

**CAUTION - ADVANCE
FOR RELEASE UPON DELIVERY**

THE S.E.C. AND THE CHANDLER ACT

ADDRESS

of

J. ANTHONY PANUCH

Special Counsel, Reorganization Division

before

the

New York County Lawyers Assn.

Symposium on "One Year of the Chandler Act"

at

14 Vesey Street

New York, New York

Tuesday, November 21, 1939, 8 p.m.

42556

I N D E X

| | Page Nos. |
|---|-----------|
| INTRODUCTORY | 1 |
| I. WHAT WE ARE TRYING TO DO The Objectives | 2 - 3 |
| II. WHAT WE DO As a Party to the Proceeding | 4 |
| 1. Participation - In General | 4 |
| (a) Test of Public Investor Interest | 4 |
| (b) Participation in 77 B Cases: Examples | 4 - 5 |
| 2. Manner of Participation | 5 |
| (a) Preliminary Orientation | 5 |
| (b) Directional of Activity as a Party | 5 - 6 |
| (c) Efforts to Attain Disinterested Investi- gation and Plan Formulation | 6 |
| The Reynolds Case | 6 |
| The Philadelphia & Reading Coal & Iron Company | 7 |
| (d) Efforts to Maintain Equality of Status | 8 |
| (e) Reports to Security Holders | 9 |
| (f) Administrative Matters | 10 |
| III. WHAT WE DO Reporting of a Plan | 11 |
| 1. The Mechanics | 11 |
| 2. The Report | 11 |
| (a) Fairness | 12 |
| (b) Feasibility | 12 |
| IV. CONCLUSION Have We Done A Good Job? | 13 - 14 |

INTRODUCTORY

When your committee invited me to address you on the performance of the SEC in corporate reorganizations under the Chandler Act, I was flattered into acceptance and, having accepted, immediately fell prey to haunting fears. Too late I realized that the scope of the subject assigned is broad and does not readily yield to adequate treatment within the time available and, under the circumstances, I had very little stomach to come here and face my colleagues of the New York Bar and deliver a harangue which would fail to satisfy the cravings of the learned customers of this symposium. Thus, *in extremis*, I did what most men do when under pressure - I acted impulsively and unwisely - I turned to your committee for advice. I asked them what features of our performance I should stress. Was there any particular approach to or treatment of the subject which, in their judgment, would be of particular interest to the bar? How, in their opinion, could I strike at the jugular? These and similar questions I addressed to your committee. I hate to say it, but these eminent and brilliant men were anything but helpful. They said in effect, "Look here, you have 30-40 minutes. We don't want any statistics or platitudes. All we want is a comprehensive 'low-down' on the role of the SEC in reorganizations. Simply tell us what you are trying to do; whether you are really 'doing a job' and, if so, how you go about it and what judges and lawyers think of your efforts. So much for the substance of your remarks. Now as to form - that is where we expect real artistry. Your talk should be dignified but not ponderous; brilliant if possible and, if practicable, refined. You get the idea - a typical seminar address. And don't forget, you have 30-40 minutes."

These suggestions of your committee virtually demoralized me. To restore my composure, I decided to circularize my friends of the reorganization bar for suggestions of a more specific character. Some of the answers to this appeal were not reassuring. Three eminent advocates wrote and said, in effect, that if they knew what I should speak about, they would volunteer to do the talking. Another segment of practitioners cynically suggested that I should discuss the topic of "How can Lawyers make Money out of Reorganizations". A third group, somewhat satanically, propounded topics of discussion which, if undertaken, would result in my professional self-destruction. Fortunately, however, there was a sizable residuum of men of good will who made suggestions that were illuminating and indicative of phases and areas of discussion which might be of interest.

In these suggestions rests the essence of what I shall have to say. And in saying it I shall attempt to answer the questions of your committee:- (1) What are we *trying* to do; (2) What *do* we do; and (3) Have we done a good job. You should bear in mind, however, that my remarks are those of an officer of the line - an off-duty narrative of crystallized experience gained in the salient assigned to me - consisting of the Federal districts of New York, Pennsylvania, and New Jersey. The views expressed by me are mine and mine alone. They are not necessarily attributable to the Commission or, for that matter, to any of my colleagues within the Reorganization Division.

WHAT WE ARE TRYING TO DO

The Objectives

Any report of what we have done and how we have fared, in the performance of our functions in corporate reorganizations since the enactment of the Chandler Act, would be an incomplete recital unless it is illumined by a sort of prologue which crystallizes at the outset the "why and wherefore" of the doing. For, if you are familiar with the objectives to which we are committed, you will be able, in your day-to-day dealings with us, to chart the directional of our specific effort and, generally, to envisage in advance, the broad outlines of the pattern of our action.

This pattern of our action is not shaped by a sinister desire to exercise a form of dictatorial control over the reorganization process. Nor is it conditioned by the postulates of an ideology spun from the texture of dreams, in some ivory tower far distant from the tumult and the shouting - the bruising realities - of the theatre where the reorganization drama unfolds. But it is determined by the objectives of Chapter X. And the ultimate end of the Act, if I were pressed to define it, in essence and in words of one syllable, is *the fair plan*. Necessarily, therefore, one of our major functions in the reorganization process, as I see it, is to provide a sort of procedural dynamic whereby this end is realized through the attainment of certain intermediate objectives of the Act upon which the evolution of *the fair plan* depends. Let me complete the action-pattern picture by sketching in the background of transition from the old order to the new.

As you all know, under the old reorganization techniques, no effective devices were available for a disinterested diagnosis of the causes of corporate failure or for an impartial evaluation of the competence and fidelity of the management. Too often reorganization was founded on optimism rather than on an informed major premise as to the true prospects of the enterprise. The formulation of a plan, in most cases, was a prerogative of protective committees so-called. The right of individual or immobilized security holders to participate in the reorganization process or to receive vital information was circumscribed to the point of non-existence. Under the old equity receivership procedure, judicial scrutiny, if any, was of a minimal character occurring by indirection at a late stage in the proceeding, and only through fear of "strikers" or of the possible consequences of the *Royd* case. True, 77B conditioned the approval of a reorganization plan upon the finding that it was fair, feasible and equitable. But this requirement was *brutum fulmen* from the outset, in that the statute provided no effective or appropriate procedure whereby the information essential to such a finding was made available either to the judge or the security holders. In sum, the enactment of 77B streamlined the existing procedure, but by-passed its fundamental defects.

In Chapter X the fundamental defects of the old order have been corrected. The causes of the debtor's failure, the competence and fidelity of its management are probed and evaluated by a disinterested trustee whose findings are reported to the security holders and the court. The evolution of a plan remains, as it should, a matter of negotiation. But the negotiations proceed under the *aegis* of the disinterested trustee whose duty it is to formulate and file a plan which must meet the test of informed judicial scrutiny. If found to be fair, feasible and equitable, it is submitted to the security holders for

approval or rejection on its merits and without the pressure of prior solicitation. No longer is effective participation in the reorganization process the sole prerogative either of the debtor or such committees as have been decorated with the epaulets of intervention. For the Act has effected an equality of status by according the creditors and stockholders of the debtor the right to be heard on all matters.

II

WHAT WE DO

As a Party to the Proceeding

1. Participation

In General

As you know, we have a two-fold function under Chapter X - participation in proceedings and the rendering of advisory reports on reorganization plans. Under Section 208 we may, with the approval of the judge, and must, if the judge requests, become a party to a proceeding for all purposes except to appeal and receive compensation. Under Section 172 if the liabilities of a debtor exceed \$3,000,000 the judge must, and if they are less the judge may, refer the plan to the Commission for examination and report. These two functions, though they are separate and distinct in character, are, as a practical matter, complementary. For our activities as a party enable us to attain a high degree of familiarity with the debtor's affairs and the various problems of the reorganization. And this orientation is of immense value to us if and when the plan is referred to the Commission for examination and report.

Accordingly, in "mandatory reference" proceedings, that is, cases involving debtor's liabilities in excess of \$3,000,000, where the plan must be referred to us for examination and report - like McKesson & Robbins and Porto Rican Tobacco - to mention two proceedings pending in the Southern District with which you are all familiar - it is our practice to apply for leave to intervene as soon as possible after the filing of the petition. In cases where there is no duty on the part of the judge to refer the plan to us, our application for participation depends primarily upon the extent of the public investor interest.

(a) Test of Public Investor Interest

What constitutes the requisite measure of public investor interest in determining application for participation? Since each reorganization is in many respects *sui generis*, no hard and fast answer is possible. As you know, the Commission's primary concern is the protection of the public investor interest and, while each case necessarily depends on its own specific considerations, the Commission has adopted a sort of *prima facie* rule that, absent exceptional circumstances, participation will not be sought in cases where the face amount of the debtor's publicly held securities is less than a quarter of a million dollars.

(b) Participation in 77B Cases: Examples

This test of public interest has guided our participation policy in cases arising under Chapter X. However, in 77B cases there is the further test of practicability. Under Section 276C (2), the provisions of Chapter X apply to 77B proceedings in which the petition was approved more than three months before the effective date of the Act - "to the extent that the judge

shall deem their application practicable". The term "practicable" has been construed by the Circuit Court of Appeals for the Second Circuit, in the *Old Algiers* case, and by the Circuit Court of Appeals for the Third Circuit, in the *Philadelphia & Reading* case, to mean feasible, fair and convenient, in the light of all that has previously happened in the proceeding. Accordingly, in 77B cases, assuming public interest exists, our application for participation depends, as a practical matter, on the stage to which the proceeding has advanced. For instance, we have intervened in several large reorganizations which have not reached an advanced stage of development. Among these are *Reynolds Investing Company*, (Newark); *Philadelphia & Reading Coal & Iron Company*, (Philadelphia); and *Pittsburgh Railways Company*, (Pittsburgh). On the other hand, we have not sought to participate in cases like *Postal Telegraph*, where the debtor's petition was filed on the day before the enactment of the Chandler Act and where the proceeding had reached the stage of plan hearings at or about the time the Act became effective. Two exceptions to this general policy are the reorganizations of *Standard Commercial Tobacco Company*, where we entered at the plan hearing stage of the proceeding at Judge Coxe's suggestion, and in the *RTO* proceeding where, at the suggestion of Judge Bondy, we intervened generally after the plan had been sustained by the Circuit Court of Appeals.

In substance, that "is all there is" to our participation policy. I might add, parenthetically and by way of postscript, that we become a party to a proceeding upon the approval by the judge of our notice of appearance. While approval rests in the discretion of the judge, it is usually forthcoming as a matter of course.

2. *Manner of Participation*

(a) Preliminary Orientation

After our notice of appearance has been approved, filed and served, our first step is to familiarize ourselves with the proceeding. In cases where there is a trustee, the Commission's counsel and a financial analyst usually meet with the trustee and his counsel, or where there is no trustee, with the officers of the debtor and the debtor's counsel, for a preliminary discussion with respect to the debtor's affairs. At this initial conference arrangements are made to make available to the Commission's representatives the necessary information, corporate and financial, as will enable us to familiarize ourselves, in preliminary fashion, as to the status of the debtor's financial condition and the problems involved in the reorganization. On our part, we outline to the trustee the scope of our activity, indicate areas of cooperation, and usually discuss with the trustee's counsel various aspects of Chapter X procedure so that defects of a procedural character may, as far as possible, be avoided. Of course, if committees have been formed and are active in the proceeding at the time of our appearance, we make it our business to consult with them in similar fashion.

(b) Directional of Activity as a Party

When our preliminary investigation is completed, the assembled data is carefully considered and a comprehensive initial analysis of the case is prepared which places us in a position to participate in the proceeding on an informed basis. From that point on, every effort is made to shape the substantive and procedural aspects of the reorganization in harmony with the

purposes of Chapter X. The tempo, intensity and character of our activity naturally vary with each proceeding and depend on the specific problems involved, the status of the case, and numerous other factors.

(c) Efforts to Attain Disinterested
Investigation and Plan Formulation

One of the primary purposes of the Chandler Act is to achieve an impartial diagnosis of the true status of the debtor's affairs, the causes of its failure, and the formulation of a plan based on these findings under disinterested auspices. The attainment of this objective, in 77B cases, has challenged our initiative and staying powers. However, it was realized in the *Reynolds* reorganization and is on the way to materialization in the *Philadelphia & Reading* case. Let me tell you what happened in these two cases, as very picturesque examples of how we operate.

The Reynolds Case

The *Reynolds Investing Company* was an investment trust organized in the "roaring twenties" by the Reynolds brothers. The capitalization at the time the petition was filed consisted, in round figures, of \$3,500,000 of 5% Debenture Bonds, \$1,000,000 in 6% Cumulative Preferred Stock of \$100 par, and about \$1,300,000 of Common Stock of \$1 par. The company's assets were represented by about \$1,000,000 in readily marketable securities and by about \$2,025,000 of more or less frozen values in non-marketable "special situations". The company had had a rather "sour" history of losses and "inside deals" under the Reynolds management which reached a startling climax when the Reynolds group, on December 31, 1933, quietly sold control of the company - represented by about 1,025,000 shares of Common for over \$2,100,000 to one Franklin E. Mayer, acting for Continental Securities Corporation. A few days after the sale, the sum of \$950,000 was taken from the company's treasury by those in control and worthless securities were placed in the company's portfolio to cover the withdrawal. This transaction, with other similar transactions by those responsible resulted in indictments and criminal prosecutions in both the federal and state courts.

These developments brought the financial condition of the company to a critical stage. In May of 1933, a receivership proceeding was filed by a creditor in the New Jersey Federal Court at Camden. A few days later an involuntary 77B petition was filed in Newark, by three bondholders alleging the pendency of the Receivership bill, the commission of an act of bankruptcy and the company's insolvency and inability to pay its debts as they matured. Answers to this petition were interposed by the debtor and by various preference and common stockholders. The issues of fact and law raised by the petition and answers were many and complex, and extended hearings thereon were held intermittently without any determination being reached. Towards the latter part of the summer when the judge and litigants had reached the point of exhaustion, the hearings were suspended in order to give the parties an opportunity to reach some agreement which would serve as the basis for a reorganization plan.

On December 7th, when the Commission intervened in the proceeding, the hearings were still suspended and the parties were still locked in the throes of a death grapple. After making a study of the case we suggested to the various interests that prompt steps should be taken so that the petition be

either approved or dismissed. After considerable effort in this direction had failed, we advised all parties that we would press for an immediate determination on the petition; and the hearing thereon was forthwith resumed before Judge Fake. After two hectic days of hearings in which over thirty New York and New Jersey lawyers participated, it was agreed by the protagonists that the petition should be deemed to be filed under the Chandler Act and as so filed, approved; that the answers thereto be withdrawn, and that a disinterested trustee should be appointed. That same day Judge Fake appointed John Gerdes of New York, and James D. Carpenter of Jersey City, as trustees, and from that point on, the situation was under complete control. The trustees immediately began a searching probe into the chaotic affairs of the company and submitted a comprehensive report of their investigation to the security holders. On the basis of these findings the participating committees submitted suggestions as to the reorganization in the form of plans. Ultimately, after a great deal of negotiation, a plan contemplating the gradual liquidation of the company's assets was formulated by the trustees after negotiations with all parties in interest. This plan which has been approved, in substance, by all committees, is now on for hearings and will, in due course, be submitted to the SEC for report. Throughout the proceedings, the trustees (who incidentally acted as their own counsel) and the Commission have cooperated to the fullest extent.

The Philadelphia & Reading Coal & Iron Co.

This company has a capitalization, in round figures, of \$25,000,000 in 5% First Mortgage Bonds, \$30,000,000 of 6% 20 year debentures - both listed on national securities exchanges - and \$8,000,000 of common stock. The company which, next to Glen Alden, is the largest anthracite unit in the country, filed a voluntary 77B petition in the District Court for the Eastern District of Pennsylvania, at Philadelphia, in February of 1937. Four protective committees, two from New York and two from Philadelphia, appeared in the proceeding, representing the bonds and debentures respectively. In addition, there was still another independent group of debenture holders participating in the case who were represented by Mr. Archibald Palmer of this city. Nothing of any importance occurred in the proceeding for almost two years after the filing of the petition, until on January 5th, 1939, Mr. Palmer made an application for the appointment of a trustee, based on charges of waste and mismanagement. Judge Dickinson referred this application to a special master to hear and report.

On January 25th, 1939, the SEC intervened in the proceeding. An initial reconnaissance of the situation showed that the company had sustained losses of about \$16,000,000 for the five years prior to the filing of its petition, and of about \$13,000,000 for the two years of operations while in reorganization. In view of this fact and other circumstances, it seemed fairly plain to us that the appointment of an examiner, under Section 167 of Chapter X, was highly desirable in order that a disinterested investigation of the company's affairs and management might be made as a basis of plan formulation under impartial auspices. Our suggestion that an examiner be appointed on the consent of all parties was politely declined, and Mr. Palmer began conducting vigorous hearings before the Master on his application for the appointment of a trustee. While these hearings were pending, Mr. Palmer made a second motion for the appointment of a trustee, this time on the theory that the enactment of Chapter X made such appointment mandatory. This motion was denied, and on appeal the order of denial was sustained by the CCA. On April 3rd, 1939, a plan sponsored by the four protective committees was filed and referred to the Special Master for hearing and report.

Shortly thereafter the Commission filed a petition for the appointment of an examiner, in which Mr. Palmer joined. On the next day Judge Dickinson entered an order directing the Special Master to suspend hearings on Mr. Palmer's application for a trustee and to proceed with hearings on the plan. Mr. Palmer appealed from this order, while hearings on the plan were in progress, and Judge Dickinson on May 8th, entered an order denying the Commission's petition for the appointment of an examiner. From this order Mr. Palmer appealed. On the appeal from this order the Commission appeared, filed a brief, and presented oral argument for reversal on the ground that the order of denial constituted an abuse of discretion. The CCA reversed and directed Judge Dickinson *himself* to hear the examiner petition and consider the practicability of such appointment. Before this hearing could take place Judge Dickinson died and the parties to the proceeding stipulated the appointment of an examiner with full statutory powers. Judge Kirkpatrick, who succeeded Judge Dickinson, on November 16th, 1939, appointed Nicholas G. Roosevelt to this post.

(d) Efforts to Maintain Equality of Status

One of the major purposes of Chapter X, as we view it, is to effect an equality of status as between the parties in interest. We feel this purpose is defeated if Protective Committees are permitted to intervene in reorganization proceedings. Do not misunderstand me. We welcome committee participation in reorganizations; what we object to and oppose is *formal intervention*.

As you know, under 77B, the right to be heard on all questions in a reorganization proceeding was the sole prerogative of the debtor. Creditors and stockholders had a right to be heard only on two matters - the permanent appointment of a trustee and on the proposed confirmation of a plan. As to all other matters, participation was dependent upon intervention. Chapter X abolished this discrimination. Under Section 206 the right to be heard on *all matters in the proceeding is accorded to creditors, stockholders, and indenture trustees*. Under Section 209 this right may be exercised through committees.

Despite these provisions, applications for intervention by Committees are still made, from time to time. We oppose all such applications on the ground that intervention is unnecessary, for to quote Judge Reeves in the *Flour Mills of America* case:

"While the interventions cannot give the intervenors any authority or position enjoyed by others not intervening, yet the allowance of such interventions might be construed as an improper preference of the Judge."

Our position on this issue was put to the acid test in the *Philadelphia & Reading* case on appeal to the Circuit Court of Appeals, of the four protective committees from the order denying their applications for intervention. The committees rested their case squarely on the prior decisions of that court in the *Baldwin Locomotive* case and in the *Central Hanover v. Philadelphia & Reading* case which laid down the principles that committee intervention was appropriate and a necessary prerequisite to compensation in proceedings under Section 77B. We filed a brief and presented oral argument on the appeal in support of the order of denial. The Circuit Court of Appeals, in sustaining the order of the court below, specifically held

"that by Secs. 206, 207 and 209 of Chapter X the Congress has removed the statutory support for intervention by committees which Sec. 77B afforded". Prior to the decision of the Circuit Court of Appeals, a similar result on the same question had been reached in written opinions by Judge Avis, in New Jersey; by Judge Moscowitz in the Eastern District of New York; and Judge Reeves in the District Court for the Western District of Missouri.

(e) Reports to Security Holders

Another phase of our activity as participant in reorganizations relates to the reports of trustees. As you all know, after a trustee or examiner has completed his investigation of the debtor's affairs, its financial condition, and the conduct of its management, it is his duty under Section 167 (5) to submit a report of his findings to the stockholders, creditors, and other parties in interest. In this report, the trustee sums up his conclusions as to the feasibility and desirability of reorganization.

It is our policy to cooperate closely with the trustee in the preparation of these reports. By that I do not mean that we gratuitously inject ourselves into a province of the trustee's duty. However, in large reorganizations involving numerous and complex problems - particularly in cases where the debtor has had a dubious corporate history - the trustee's reporting function is not an easy task. Under the circumstances, a trustee is frequently interested in obtaining our reaction with respect to the adequacy of the report before it is set up in final form and mailed out to the security holders. When the trustee requests our comments on his draft report, what usually happens, as a practical matter, is this. We give the draft careful study and then sit down with the trustee and his counsel and discuss our suggestions with respect to the substance and form of his draft. In practice this system has proved eminently satisfactory to the trustees and to the Commission. Two outstanding reports which have gone through this kind of sifting process since Chapter X was enacted are the trustees' report in the *Reynolds* case, and the July 1st, 1939 report of Mr. Wardall, the trustee, in the *McKesson & Robbins* proceeding. I commend these reports to your careful attention as examples of the kind of reports that really tell the security holders "what the score is".

Generally, trustees' reports going out to security holders pursuant to Section 167 (5) are accompanied by a notice inviting them to send in any suggestions which they may have with respect to a plan of reorganization. The response to this invitation depends on the clarity with which the trustee in his report has explained the problems of the reorganization and the manner and extent to which he has indicated an approach to their solution. For instance, in the forthcoming report under Section 167 (5) in *McKesson & Robbins*, the trustee, after describing the problems involved in the reorganization proceeding, tentatively suggests for the consideration of the security holders, several alternative plan formulae.

The examples which I have given are indicative of what competent and conscientious trustees can do in the way of reports to security holders under Chapter X. In smaller and less complicated cases, the reports have not been nearly as elaborate, but by and large, they have painted a complete and accurate picture. Naturally, as the practice under Chapter X develops, report standards generally will improve. However, in the final analysis the character and quality of the report will usually depend on the trustee.

(f) Administrative Matters

There is one more area of our activity as a party to a proceeding which will be of interest to you. In all large reorganizations, and in some of the smaller ones, there is usually a substantial volume of motions and *ex parte* applications dealing with the administration of the estate. While these applications, as a rule, involve routine matters, they sometimes raise substantive and procedural questions of importance in which, of course, we are vitally interested. With respect to matters of this character, which are brought on by motion, there is usually ample time to form a conclusion as to the matters involved, and on the return day we appear and either support the motion or oppose or state our position, depending on the circumstances. However, the *ex parte* applications present a more difficult situation.

Let me give you an illustration of the *ex parte* problem that arose in McKesson & Robbins and the way it was solved to the satisfaction of all concerned. At the outset of that proceeding, the usual host of *ex parte* applications were made and, of course, we knew nothing of what had happened until after the orders had been signed and served upon us. Some of these orders we felt were open to serious objection as not in compliance with Chapter X procedure. For instance, certain orders were entered authorizing the trustee to retain and pay special counsel. We took the position that under Section 247 of Chapter X any payments to counsel could only be made at a hearing on notice to creditors and stockholders. The trustee's counsel pointed out that the giving of statutory notice in *McKesson & Robbins* would be a very expensive proposition. The problem was solved in a very practical way. The orders were permitted to stand with the understanding that no action would be taken thereunder by the trustee; that when the trustee's report went out to the security holders in July, it would be accompanied by a notice, as required by Section 247, of a hearing with respect to the retainers and allowances, and that after such hearing, the existing orders would be superseded by regularizing orders.

Now there are two points to that story. We were aggrieved by the disregard of Chandler Act safeguards but we did not rush into court with a lot of motions to vacate. We sat down with counsel for the trustee and arrived at realistic formula which effected compliance with the statute and did not subject the estate to undue expense. Secondly, the whole episode might have been avoided had we received notice *before* the orders referred to were signed. It was decided then and there by the trustee's counsel and ourselves, to work out some arrangement which would eliminate the possibility of having a similar controversy arise in the future. Two considerations had to be kept in mind with respect to any such arrangement. The trustee could not afford to have his hands tied unduly by any rigid notice requirements and, on the other hand, we had to be relieved of the continuing burden of being obliged to move to vacate any *ex parte* orders deemed by us to be improper, which were entered without prior notice. After considerable discussion we devised a practice whereby all *ex parte* orders are submitted on 48 hours' notice of settlement. This technique has worked out in eminently satisfactory fashion. Now, we are informed in advance as to all *ex parte* business and if we have any objections or questions with respect to any specific applications, they are generally resolved in a mutually satisfactory fashion in advance of submission. If we are unable to agree, the issue comes on informally before the judge upon the settlement of the order. So far, there has been only one such *ex parte* application on which a controversy between the SEC and the trustee had to be decided by the judge.

III

WHAT WE DO

Reporting on a Plan

From the instances of our activity which I have recounted, you will be able to form a fairly accurate general notion of the character, scope, and directional of our function as intervenor and to appreciate how our activity in this respect is complementary to our function of rendering advisory reports which, of course, takes place at an advanced stage in the proceeding.

1. *The Mechanics*

The procedure of referring a plan to the Commission for report is relatively simple. For the purposes of discussion I shall take a case where the reference is mandatory. After the trustee has filed a plan, an initial hearing is had at which the plan and any objections are considered. For that matter, any other plans which may then be submitted by creditors, stockholders, or the debtor may also be considered at this hearing. However, assuming that the trustee's plan is the only one before the court and meets with no substantial objection from the committees and others participating in the hearing, it is our main concern to see to it that there is sufficient evidence in the record (1) to enable the judge to decide whether the plan is one which is worthy of consideration and (2) to enable the Commission in reporting on the plan to base its factual premises - so far as is conveniently possible - on evidence which is a matter of record. If such evidence is lacking, we endeavor to develop it either through the trustee's witnesses or by calling our own experts. If, after such hearing, the judge finds the plan to be worthy of consideration, it is referred to the Commission and the hearing is usually continued pending the coming in of our report.

After our report is filed in the proceeding and copies are made available to the parties who have appeared, the hearing is resumed and proceeds to approval, modification, or disapproval of the plan. If found by the judge to be fair, equitable, and feasible, the plan goes to the stockholders for approval or rejection accompanied by a copy of the judge's opinion and a copy of our report, or a summary thereof, prepared by us.

Under this set-up, the plan as submitted to the security holders has been developed under what we believe are real safeguards. When they receive it, they know, if they are interested enough to read, that the judge has approved the plan and they know the Commission's opinion of it. The judgment which they exercise in voicing their approval or disapproval is free from any prior pressure since solicitations in advance of approval of a plan are not permitted except upon special authorization by the court.

2. *The Report*

In the report we state our conclusions as to whether or not, in our opinion, the plan submitted to us is fair, equitable, and feasible. We discuss the plan in detail and set forth the reasons for our conclusions.

(a) Fairness

Each plan, of course, presents special considerations and, to that extent, is *sui generis*. But the fundamental principles of fairness, which in our opinion apply to any plan, are simple. The standard of fairness to which we adhere, is derived from the *Boyd* case and related cases. That standard, known as the strict priority rule, requires that a plan, to be fair, must provide full recognition of claims in the order of their priority. To restate the thesis, we believe that a plan of reorganization which fails to give precedence to the entire claim of senior creditors before permitting participation by junior creditors or stockholders, is not fair and equitable as a matter of law. And, necessarily, a plan which is unfair as a matter of law, cannot be made valid by the consent of the percentage of a class of security holders required for confirmation of a plan. As against this strict priority doctrine, some courts tended to the so-called "relative priority rule" or "composition" rule in the practical administration of the reorganization law. The resulting confusion and inconsistencies of doctrine recently moved the Supreme Court of the United States to grant *certiorari* in the *Los Angeles Lumber Products Company* case which presented a conflict on this issue between the Second and the Ninth Circuits.

On November 6th, 1939, Mr. Justice Douglas, speaking for an unanimous court, handed down an opinion in this case which, we feel, confirms the "strict priority rule" in such a way as to foreclose any serious speculation as to the principles that determine whether a given plan is fair and equitable. This decision, in my opinion, establishes a landmark in reorganization law, and if you are not familiar with it, I commend it to your careful reading.

(b) Feasibility

The problems of feasibility sometimes are as complex as those of fairness. The *capital structure* proposed by any plan determines the securities which may be allocable to various classes of creditors or stockholders. The *total capitalization* which can be safely proposed for the new company will necessarily depend on the *fair value* of the debtor's properties which, in turn, will determine the distribution of the available securities among the old security holders. We hold that for purposes of reorganization, prospective earning power is the most reliable index of value; that value so found is the controlling factor in arriving at an appropriate capitalization; that the prospective earning power of the enterprise as reorganized should control the *character* of new securities that are prudently issuable. For if you do not have a proper capital structure upon emergence from reorganization, a second reorganization is invited, if not assured. Inadequacy of working capital usually has been a prime cause of recurrent insolvency, and any plan which fails to eliminate this cause of failure is financially unsound.

The foregoing, of course, are only a few phases of a subject which cannot be adequately treated here. They will, however, serve to indicate to you our approach to the problem, in broad outline.

IV

CONCLUSION

Have We Done A Good Job?

I have outlined our objectives. In some measure at least, I have detailed a few aspects of our performance towards their attainment. There is a third point - Have we done a good job? To this question, there is no complete answer available as yet; for our work, in reality, has just begun. However, I believe that I am entirely objective when I say that we have carried on with alertness, competence, and mobility. And in this respect, I am content, in Dorothy Thompson's phrase, to "let the record speak".

But do not misunderstand me. My approach to the effort in hand would be myopic indeed if I appraised the character and quality of our performance on the factors of technical competence and despatch alone. For these, important though they may be, are overshadowed by an all-controlling imponderable - the public relations aspect of our task. By public relations, I mean the spirit and understanding which we bring to our endeavor. For it is my conviction that, in the last analysis, the attainment of the high purpose of this law rests on the *manner* of its administration by the judges, the trustees and the SEC in their respective functions which, though separate in immediate scope, are in totality, integrative. And in the manner and spirit of administration, personal philosophies, even predilections, become immensely important. Sometimes they present a problem of psychological conflicts which, if not fused, may frustrate the ends of administration.

What I am saying now was partially envisaged by some of us when the law was enacted. One aspect of it was given vivid expression by one of the leaders of the Reorganization Bar, Mr. James N. Rosenberg, in his article which appeared in the Virginia Law Review, entitled REORGANIZATION - YESTERDAY - TODAY - and TOMORROW. Touching on the importance of the human factor, he said in part:

"... This statute provides a forward looking apparatus which will work provided the approach by courts, trustees, and the S.E.C. toward all parties alike - investors, creditors, bargain-hunters, management, bankers, committees, indenture trustees, and even their array of counsel - is without impatience or prejudice, with full consciousness of a very simple fact, namely that the debtor's property belongs, after all, to its creditors and stockholders, that efforts at resuscitation, whether prior or subsequent to institution of the proceedings, are not to be suspect; that in the typical large cases involving thousands of security-holders some must be spokesmen and leaders, and that in the drama of reorganization not only hypocrisy, greed and ruthlessness but also decency and desire for constructive accomplishment play their part."

This statement defines a realistic public relations policy from which few will dissent. Our relations with the parties to a reorganization have been devoid of impatience and prejudice. We have approached our task in a spirit which without preconception, appraises every case, every man, and every group on their own respective merits. In so doing we believe we have dispelled the belief held by a few distinguished members of the Reorganization bench and bar that the Chandler Act had rejected the gods of the old order of reorganization, only to fashion a new god in its own image and a demonology of its own.