FUNCTIONS OF THE S.E.C. UNDER THE CHANDLER ACT

ADDRESS

by

JOSEPH L. WEINER

Special Counsel, Reorganization Division,
Securities and Exchange Commission.

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The first observation which I would like to make about the Chandler Act is that it is not a Commission Act in the sense in which we talk about the 1933 Act or the 1934 Act. You can't logically talk about the Chandler Act as the 1938 Act. The Commission has to do with only a very small part of that Act. Because of the confusion that prevails in many minds afout it, I will take a few moments to clear that up,

The Chandler Act is a general amendment of the National Bankruptcy Law. The National Bankruptcy Law which we have today was first placed on the statute books in 1898 and it has been amended from time to time. Then in 1938 this pretty wholesale revision of the law was made and it bears the name of its introducer, Congressman Chandler. The law provides generally, as you would expect of a bankruptcy law, for many types of financial distresses - individuals, corporations, farmers, wage earners - dependent upon the kind of relief which Congress thinks is appropriate for that particular person or group in the light of public policy, in the event that they come into financial difficulties which, of course, is the reason for having a bankruptcy law.

In 1934 for the first time, in this country at least, the law provided a statutory scheme whereby a corporation of substantial size with all kinds of creditors, some of whom had securities such as a lien or a mortgage, others of whom were general creditors without security, could, in the event of financial difficulties, change their corporate set-up to some form which would be more consistent with the then realities of the situation. That was through an amendment of the Bankruptcy Law which became popularly known by the section number in the law itself, so that even the ordinary, average business man would understand what you meant when you said that a corporation was under 77B. In fact, when that law was passed you might almost say that it became fashionable to say you were under 77B because of the number of corporations that immediately came under it.

That section has now grown into a full chapter and the present equivalent in the bankruptcy law for what used to be Section 77B is now Chapter X, and I expect that in the course of time we'll be talking about Chapter X in about the same friendly and familiar way that they used to talk about 77B. The Chandler Act also amended many other sections and added many new chapters and provisions, but the Commission has no function to perform and no authority to act under any provision of the bankruptcy law except Chapter X which, as I stated, deals exclusively with the reorganization of corporations and the treatment through judicial proceedings of a corporation which is in financial difficulties.

Now, specifically, there are two things which the Commission is authorized to do in such a case but in order to understand the two things it is necessary to consider just what it is that happens when a corporation is in financial difficulties and resorts to Chapter X. The corporation, if it chooses to act itself, files a petition with the court in which it sets forth the nature of its business, the amount and value of its assets, the amount and kind of liabilities it has, the fact that it is unable to meet its debts as they are maturing or that its assets are less than its liabilities, that it wants to reorganize, that it wants to adopt some new corporate structure, and that there is a reason for it to be given such an opportunity - in the language of the

statute, that there is a need for relief under Chapter X - ; and it asks the court to approve the petition. If the court finds that the petition is proper it enters an order which says that the petition is approved.

The first effect of that order is that it prevents any creditor of this corporation from resorting to the ordinary remedies of a creditor. If you have a claim, you can't sue the corporation. If you have a judgment, you can't send the sheriff out, because after the order is approved, if the sheriff takes any property belonging to the debtor, he is likely to find himself in jail.

The corporation then may be left in possession, that is the judge may, if he thinks it proper, let the regular management of the corporation, through its existing officers and Board of Directors, continue to manage the business and affairs of the corporation exactly as they would have if the petition had not been filed except that they are now relieved of the immediate necessity of meeting their debts. Under 77B the court had that option in all cases, regardless of how large or how small. Under Chapter X it is provided that where the fixed debts, that is the debts which are liquidated, so that there is no question about the amount, and where the debts are due, that is, they are not contingent liabilities but absolutely owing, - where such debts amount to $250,000 or over, the court must appoint one or more trustees. It can't let the old management run on just as if nothing had happened, but must put some independent person in charge. Some time later, the trustee, if a trustee is appointed, and possibly creditors or stockholders, will propose some plan. They will have a scheme for the rehabilitation of that corporation. Suppose the corporation has some bonds outstanding. The corporation hasn't the funds to meet them, but it appears to be solvent, it is earning more than enough to pay the interest on the bonds, but the bonds fell due at an awkward time and the corporation is unable to pay them immediately. A plan may be proposed whereby the maturity of the bonds is extended, perhaps provision is made for paying them off gradually, possibly they might be given some stock in consideration of their waiting for the payment of their bonds. Or some other plan is proposed.

The plan must come before the court for a hearing of which all stockholders and creditors and the Securities and Exchange Commission are notified, and then again we have a branching out. If the amount of the liabilities of the corporation is in excess of $3,000,000, the judge cannot approve that plan without first sending it to the Commission for an advisory report. The judge is permitted to fix the time in which the Commission has to report, and I might add that the Commission has the option of telling the judge that it does not wish to report for whatever reason it sees fit, but the judge must permit the Commission at least an opportunity to submit an advisory report if it sees fit to do so, and if the Commission does do so that advisory report not only goes back to the judge for his consideration as to whether he should approve the plan, but also must go out to all the parties in interest. The reason for the latter provision is that no plan can be approved unless it secures in addition to the approval of the judge, the approval of specified percentages of the creditors and stockholders. If the corporation is not insolvent the plan must be approved by two-thirds of the creditors and by a majority of the stockholders. That percentage

refers to amounts and not numbers; the $1000 bond has 10 votes as compared to the $100 bond. The reason for sending this report out is that the security holders, typically investors in those cases where there are over $3,000,000 of claims, are to have the benefit of the Commission's analysis of the situation when they are called upon to decide whether they wish to go along with the plan and accept its provisions, which means that normally they will get new securities or changed securities in one way or another. Now that is one of the two places where, as I said, the Commission has a part to play. It is limited only to Chapter X. This is one of the points in Chapter X where the Commission has a role.

The other provision relating to the Commission is that in any Chapter X case, for the reorganization of a corporation, the Commission may be a party to the proceeding in one of two ways. First, the judge may request it to become a party, or the Commission may ask the judge to become a party. Becoming a party in any judicial proceeding in effect means that you have the standing to ask the judge for relief of one sort or another that may be appropriate, and that you have the standing to appear in court when other people make some kind of motion for relief of one sort or another and be heard with respect to their applications.

Now, up to the present time we have not had any case which has come to the point where the Commission has been requested for an advisory report, that is, a case where the judge has had a hearing on a plan which actually contains a specific proposal for reorganization of a corporation with liabilities of more than $3,000,000. We have had a number of cases of the other type, where the other form of Commission participation is involved, that is, cases where judges have asked us to appear and become a party and cases where we have asked the judge for permission to appear and become a party. I might add that so far as the judge's requesting us to become a party, that is a form of politeness. We have no option in the matter, as we do in the event of an advisory report where we can tell the judge we don't intend to write a report. If the judge requests us to file a notice of appearance and become a party, that in effect is a command and we must file a notice of appearance. I suppose as a matter of fact there is no way in which the judge can force us to speak but it is plain that when we do become a party we have not only a privilege but an obligation to take an interested part in the proceeding and assist in whatever way we can.

The problems that arise in the course of a corporate reorganization are many and they are quite varied. They are not entirely novel to the Commission. Where the corporation is a public utility holding company you no doubt all know that the Commission has a somewhat similar jurisdiction, and in fact in many respects, has a greater jurisdiction than it has under the Chandler Act with respect to corporations seeking reorganization generally. The main difference between the Commission's functions under the Chandler Act and its functions under any of the other acts is that the Chandler Act doesn't give the Commission power to veto or to insist upon anything.

Suppose, for example, that the court sends us a plan for an advisory report as it has to do in the larger cases and may do in the smaller cases. The Commission prepares an analysis from which it concludes that

the plan is simply hopeless, it is unfair, it is not feasible, in other words, it is terrible, and that report is submitted to the court. There is nothing in the law that says, despite that report, the judge may not disagree with everything we said and approve the plan as being fair, feasible, and in the best interest of the creditors and stockholders. There is nothing to prevent the creditors and stockholders from saying "We agree with the judge and not with the Commission", or perhaps saying "The Commission may be right theoretically, but judging from our past experience if we don't take this we'll probably get worse".

The same thing is true with respect to the Commission appearing as a party. A party has a right to be heard but, of course, has no right to control the judge's decision. Being a party in fact amounts to the right to argue. The right to argue in fact often means defeat.

From that standpoint, you can see that the problem in the Reorganization Division in some respects is different from the problems in other divisions. In the first place practically all of the work is court work. It all relates to court work, but principally it is work prepared for the court and which will reach its fruition, so to speak, in the court. As a matter of policy we are proceeding on the theory that if the case is one in which the Commission must be asked for an advisory report, then we ought to come to the court and become a party as quickly as possible, and apply ourselves if the judge doesn't request us. In that way we will be in the case from the start and won't have to find out what it is all about when the judge sends it to us months, possibly years, later, with a plan, saying "Here is a plan submitted to you as provided by statute". So that our work is all centered about a court case, in which our job is not only to analyze the situation - find out what ought to be done, what principles should control in the preparation of a plan of reorganization - for presentation to the Commission for its consideration, but, thereafter to persuade the judge and the interested parties that the views of the Commission should be adopted. That, naturally, is a far lesser degree of control than the power to issue stop orders or the power to withhold approval of the plan under the Public Utility Act. Again, of course, that indicates that since the subject matter we deal with is almost exclusively court papers or papers intended for use in the courts, from the standpoint of staff organization and function - not only lawyers but everybody else, including stenographic help, it is a legal job, in some respects perhaps more of a legal job than General Counsel's work which deals perhaps more with office memoranda. Our memoranda must ultimately find their way to the court, in one form or another.

The things that the Commission hopes to accomplish under this Act and the reasons why it urged that it be given the right to participate, are these. Looking back over the experience under Section 77B under which there was no participation either by this Commission or by any similar body, and the experience prior to 77B under other forms of corporate reorganizations, certain things appeared to the Commission, as disclosed by the Protective Committee Study, to be reasonably clear. In the first place, the Commission reached the conclusion that when a corporation got into financial difficulties it was usually the management, and the bankers who had acted as underwriters for the management, who continued to control the entire machinery despite the fact that not infrequently the reason for failure might be ascribed not only to lack of ability but perhaps to mismanagement, to actual mishandling. Although there was at

least the possibility that in the past history of the corporation transactions had taken place which gave the corporation a right to recover moneys due it for one reason or another, the people who had been involved in the transactions could hardly be expected to bring them to the attention of the security holders and to insist upon recovery. In addition, there was the feeling, supported by lengthy examination of many specific reorganizations, that the actual plans that were produced for the reorganization, the proposed corporate set-up, frequently were not feasible or desirable, and, even where feasible, the distribution of the new securities among the present claimants was frequently unfair. Even where, as under 77B, you couldn't put the plan into effect without securing the approval of the judge, the judge really was not in a position in most cases, or at least in many cases, of rendering an informed, expert judgment with respect to the fairness of the plan, for a variety of reasons. In the first place, the judge didn't have the time, he couldn't live with this case, this was just one of a lot of cases that he had, and, in addition to the reorganization cases that he had, he had ordinary bankruptcy cases which involved the liquidation of small bankruptcy cases, he sat at times in criminal cases, civil cases, the week after in involved patent cases. That was not the kind of attention which could on the part of a most competent and intelligent person, produce the knowledge and familiarity which was needed for expert judgment. In the second place, it was the view of the Commission that to render an informed judgment, one needed more assistance than a judge ordinarily had at his command. You couldn't prescribe medicine for a sick corporation without having some better qualified doctors than the judge was likely to have at his command. The studies involved, the analysis, even the securing of the facts, let alone drawing the conclusions from the facts, were something which the judge couldn't do by himself. As a rule he had to rely on the parties who all had their own axes to grind. It isn't customary to find people coming into court representing a private client and telling the judge all the relevant facts, without omissions or color. So the need for an expert form of assistance was most strongly stressed. One of the forms which the supplying of that assistance took, as I have already indicated, is the Commission's participation. I should add, however, that on the Commission's recommendation other changes were made. For example, the appointment of an independent trustee wherever the debts amount to $250,000 or more was also one of the recommendations strongly insisted upon. The Commission felt strongly that the judge and the security holders required that an independent person should take hold of the situation when things reached the stage of insolvency. That is, it isn't a single device of Commission participation as a cure-all for these cases. The Commission's functions are one of the devices provided in the new law for the purpose of securing fairer reorganizations, more feasible reorganizations, a greater scrutiny of the Board of Directors, a greater call of management to account for what has happened in the past. But the Commission would be the last to assert, and would want to dispel the idea that its participation is to be regarded as all-sufficient for this purpose. The Commission itself insisted upon a number of other safeguards, and the question lies still in the future as to the extent to which all of these safeguards joined together will produce a system of corporate reorganizations which will be in the public interest and in the interest of investors.

That, of course, is our objective. We can only achieve it by recognizing that our job is to be as helpful as possible. In that way we hope that we can justify the confidence which has been placed in us by giving us this right to participate in corporate reorganizations.