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FUNCTIONS OF THE SECURITIES AND EXCHANGE COMMISSION
in
CORPORATE REORGANIZATION PROCEEDINGS

ADDRESS

of

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FUNCTIONS OF THE SECURITIES AND EXCHANGE COMMISSION
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This is the second time I have had the pleasure of speaking on the same program with Mr. Gerdes. While it is always both pleasant and profitable to listen to Mr. Gerdes, it is somewhat difficult to speak after him. When he has finished with Chapter X of the Chandler Act, not much is left for me to say. Nevertheless, I should like to say a few words about the functions of the Securities and Exchange Commission under that Chapter and the way in which it proposes to discharge those functions.

Mr. Gerdes has already mentioned the two functions which the Commission may be called upon to perform in corporate reorganization proceedings: first, intervention as a party in the proceedings themselves, and second, the rendition of advisory reports on reorganization plans.

1. Railroad Reorganization Procedure Compared

Section 77, the railroad reorganization section -- which was not affected by the Chandler Act --, presents perhaps the most familiar instance of participation by an administrative body in reorganization proceedings. But there are fundamental differences between the ICC's functions and procedure under Section 77 and those of the SEC under Chapter X. I think that an analysis of these differences will give us a clearer picture of the position of the SEC in corporate reorganization proceedings than can be obtained in any other way.

When a railroad corporation goes into reorganization proceedings under Section 77, the Interstate Commerce Commission must ratify the selection of the trustee before his appointment becomes effective.[1] When it is ready to emerge, its reorganization plan may not be approved or confirmed by the court unless it has been first approved by the ICC and certified to the court.[2] And throughout the proceedings, the ICC has a number of prerogatives which the Securities and Exchange Commission does not possess under Chapter X. For example, under Section 77, findings as to insolvency, findings as to whether certain classes of claimants are affected by the plan, and valuations of property, are or may be made in the first instance by the ICC.[3] The ICC may at the expense of the estate make reports on various aspects of the debtor's business, and such reports are _prima facie_ evidence.[4] And the ICC may fix maximum limits upon allowances for fees and expenses.[5] In the performance of practically all of these functions, the ICC may, and in some cases must, hold public hearings, ordinarily at its offices in Washington.

I do not intend by any means to imply that these provisions are not necessary and appropriate. I mention them here because of the contrast they afford to the much more subordinate position of the Securities and Exchange Commission under Chapter X of the Chandler Act.

2. Functions of SEC under Chapter X

What then are the functions which the Securities and Exchange

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1/ Section 77(c)(1).

2/ Section 77(d).

3/ Section 77(e).

4/ Section 77(c)(11).

5/ Sections 77(c)(2) and 77(c)(12).

Commission may be called upon to perform in proceedings under Chapter X?

(a) Reports by SEC on Reorganization Plans

As you know, under Chapter X, it is only in the larger cases, where the scheduled liabilities of the debtor corporation are over $3,000,000, that the Judge will automatically refer proposed reorganization plans to the SEC for report. But the Judge may, if he sees fit, request the SEC to render such a report in any case, irrespective of the amount of the debtor's liabilities. In any event the SEC's report, when rendered, is of an advisory character only. The Act specifically so provides, even as to cases in which a reference of the plan to the SEC is mandatory.[6/]

In other words, if, after consideration of the Commission's views, the Judge disagrees with them, he is still at liberty to approve or disapprove the plan, as he sees fit. Since the report is intended for the information of the security holders and creditors, however, as well as for the information of the Judge, a copy or summary of the report must of course be sent them, when the plan is submitted to them for action.[7/]

(b) Appearance by SEC as a Party

In addition to advisory reports, the court may obtain the advice and assistance of the SEC throughout the reorganization by making the SEC a party to the proceedings. The Commission must appear in any Chapter X proceeding, if the Judge requests it to do so. The Commission

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6/ Section 172.

7/ Sections 175 and 176.

may also file a notice of appearance on its own motion, with the approval of the Judge. Where the Judge requests or permits the Commission to file a notice of appearance, the Commission is deemed to be a party in interest, for all purposes, and has the right to be heard on all matters arising in the proceeding.

Even in cases in which it has appeared, the SEC has no higher standing than other parties to the proceeding; it is given no special privilege which is denied to them. And it is specifically denied the right to take any appeal in the proceeding.

The matter of appearances by the Commission is covered by section 208. Interventions by other parties are governed by section 207.

(c) Recapitulation of Functions of SEC

It is perfectly clear from the Committee Reports on the Chandler Bill, and from Chapter X itself, that the purpose of these provisions is merely to make available to the courts expert and impartial assistance in the determination of the complex problems arising in connection with the plan, or in the proceedings themselves. And except in the larger cases in which reference of the plan is mandatory, the Commission will furnish that assistance only where the court wishes to have it.

It is apparent, therefore, that under Chapter X the SEC is in no sense a reorganization tribunal, of coordinate jurisdiction with the courts. The Commission has no authority under the Act either to veto or to require the adoption of any reorganization plan, or to adjudicate any of the other issues arising in the proceeding. The facilities of its technical staff and its disinterested judgment are merely placed

at the service of the court.

As respects reports on reorganization plans, it is worth pointing out that the Commission is called upon to perform a similar function under the Holding Company Act. Its study of corporate reorganizations, pursuant to the Securities Exchange Act, has also provided it with a valuable backlog of experience in this field. The advisory reports will of course be drafted by the Commission's legal and financial staff, but they will be subject to the scrutiny and approval of the Commission itself.

By virtue of this experience, and the knowledge gained through the administration of the Securities Act and the Securities Exchange Act, the Commission is equipped to offer the courts a disinterested, expert opinion on numerous other matters arising in the course of the proceedings and the administration of the estate.

3. Mode of Exercise of SEC's Functions

These provisions with regard to participation by the SEC in proceedings under Chapter X were clearly devised with one important objective in mind, namely, the complete integration of the reorganization process. The SEC is to act, where it acts at all, within the framework of the proceedings themselves. Duplicate hearings on the plan or other matters, before the court and the SEC, are not required. There will be no going down to Washington with a busload of witnesses and a van load of exhibits. We shall get our information just as you get yours -- from the files of the court, the referee and the trustee, and from testimony before the court, the referee and the special master.

In accordance with this philosophy, the Commission has determined to decentralize, so far as possible, the work of its Reorganization Division. For example, we have a staff right here on the ground, at the New York Regional Office, especially assigned to this reorganization work, and selected with that assignment in mind. The Commission believes that the convenience of the parties, and of the court itself, will best be served by this procedure.

It has been suggested that the provision with respect to advisory reports on reorganization plans might result in delay. We are confident that this fear is groundless. In the first place, where a report is to be rendered, it must be rendered within a reasonable time fixed by the court. More important however, in cases in which the plan was to be referred to us for report, we would ordinarily have become a party at a comparatively early stage in the proceedings. We would thus be familiar with the case in all its aspects by the time the plan was referred to us by the Judge. This practice should greatly expedite the rendition of our advisory report.

I am sure that the Commission will be glad to cooperate in every bona fide effort to compose, in the public interest, any differences which may arise, to save needless expense to the estate. But where those efforts are unsuccessful, with respect to matters at issue before a judge, referee or master, we will walk right in the front door of the courtroom with you, and if the SEC is a party to the proceeding, present our witnesses, you will present your witnesses, and the decision will be for the court.

4. Cases in which the SEC might participate

Even where the SEC has become a party to a Chapter X proceeding, the SEC, unlike other parties, is not entitled to receive any allowance out of the estate.[8/] The expense of administration of the Commission's functions under Chapter X must be met out of funds appropriated by the Congress for that purpose. Budgetary limitations alone would prevent participation by the Commission in every proceeding under Chapter X. And it is manifest from the hearings and reports on the Chandler Bill that the Congress did not consider such participation necessary in every case.

(a) In General

Our statistics show that filings under Section 77B during each of the last two calendar years totaled nearly 1000 cases per year. For the first nine months of this year, filings have been at a slightly higher rate. But a great many of these cases were very small indeed, involving hot-dog stands, corner groceries and the like. In cases of this type, the debtor is ordinarily a closely held corporation, and only business creditors are involved, who are generally well able to take care of themselves. As a general proportion, it may be said that neither the Commission's advisory report nor its active participation would normally be necessary or appropriate in such cases. Further, most cases of this sort are in substance "composition" cases, which under the Chandler Act should properly be brought under Chapter XI.

8/ Section 242(2).

Generally speaking, it is perhaps appropriate that the Commission participate in Chapter X proceedings only where the latter involve issues of securities outstanding in the hands of the public, or where the public interest is involved in some other way. The size of the case might not itself be the sole criterion, for participation by the Commission might be appropriate where, although the investor interest was small, those investors lacked adequate representation.

(b) Participation in Old Cases

Proceedings pending at the time the Chandler Act was approved present of course a special problem. In determining the extent to which new legislation should apply to pending cases, considerations of practicability are of course of great importance. That is the test established by Chapter X.[9]

Let us consider for a moment the Smith Corporation, say, which has been in the hands of the courts for perhaps three or four years. Assume that each of the various interests in the picture has had able and loyal representation from the start. The material facts have been fully developed, and the efforts of the parties have culminated in an approved reorganization plan. The corporate tailors have been working on the plan for months, taking it in a little here, letting it out a little there, as the current financial season requires. The enterprise comes into court for the final fitting of its new corporate garment. That, we would all agree, is a bad time for anyone to suggest that the SEC be asked whether it thinks a top-coat or an ulster would be more suitable.

9/ Section 276(c)(2).

I do not mean by this to imply that participation by the SEC is always inappropriate in cases instituted before the Chandler Act became law. Let us take a case at the other extreme. The Jones Corporation, say, got into financial difficulties about the same time as the Smith Corporation. It promptly dove into Section 77B; its management was continued in possession, and has been in possession ever since. The security holders either are not organized at all, or are represented by a handpicked committee, and nothing has been done toward preparing a plan. The management has been quite content to stay under the court's umbrella and wait for it to stop raining outside. Finally, after the effective date of Chapter X, a plan is proposed. Sufficient facts are not disclcsed to enable the court, or the security holders and creditors, to determine whether the plan is fair. Its proponents nevertheless press for confirmation of the plan. This is a case in which participation by the SEC might well be helpful to the courts and to investors who are either inadequately represented or not represented at all.

The Smith Corporation and the Jones Corporation represent the two extremes, you will say; most situations will fall somewhere between them. These old cases present separate questions for the Judges determination. He must first decide whether it is "practicable" -- the word used by Congress -- to apply these provisions of the Chandler Act to the particular proceeding. Once the Judge has determined that it is "practicable" to apply them, the proceeding stands upon exactly the same footing from that point onward as cases instituted after the Chandler Act became law, so far as those provisions are concerned. The Judge

must then determine the second question, which is, whether he should invite or permit the SEC to participate.

The reason for pointing out that there are two decisions to be made is that conceivably a Judge might decide that, although it was practicable to apply either or both of these provisions to the pending case, nevertheless the situation was not such as to require participation by the SEC. The first decision -- whether or not the statutory provisions should apply -- turns on the objective test of practicability. Presumably among the factors to be considered are how long the proceeding has been going on and what stage the proceeding has reached.

The second decision -- whether or not the Judge should then request the SEC to render a report or request or permit the SEC to appear -- is left entirely to the Judge's discretion. In an old case the only situation in which a single determination by the Judge will automatically result in SEC participation is where the Judge decides that it is practicable to apply the provisions for advisory reports, and the fixed liabilities of the debtor exceed $3,000,000. In that case the plan must automatically be presented to the Commission for report.

5. Conclusion

I need hardly mention to this group that no man-made statute can breathe new value into securities which have long since been worthless. The most that can be done is to try to insure, so far as possible, the preservation and realization of all the values which there are, a fair and equitable allocation of those values, and the reorganization of the corporation under a financially sound plan and in the hands of competent and loyal management. The Commission's job under Chapter X is

to aid the courts in their efforst to attain these objectives. We stand ready to do that job to the best of our ability, in wholehearted cooperation with the bench and bar.

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