

ADDRESS

of

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Salvaging Capital Waste

As we move forward on the road of prosperity, we find ourselves in a new world. In some foreign countries the old order is gone, in the sense that these countries are under a new political regime--a despotism of one kind or another under which few, if any, old democratic institutions have survived. Such of those larger countries as have not succumbed to one or another type of despotism have maintained their democratic liberties only by reform and some attempt at control over the forces of exploitation which breed insecurity and in turn despotism. Irresponsible, laissez-faire democracy is dead everywhere.

If the current phenomena abroad teach anything, they should convince us that we must attack relentlessly and continuously the various forces which breed insecurity. It should need no argument to persuade that in order to avoid such tragedies our course should continue in the direction of strengthening liberty by building it on security. To this there is no escape, no alternative; either we run the risks of sacrificing liberty, or we set ourselves earnestly and steadfastly to build a structure of democracy based on security and stability. We should know by now that an economic democracy in action is the only kind of democracy that can provide that degree of security and stability necessary for survival. Only by such a course can we really preserve our liberties, for they are not virile unless they are bottomed on security. The jungle psychology of everybody for himself will not work in an organized, delicately interdependent society. If we can intelligently reform our democracy to make it a constructive instrument which can act swiftly and decisively; powerfully and constructively, without sacrificing any of the substance of democracy, then we can not only rekindle our confidence in Democracy but make it our true faith.

Of the many forces which breed insecurity, I wish to speak of one, I wish to speak of the exploitation and dissipation of capital at the hands of high finance. And I wish to discuss the importance of salvaging the waste and preventing the leakage of our financial resources in such ways.

The reality of such waste and leakage comes forcibly home when you see the tottering ruins of industry in bankruptcy or receivership. During the last two years in Washington I have had occasion to examine into those ruins with some care. Under a mandate of Congress we made a study and investigation of dozens of protective and reorganization committees. Our examination of the files of companies, trustees, committees and lawyers ranged from Los Angeles to Boston. We spent many weeks in this city examining some of the reorganization ruins with which most of you are familiar. Some of our reports and findings have gone to Congress. Others are still in preparation. Since I am still immersed in these matters and since the memories of these reorganization adventures are still fresh in mind, I would like you to step with me behind the scenes and to observe at close hand some of the aspects of this problem of capital waste.

Through the window of reorganization most of the many varieties of capital exploitation and dissipation can be seen--certainly if a reorganization is studied, as it should be, in its financial and economic setting. Reorganization is a vantage point from which this whole problem can be advantageously viewed, since the result of the operations of high finance is to weaken the vitality of companies and to cause or to contribute to their failure.

Before discussing specific aspects of the reorganization problem it is important to make certain general reservations and to define terms. Many of the losses reflected in reorganizations are unavoidable and inevitable in any system of free enterprise. In a sense, capital is a thing to be lost, not saved, anomalous as that may seem. The silent and rotted water wheels of New England bear mute evidence to this. The onward rush of technology makes certain that this phenomenon will be constantly repeated. But dissipation and exploitation of capital which cause or contribute to failure are other matters. They relate not to the onward rush of technology and the displacement of old devices for new and more efficient ones, but to tribute at the hands of those who may be accurately termed financial "termites".

Webster defines "termite" as "any of numerous pale-colored, soft-bodied, social insects of the family Termitidae". Years ago they were not so well-known. Their operations baffled engineers. Their damage ran into appalling figures. Structures ostensibly secure collapsed as a consequence of their subtle operations. Their mysterious and destructive work ruined many fine edifices. And at time the first warning of their presence was a disastrous collapse. The financial and industrial world also has been afflicted with "termites" as insidious and destructive as these other termites. Instead of feeding on wood they feed and thrive on other people's money. These financial "termites" have caused the fall of sound and substantial enterprises. Years ago they were not so well-known. Their operations baffled agencies of control. Their damage ran into huge figures. Enterprises ostensibly secure collapsed as a consequence of their subtle operations. Their mysterious and destructive work ruined many fine businesses. And at times the first warning of their presence which security holders had was the disastrous collapse and the necessity to reorganize the company.

These financial "termites" of which I speak are those who practice the art of predatory or high finance. Finance proper deserves no such condemnation because it supplies the necessary and vital machinery whereby business and investors can be served in legitimate and essential ways. These financial "termites", however, pervert the true function of finance and become a common enemy of investors and business. While they are not seen in the antecedents of every reorganization, they have been present with such frequency that the importance of the problem of dealing with them directly and forthrightly cannot be denied.

As I have indicated the end result of the operations of financial "termites" is the failure of companies and the depreciation of values of securities. The backbone of wealth of all of our institutions—commercial banks, savings banks, insurance companies, public foundations and churches, and universities—are our securities, and in back of those securities are railroads, factories, public utilities, foreign credits, etc. When the financial "termites" feed on those enterprises which underlie these securities, they breed insecurity and instability in those values. When their operations are on a large scale, the whole national life becomes involved. It is estimated that there are 25 million persons who are direct owners of securities in this country. These persons are or should be definitely concerned with the destructive nature of high finance. Furthermore every man who has a deposit in a bank, or has an insurance policy, or owns a home or a farm which is mortgaged is affected and should be concerned. That is, all of us are interested, whether we know it or not, in healthy conditions in our security markets, in the new issues that are being floated as much as those that are being dealt in in our public markets. Correction of abuses disclosed in reorganization thus becomes a foremost national problem.

That the losses have been staggering none will deny. Thus from 1929 to 1932 security values on organized exchanges dropped over one hundred billion dollars. In order to comprehend what that means, suffice it to say that the total income of the federal government since 1789 to June 1936, that is, since the beginning of the Union to date, from all sources, income taxes and any other, aggregated only ninety-two billion dollars. What portion of this vast decline is attributable to the predatory elements in finance is of course only conjectural, since the variety of these "termites" is large and the cumulative effect of their work is pervasive. But if we could salvage only fifty billion dollars of such losses through elimination of these financial "termites", together with related constructive sanitation measures, such a salvage would represent more than half of all the federal expenditures in the whole history of the United States. Here is a great reservoir of waste salvage.

High finance has the following characteristics. In the first place it is nothing but a game--a game played for large stakes. Those stakes are other people's money or control over other people's money. Under the aegis of high finance, business becomes pieces of paper--mere conglomerations of stocks, bonds, notes, debentures. Transportation, manufacture, distribution, investment become not vital processes in economic society but channels of money which can be diverted and appropriated by those in control. The farmer with his raw materials, the laborer whose blood and sweat have gone into the steel and the cement, the investor and the consumer who are dependent on the enterprise, become either secondary rather than primary, or inconsequential rather than paramount. Business becomes not service at a profit but preserves for exploitation. The basic social and economic values in free enterprise disappear. For such reasons one of the chief characteristics of such finance has been its inhumanity. Its ruthlessness has precluded consideration of human values. Its predatory nature has excluded regard for all social values.

In the second place, high finance is interested in an immediate profit. It cannot forego that profit by telling customers not to buy this or that because it is not economically justified. Its job is to sell the customers whatever they want (not infrequently what they are made to want), at any price which the traffic will bear. It would not take the longer view, as that is against its financial interest. The pressure of big selling organizations clamors for salable securities. Such organizations cannot be interested in whether our natural resources are wasted, in whether we are overbuilding in one direction and underbuilding in another and whether our economic machinery is getting out of balance. Such groups cannot be concerned with whether our credit resources are being used up too rapidly, since a larger demand for credit means high returns on money and they are dealers in money and capital. Like other merchants, they do not like to see their merchandise at a low price. It goes without saying that the great majority of them do not like depressions and business failures as they suffer from them along with others. But the trouble is that they are in a business in which they lose immediate profits if they take longer views.

As I have said, high finance creates and promotes stylish merchandise -- that which has a popular demand. Merchandise that is stylish usually reflects a situation exploited and over-exploited. It is this type of security which is the easiest to sell and which commission-hungry brokers, dealers, and bankers will sell. Only recently one banker, as justification for the abuses of 1929, said: "You must remember that in 1929 we were all commission-hungry."

But when are brokers, dealers, and bankers not commission-hungry? It is clear that hunger for these commissions has too often and too long been the sole arbiter of the process of capital distribution and preservation. These judgments will be confirmed by your own observation of what transpired in your own city in real estate and other fields.

In the third place, high finance is interested in instability in the securities markets caused by the artificial raising or lowering of security prices--a practice which frequently ruins both investors and business. In this way high finance also levies tribute. One operation sometimes seen and very common in the past is the following: An insider (an officer, director or banker of the company) owns stock which, we will say, has a true value of \$10 per share. This insider gives a broker an option on the stock on a graduating scale from \$25 up to \$40. This broker starts his operation by purchasing in the market as much of the floating supply as will make the whole of the option profitable--that is, until the stock goes above \$40. As a result of his purchases in the market, he puts the stock up to \$40. The usual developments then take place: rumors in the financial world that something is happening in the company, occasionally some paragraphs in the financial press, circulars and articles of inspired nature, all of which finds expression in increased activity. Then customers' men will inform their customers and suggest that they buy the stock. If the activity is broad enough, the broker can then sell at a profit in the market all the stock purchased under the option as well as all that he acquired in the market. Frequently, however, it is not so easy to develop such an atmosphere of activity. The broker will then keep on buying just enough stock to keep it around \$40, while in the meantime he will send out an army of salesmen to place the stock over-the-counter with the public. Such salesmen usually get a good commission--possibly as much as \$2 per share, certainly \$1. It frequently happens that the distribution is not an easy one. There have been cases where one share taken down under the option came back ten times to the broker until it was finally placed. These multiply commissions which, if they go to him, are an offset to the increased expensiveness of such an active account and reduce his profit in the account; if the commissions go to others, they reduce his profit in that account. But it is only in extreme situations that he cannot find one who will retain it when he sells it to ten men. When the stock is finally disposed of in this over-the-counter fashion, the broker takes whatever profit remains after all his expenses and the stock drops to \$10. This is one type of manipulation which does not need to be and is not conducted by a pool. The cost to the public is not only the difference between \$40 and the \$10 which the stock is worth, but the operation caused other wastes. It is rarely realized how the company itself suffers from such a situation. It costs approximately \$1 in registration, transfer and similar fees per certificate. The larger the activity, the larger the transfer and registration costs which are borne not by the broker and not by the speculator, but by the company. There are other ways in which the company suffers. gyrations of stocks on the up-side are of little value to the company, but more often than not its credit is severely impaired when there is a sharp break in the market.

The ways of a manipulator are frequently of a much more subtle nature than those described. Without entering into a discussion of all his practices I should point out one other which is commonly pursued in such distribution. After the broker has bought enough stock to put it up to say \$40, he looks around to see how he can liquidate his position. There is a method to harness purchasing power of the very people whom he is eventually going to exploit. And this is done in the following way. He will give other dealers

and speculators puts at the market, i.e., the right to sell to him say one thousand shares within seven days at the market, say \$40. Where a dealer or speculator gets a put at the market for a thousand shares, he will usually buy five hundred shares in the market and in this way make money whichever way the stock moves. If the stock goes down, he will make a profit on his put. For example, if the market declines to \$35, he will buy at \$35 one thousand shares and deliver at \$40, making \$5000 against which he lost \$2500 on his long stock. And if the stock goes up, he will make money on his five hundred shares; for example, if it goes to \$45, the gross profit is \$2500.

These are the chief characteristics of high finance. As one probes into the background of particular reorganizations he finds them reflected in practices and policies which have preceded the collapse of enterprises. He finds practices designed to syphon the money both from investors and from business. He sees that high finance has piled holding companies on top of holding companies until investors whose money has been taken have no more than a piece of blue sky for their security. He sees these market manipulations which I have mentioned. Companies have been merged and consolidated for no sound business reasons but only to create work and profits for high finance at the expense of business and investors. The over-head and costs of finance have been piled on business merely to keep high finance prosperous when it was clear that those overheads and costs would soon crush business. High finance has levied its toll by taking watered stock while investors put up real money and by unloading that watered stock on the public through our securities exchanges or otherwise. All of such practices ultimately crush investors and business. Therefore, it needs no argument to demonstrate that predatory finance, since it feeds on and generates instability, is the common enemy of business and investors. But for its presence the problem of reorganization reform would be relatively simple. If such transactions have occurred prior to reorganization, it is important to know it, for they have an important bearing on the reorganization itself. For example, some of these transactions may have resulted in claims of the security holders or the corporation against those who caused the damage. In the reorganization it will be important to collect on those claims. Those claims will not be collected if those who have caused the damage succeed in controlling the reorganization.

You frequently observe in these reorganizations that the damages caused by high finance have been particularly acute because it has operated from within business itself. That is to say, business has become the preserves for exploitation. A banker who has done business for the company may acquire effective control without any expenditure of money by having his representatives or nominees placed on the board. If an outsider, he may buy that control in the market. Buying control in the market by no means entails the acquisition of a majority of the voting stock. It may mean only 10%, 5%, perhaps 1%, or even less, of the voting stock. Control in these situations does not necessitate acquisition of any fixed amount. It means acquisition of an amount of voting stock which is larger than the largest block of concentrated holdings. In case of a pitched battle between two opposing groups, larger amounts may be necessary. But for normal working control, he who acquires a position which tops the largest concentrated holding has won his victory. But once that control is obtained (whether by stock control or otherwise) by one who is interested in playing the game of predatory finance, legitimate business can be made a preserve for exploitation.

Current reorganization records are replete with instances of abuse of this power. Excessive and extravagant bonuses is one form. Honeycombing the organization with incompetent relatives and friends at liberal salaries is another type. But predatory finance is concerned with larger stakes. Our studies reveal that resources of the company are employed to help maintain the market while those in control unload their own holdings at a profit. Resources of the company are used to buy unneeded and extravagant material and equipment from other companies in which those in power are interested and which are suffering from the ravages of a depression. Resources of the company are used to buy from those in power cats and dogs of securities which they had unwisely acquired, and on which they would themselves suffer great losses. Resources of the company are employed to make it possible for those in control to acquire other properties, so that they may sell those properties to the company at a profit. The company is ruined and gutted by subtle mismanagement, merely because those in control have larger financial stakes in other companies. The company buys and sells securities merely to give those in control income to help carry their overhead in the doldrums of a depression; thus, as the securities go round and round, the banker-broker in control collects his regular brokerage commission for causing this churning of the portfolio of the company. I referred above to the manner in which high finance manufactures securities to satisfy the appetites of its large sales organization. He who practices the art of high finance has a decided advantage in this respect if he has a place on the board of directors of a company. From that vantage point he can originate security issues of the company which have no legitimate justification, but the issuance of which bring commissions and fees to the banker.

The variations and permutations are endless. Some of these methods are age old. Others are adaptations of tried and true devices to new situations. It is easy to dismiss these matters by calling them historical and by imagining that they happened once but cannot or will not happen now. But that attitude disregards the reality of the situation, for these practices have been current - some of them have created depression fortunes.

These practices are all germane to the problem of reorganization for the following reasons. In the first place, as I have said, some of them will create claims of the company against those who participated in the misdeeds. These claims are assets of the company. In the interests of the security holders they should be collected. It will however be to the interest of those responsible not to have them collected. If the reorganization is completed without their enforcement, the reorganization will not be complete because it has not settled the accounts of the old venture before it launches the new. In the second place it will be to the advantage of those who participated in the misdeeds to gain control of the reorganization so as to protect themselves and their interests against the security holders, and to perpetuate their own control over the business. If they are in control of the reorganization they can accomplish these objectives by suppressing investigation of the transactions which might result in their being sued or in their being discredited. In this connection let me recite to you the parable of the cow.

Once upon a time there was a truly wondrous cow. Feeble in health it was acquired for a paltry sum by an industrious and energetic American who cared for and fed it well, until it was restored physically and contented spiritually. Soon the cow developed prodigious capacity to produce milk. Ten gallons a day was its average. The fame of the cow spread far and wide.

Farmers drove miles to see it. Its fame spread until word of this wondrous cow came to the ears of a syndicate in LaSalle Street. This syndicate approached this God-fearing and honest farmer and offered him \$100 for the cow. The farmer accepted the offer. At this point the record is not very clear. But it appears that the farmer was induced (perhaps because of his confidence in the cow and his abiding affection for it) to turn back his \$100 to the syndicate and receive for it 10 shares of stock in the cow. Thereupon, with both the \$100 and the cow in their possession, the syndicate proceeded to sell to other industrious citizens more stock in the cow until they had received a total of \$1000 from the public. Now this cow, wondrous as it was, could not service these dozens of stockholders to their satisfaction. Nor did the ten gallons of milk bring in enough to pay anything more than the fees which the syndicate had decided should be retained by them for their services in managing and in supervising the management of the cow and the expenses of operating the cow. So after a few lean years, these stockholders became indignant and disgruntled. The syndicate being hard pressed decided the cow should be reorganized. Accordingly, they appointed themselves as reorganization managers and worked out a plan of reorganization "fair to the interests of all". They also appointed themselves a protective committee to represent and safeguard the interests of the stockholders. Pursuant to the plan of reorganization, the syndicate held a sale and acquired the cow for the sole benefit of the syndicate, carefully explaining to the stockholders that their investment had been wiped out due to the fact that an unprecedented depression had made it impossible for the cow to increase its production and its earnings to the levels which had been expected; and that cows the world over were experiencing similar difficulties.

If you will substitute oil, films, gas, electricity, foods, etc. for the cow, you will have a fair idea of the manner and objectives of current reorganizations. You, a security holder, are unaware that tribute has been exacted from your company. You realize that dividends have decreased or ceased, that earnings have fallen off. But you assume that that is due to world conditions or cycles or other convenient and scholarly sounding evils. Yet weeks or even months in advance, those in control know that there is going to be a reorganization. You do not know and you could not find out if you inquired. Outwardly everything is calm and serence. Behind the scenes, the management, the bankers, and their lawyers are busy setting the stage for the reorganization and choosing the reorganization paraphernalia of their own liking. Their immediate objective is to obtain control over the receivership or bankruptcy proceedings and over the protective committees, soon to be announced. So they carefully select the court where they are most likely to receive friendly cooperation. They man their protective committees with members of the management and the bankers or with those on whose loyalty and friendship they can confidently depend. When their plans have been perfected, announcement of default is made. With promptness and dispatch, they secure appointment of receivers or trustees in bankruptcy, and counsel to these receivers and trustees, friendly to them. You, as a security holder, are deluged with literature urging your cooperation with committees which have been formed. You as a security holder could not circularize your fellow investors if you wanted, for you do not have their names and addresses. But those in control of the reorganization can, for they have a virtual monopoly on such lists. No unsavory details of the company are disclosed to you in the literature you receive; there is no hint that high finance has caused or contributed to the failure. Rather, your fears are calmed, your indignation is cooled by soothing words of bright prospects. Default is explained away on grounds of world wide depression. You are unaware of the toll and tribute which have been exacted from you and your company.

The immediate result is that those who despoiled your company have gained control of the reorganization. Your securities are lodged with committees controlled by those under whose stewardship the company failed. Those committees are now your spokesmen, telling the court and other committees what should be done to protect you. But there is no reason to believe that they will now be any more solicitous of your interests than they were before. You will not find them urging that the management and the bankers (that is, themselves) be investigated for the purpose of determining whether or not the company has any claims against them arising out of mismanagement. You will not find them urging that the acts of the management be carefully scrutinized for the purpose of determining whether or not it has been so wasteful, faithless and extravagant that it should not be restored to power. Quite the contrary -- you will find that the facts are carefully edited before they are sent to you. You will find that your committees will be creating the appearance of strenuous and loyal service in your cause. And you will find that the reorganization plan which your representatives sponsor and urge you to accept provides either for their restoration to power in the management of the new company or for machinery whereby those who will manage the new company will be selected by them or by their nominees. In other words, you will discover that the reorganization has been conceived not as a device to settle the accounts of the old company, but to prevent those accounts from being settled and to restore to power those who ruined or participated in the ruin of your enterprise.

But this is not all. During the interim, exploitation will continue. Your representatives on these committees will not be lacking in inside information. On the grounds that they are exercising the privileges of any free-born American citizens, they will be trading in the securities which they represent. They will be at times using their fiduciary position as a trading post for their own profit. Over and above that there will be a large amount of business patronage which they can dispense during the reorganization. They can dispense this patronage with the astuteness of any dispenser of political patronage (the cousin of business patronage). This patronage can be used to still protests from dissenters. It can be used to widen the zone of influence of those in control. It can be used to return favors previously given or as consideration for favors to be received. It can be employed to line the pockets of affiliated interests of the committee members. This will include the fat depository fees resulting from the necessity of having some one keep custody of the securities which you deposit with the committees. In any one reorganization these may run into thousands and thousands of dollars. There will be contracts which will have to be awarded; there will be contracts outstanding which will have to be terminated or continued. The award, termination or continuance of such contracts constitute patronage of the highest order. In addition, there will be the determination of what banking house underwrites the new securities. This underwriting is not only important for its commissions; it establishes that house as bankers for the company with virtual assurance of future business. In some reorganizations there will be fees for managing the properties in addition to fees of receivers or trustees. Over and above all this there will be the patronage to lawyers and the fees of committee members. As a matter of fact, every morsel of business patronage will be strategically placed, even down to the printing and the stationery. In the words of men active in these fields, such patronage is worth "fighting for". He who has control over it has a

war chest for campaign purposes which almost assures success before the election (of the new management) takes place. Of course, the security holders eventually pay for all these fees and expenses for they come out of the assets of the reorganized company. But in determining the amount of those fees and expenses, those in control have, until recent activity of the courts, been in large measure the sole arbiters. Until recently they have been largely unhampered since they are not on competitive ground; they are dispensing patronage of a monopoly.

But this is not all. During the reorganization there will be other interests of these inside groups to serve. They will be likely to have financial stakes in the enterprise which they also desire to protect. If their interest is in the common stock, they may be dominating the committee organized to protect your first mortgage bonds. From such vantage point, they could have some assurance that the first mortgage bonds would not deal harshly with the stock. They may be interested as short term creditors. If so, it would not be unlikely that when all was quiet and serene on the eve of reorganization, they had taken steps to protect those claims by obtaining additional security. In other words, before they had formed committees to represent you, they may have been feathering their own nest. Indeed, that may have been one of the reasons for delay in announcing to you the fact of default.

In sum, those who levied such high tribute prior to default, continue to levy tribute during reorganization. To the original waste which they have caused they add more. And over and above that, they use reorganization as a method of concealing their past misdeeds and of perpetuating their control over the new company as it emerges from bankruptcy or receivership. In other words, they use reorganization as a way for them to obtain safe passage and clearance from the old company to the new. Once they are restored to power, their tenure is largely self-perpetuating since they have control over the proxy machine through which directors are annually elected.

If a tailor makes a suit of clothes for you that does not fit, or if the plumber does a poor job for you, the next time you will look for another and better mechanic. But this is not the way in the financial empire. In no other sphere of life is it possible to reap the rewards of mismanagement by suppression of investigation and prosecution of law suits, by dispensation of reorganization patronage, by obtaining control of the new company, by financial ambulance chasing, except in the financial world. The reason for this is that a clever alliance between lawyers, bankers and managers has put such fences around these financial empires that nobody except themselves, certainly not the security holders, is allowed to trespass. These sacred grounds are as jealously guarded as the monasteries of Asia to which only the high priests have the keys. When they speak about freedom, they mean freedom to do as they please, and not freedom for the masses of security holders who are so frequently abused by them. When they speak about private initiative, they mean initiative that is so strictly private as to be kept all to themselves. But in terms of freedom and private initiative, that which is needed is an opportunity for security holders to exercise both their initiative and freedom; freedom to protect their interests; freedom to get rid of perennial despoilers; freedom to cast out financial dictators whose initiative has all too long been expended in levying toll on other people's savings.

Another type of reorganization offers great opportunity for exploitation. This is not a case where a company has failed but rather where it has prospered.

In recent weeks the inside groups, with the help of certain state laws, have been successful in breaking the corporation's contracts with the preferred stockholders. Many companies which had omitted, or paid only partial, dividends on their cumulative preferred stocks in recent years are now taking steps to get rid of those accumulations of dividends. They are now offering exchange plans whereby the preferred stockholder is asked to accept securities in whole or partial payment of his accumulations. At the same time he is asked to exchange his stock for one with a lower fixed dividend rate. Thus they kill two birds with one stone. Some such plans were proposed by companies a few years ago. At that time they may have been justified by reason of the fact that the companies were then in overburdened and hapless situations. But many of the companies now offering these plans are financially able to shoulder their obligations. They are on the verge, and some at the crest, of restored earnings. Many are able to pay their preferred accumulations in cash. Or, if they desired, they could effect dividend savings by the regular method of financing a new issue and calling the outstanding preferred stock at the designated call price pursuant to the terms of the contract with the preferred stockholder. But this is not the way in which it is profitable for the insiders to work. By legal legerdemain they can make contracts mere scraps of paper, not by reason of an emergency condition but solely by reason of their selfish interests. These selfish interests are not difficult to divine. Their fortunes or affiliations lie with the common stock. And they ask, why should the preferred stock stand between us and immediate profits? And frequently when the management recommends this exchange to the preferred stockholders, it fails to disclose to them that its own interests lie with the common stock. The management gives the proposal the tone of impartiality by indicating that it is necessary or desirable in the interest of the corporation as a whole. As a matter of fact, the sacrifice of the preferred stockholder is commonly the management's gain.

Four of the plans being currently offered propose to give the preferred stockholders cash and securities aggregating 80 percent of the amount these security holders are entitled to receive on the basis of call and payment of accumulations. One company recently effected an exchange plan, wherein the preferred stockholders made a considerable sacrifice, by pointing out the uncertain fate of the company in view of economic conditions within its industry, and the likelihood of further dividend defections. But this company not only resumed common stock payments soon after acceptance of the plan, but has recently declared, in addition to another dividend, the payment of an extra one on the equity stock.

As dividends, although earned, are withheld from the preferred stockholder, he usually gets a proxy designating nominees of the management to vote for him in approval of the plan. At times the plans are so confused that he would need a sophisticated Wall Street lawyer or statistician to figure out exactly what he is getting and what he is giving up

under the new plan. As a practical matter, there is often very little which he can do except sign the proxy. The pressure to accept the plan is great because the preferred stockholder realizes that if he does he will get at least some dividends. In fact, that is the bait and the inducement. The proxy campaign goes on with the finesse of a trained political leader marshalling the votes in his district. Furthermore, the proxy campaign is well financed. It has the treasury of the company behind it. It has the good offices of friends, banks, and their own employees to aid in the campaign. It has the advice of astute lawyers, trained in the art of telling the truth in oblique and confusing ways. It not infrequently happens that the corporation is also moving against its own stockholders by using company funds to buy, in the name of subsidiaries or others, as much of this stock as is possible and thus increasing the number of votes in favor of the plan or decreasing the number of possible dissents. As against this campaign, the feeble protests of scattered and hapless preferred stockholders are almost futile. Consequently, the few who do not sign find that they have to take the new plan anyway. Such plans should never claim impartiality unless preferred stockholders, through an independent committee, specially organized, have discussed and approved them.

The foregoing is one current evidence of the quality of the dictatorship and of the manner in which tribute is exacted from investors by the sheer force of financial power with the aid of strange corporation laws drafted and designed not without the influence of these self-same interests and their lawyers.

We hear a lot these days of taxes--income taxes, hidden taxes. We also hear a lot about doles to this or the other class of people in our nation. And once in a while from the side lines we hear the cry of capital levies. But we are prone to overlook the fact that one of the most destructive and heavy taxes which this nation of investors has had to pay has been in the form of this tribute of which I have spoken. It has been not only hidden; it has been secret. And it has not been general taxation for the common welfare; it has been special taxation for one special group. It has not been taxation designed to even out the dislocations in income and purchasing power; it has been levy of tribute which creates dislocations in income and purchasing power and which eventually upsets the economic balance. It would be more proper to speak of this not as taxation but as a dole to predatory finance. Or if the word dole is offensive, it may be properly called a capital levy for the benefit of predatory finance. But it is a capital levy exacted not as a result of the constitutional route; not as a result of public debate and decision; not as a result of extreme national distress. It is a capital levy exacted by the fiat of those in financial power. It is a major source of capital waste and leakage. For such reasons high finance is the common enemy of security holders and of business.

As I have said, these generalizations are obviously not applicable to every reorganization in receivership or bankruptcy for losses are unavoidable and inevitable in any system of free enterprise. Nor are these generalizations applicable to all finance. It would be an error glibly to denounce finance as such. Finance occupies an important place in our society. But finance moves into the zone of exploitation whenever it becomes the *master* rather than the faithful and loyal *servant* of investors and business. To make finance such a *servant* rather than a *master* becomes a central plank in any platform for reform.

When I speak of reform, I mean fundamentally, reform by business and by investors. Government can and should help, by pointing the way. An economic democracy in action would be recalcitrant in its obligations if it did not do so. It has done so in the Securities Act of 1933, the Securities Exchange Act of 1934, and the Public Utility Act of 1935. But the fact that there is at last a Securities and Exchange Commission in Washington should not lull investors and business into forgetfulness of the fact that the problem of what happens to their capital is still their concern. Nor should they forget that the ultimate victories over predatory finance must be won by investors and by business. The program by which investors and business can keep the national riches from exploitation cannot be realized overnight. Yet it is clear that the necessity to eliminate the elements of instability occasioned by predatory finance will not brook delay.

The struggle between investors and business on the one hand and high finance on the other will be bitter, for these predatory interests, working in compact groups with friendly alliances, wield an economic and financial power second to none. The danger of that concentration of power is that it is not accompanied by the assumption of *social responsibility*. These groups, being composed of ordinary human beings like others, but collectively divorced from social responsibility, are the chief agents through which our economic and financial blunders accumulate until the next blood-letting process. This is called a crisis, but it is nothing more than the pent-up forces of abuse, mismanagement, mal-distribution of economic effort and income which breaks out in rhythmic fashion and towards which these individuals make a major contribution. Academic economists in the service of high finance have tried to endow cycles and crises thus created with natural attributes. In this way they have cleverly washed the hands of high finance and excused it from social responsibility. But as to cycles and crises thus created, there is nothing inescapable. We may in years to come look at them as monuments to the folly of a race which in universities is called "homo sapiens."

As I have indicated, such a program of reform outruns reorganization as such. It goes back to the management of business. In such a program there is one important central idea which must be recognized. This is the elimination and rectification of one fundamental and basic condition which makes it possible for business and investors to be exploited in such manner. This condition is a simple and obvious one. Yet as Mr. Justice Holmes, I believe, used to say, the most difficult task is to teach the obvious. The obvious condition for reform is that these predatory interests are on both sides of the transactions out of which their profits flow. If an investment banker did not have control over a company, he would not be able to load that company with the cats and dogs which he as an investment banker had acquired. If a banker-management group were not in control of the protective committees in a reorganization, they would not be able to improvise a plan of reorganization which restored them to power and gave them another feudal tenure in the company. If an operator was not in absolute control of a company, he would not be able to use the funds of that company so that he could acquire another company and sell it to the first company at a profit. Or to state the matter more realistically, if the current moral and legal standards governing transactions of these men who are on both sides of the bargain more nearly conformed to the notions of decency and ethics embodied in the ancient standards for fiduciaries, their operations would be substantially curtailed.

The transactions themselves are often involved, intricate and mysterious. Their legal garb often is awe-inspiring or baffling. Only an analyst or lawyer may be able to fathom them. Actually, however, the fundamental problem is neither intricate nor involved. It is not one reserved for analysts, financiers or lawyers. It is so simple that he who runs may read and understand. It is basically nothing more nor less than a man serving at least two masters -- security holders on the one hand; himself on the other. I say it is nothing more nor less than a man serving at least two masters, because more often than not high finance has a plurality rather than a mere duality of interest. When that plurality or duality of interest enters, history has it that one of his several self-interests will be served first.

It is not simply a question of policing and curtailing the activities of dishonest men. No system can be designed to permit of such classification. If the system is provided so that honest men may have their two or more masters, the dishonest will rush to take advantage of the opportunities afforded. Furthermore, it is not solely and simply a question of honesty on the one hand and dishonesty on the other. No man's judgment can be trusted to act in those situations in a sound and disinterested way where the issue is whether he shall make a turn in the market or some other profit if he can only use other people's money to finance it.

This duality or plurality of interest permeates the whole fabric of our financial system. One sees it wherever one turns. The whole mechanism has become so complicated and intricate that frequently it is hidden and concealed even from the deep probings of investigation. But it exists in a multitude of subtle and indirect ways. It has been accepted in practice. It has gone so far that frequently the very cornerstones of certain institutions seem bottomed on it. In fact, it is commonly said that one who seeks to tinker with that part of our financial mechanism is retarding prosperity, interfering with the American way, and stifling freedom and initiative. As one banker recently put it, if steps are made in that direction "you are going to crab the initiative of lots of financial concerns". Hence, when protest is made at these practices which violate ancient standards for trustees and there is insistence that they be discontinued, walls and objections go up, even by responsible and social-minded individuals, that business could not be conducted without it. More often than not these are protestations of spokesmen for the predatory elements in finance; in the guise of the profound judgment of practical men of affairs.

But is clear that all who are genuinely interested in preserving capitalism will favor such reforms. For it cannot be denied that if the present system is allowed to continue this cancerous growth in our financial and industrial body will eventually consume it. It will be consumed because under such conditions high finance thrives and flourishes. There are two consequences. First, there are dislocations in income and purchasing power which eventually upset the economic balance. Second, our faith in fair play and in equality, and hence our trust in democracy, is undermined. These two work for social disintegration.

America, including American finance, needs re-education on this simple and obvious principle. Whatever the world of high finance may think, he who has not much meditated upon ethics, the human mind, and the *summum bonum* may possibly make a thriving "termite", but he will most indubitably make a sorry fiduciary and a sorry economic statesman.