider these matters in the traditional judicial fashion — that is to say, to receive filings of plans, to hold hearings, and to approve or disapprove of plans upon the basis of the record, without any attempt to furnish advice and assistance

to the interested parties. The round-table method involves the risk that members of the staff may be misquoted; that various factions interested in a reorganization will attempt to use actual or alleged statements of the staff for bargaining purposes; and it involves considerable embarrassment in the event that the Commission, subsequently passing upon a plan in a judicial fashion, disagrees with the recommendations of the staff -- as not infrequently happens.

On the other hand, I am convinced that these are all risks which should be taken in order that the job of reorganizing corporations shall be effectively and speedily accomplished. Without the round-table method, the administrative process has few advantages over court proceedings. The flexibility and informality which are the life blood of administration are lost; and such superior ability as the Commission might possess to pass upon plans would derive solely from the expert qualifications of its staff and its facilities to make investigations and analyses.

Such experience as we have had convinces me that the round-table method is the desirable way to do our job in connection with reorganizations. It has all the advantages which I have mentioned above, and ultimately plans which result from its application are considered and passed upon by the members of the Commission who consider them judicially, upon the basis of the record. In this way a quasi-judicial check is provided for the purely administrative work of the staff, cooperating with the parties interested in the reorganization.

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