

ADDRESS

of

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BEFORE

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I wonder why you are here tonight. I have a friend who says "he won't go to any lectures he doesn't give". I agree, except that I add, "and very few of those".

Since however, I'm here, I want to chat with you about the SEC and its role, as I see it, in the current national political economic drama.

The SEC's task is not primarily creative. Its role is a physician's role. It plays the doctor to our financial system -- not to the bankers and brokers who operate within the system, but to the financial system itself. It must cure past ailments. But more important, it must furnish a preventative financial health service to prevent the occurrence of practices that led to ill health.

The New Deal believes that America can prosper under a profit system inside a political Democracy. The Communists say that is nonsense. They say that a profit system anywhere is inherently dishonest and corrupt, incurably diseased, and so hopelessly infected that misery and disaster must be the lot of people who continue to live under such a system. The New Deal considers that to urge upon America the program of the Communists is like advocating the burning down of a house to get rid of the bugs.

"Under a profit system," say the Communists, "we have come on evil days. That proves that the evils we must avert are inevitable under any profit system whatever." It proves nothing of the sort. It proves only that the way in which we have heretofore conducted the American profit system has produced grave evils. If a man who tries to swim while wearing heavy boots sinks to the bottom, that does not prove that he could not stay on the surface if he took off his boots. Certain tropical areas seemed fatal to white men because of malaria, but it was not concluded that malaria was an inherent and ineradicable affliction of white men; instead, the swamps were drained and malaria was eradicated. When a crop is afflicted with a killing pest, civilized man does not accept that fact as a final decree of providence; he often finds a way to eliminate the pest.

The question that we need to ask is whether our grave troubles have not been caused by certain eradicable stupidities in our use of the profit system. And it is no final answer to that question to state that our difficulties are like those of Europe under a profit system. We need to consider whether we did not foolishly and needlessly adopt some European stupidities, stupidities not inherent in the mere existence of a profit economy, stupidities avoidable in the United States, even if not avoidable today in Europe.

The Communist philosophy, as far as America is concerned, is one of despair. That despair we should reject. But the rejection must not consist merely of angry denials. It must take the form of concrete steps toward the eradication of most of the unwise practices which we find in our economy.

What I have been saying is so crucial to the future of America that it is well to rephrase it. In America, democracy and the profit system are especially cherished by the great majority of the people. Our civilization would therefore be in grave danger if the choice ever arose here between the eradication of those institutions and our survival. Fortunately, our economic situation is such that we can retain our political democracy

and the profit system. We need only modify certain of our national habits. Those habits became associated in Europe with the profit system and were foolishly borrowed by us. We need not scrap our profit system or our democracy in order for the majority of our people to live plentifully. In order to prevent havoc-making crashes, we should adhere to those principles which the great majority of Americans consider to be part of our permanent values. That we can do because, unlike Europeans, we are living in a politically and economically integrated continent.

In Europe, as I have suggested, the situation is different. There the devotion to the perpetuation, on a single continent, of several independent national states, most of them highly industrialized, and yet each without adequate national resources to sustain itself, is bringing about a condition in which the profit system cannot continue to operate. There is a fatal contradiction between the perpetuation of those independent European states and the perpetuation of the profit system. We are now witnessing the consequences of that contradiction. In an effort to avoid those consequences, Germany and Italy abandoned democracy. Such abandonment was not too difficult in Germany, for she had remained predominantly feudal well into the nineteenth century. And Bismarck had accustomed that country to a kind of dictatorship not too markedly different from Hitler's, so that dictatorship has long been a part of the German mores. In Italy, too, democracy had never gained a steady foothold. In neither of those countries was dictatorship repugnant to the vital folkways. But in both countries the profit system, to the bulk of the population, is still a culture value, and therefore Fascism rather than Communism was the response to the need for change.

In England and France, as in this country, political democracy and the profit system are both deeply embedded in the folkways. The resistance to abandoning either of those customary aspects of the group life will be vigorous indeed. An objective situation which calls for the elimination of either or both of these institutions may therefore cause chaos. It is by no means clear, however, that such a situation may not soon exist, unless, on some sane basis, the economic and political integration of the European continent occurs first.

This country, happily, is confronted with no such dilemma. The traditions most highly cherished by our people can be preserved without harm to our civilization. As I've indicated, we need but slough off some bad habits which have become associated with our most highly esteemed ways of living. And this we can do. On this continent there will not occur the clash between, on the one hand, a system linking the profit economy with a political democracy and, on the other, an obsessional devotion to the existence of completely independent national American states. The social changes called for in the United States will thus not go to the heart of our institutions.

I therefore believe that America can achieve lasting and widespread well-being under the profit system under a democracy. The Fascists jeer when that is said. They insist that only under a political dictatorship can there be economic health.

It may be true that, in Europe, both capitalism and democracy are on their way to extinction. The lack of economic and political integration in Europe gives pause to all constructive thinkers concerned with the European future. But our good fortune, our unity, and our immense resources, make plainly possible a different future for America. By eliminating some bad habits, not at all inherent in American life, we can have a healthy profit system within a democracy. We should constantly remember that America is not Europe. What is called capitalism in Europe is not what we have here. And a profit system, shorn of evils ineradicable in the European setting, is something that we can have -- if only we are intelligent. Let us but keep our eye on the American ball (with no side glances at Europe as if our ways had to be those of Europe) and we can be healthy and wealthy, if we are wise.

But we must cut out some of our bad habits. And not the least of these habits which need correction are some of our bad *financial* practices. There enters the S.E.C.

I have likened the S.E.C. to a physician. Congress, as the master physician, diagnosed the ailments and provided the medicines. We are the practising, day-to-day, doctor. Now nobody but a hypochondriac likes to have a doctor around unless he's really needed. And the best physician is one who makes his own job unnecessary. That's what the S.E.C. aims to do. It realizes that a patient, if he will, is able to do almost as much to cure himself as can the doctor. The S.E.C. seeks to encourage its patients and to enlist their aid.

But the S.E.C. can't discharge its patients until its essential tasks are finished. In the performance of those tasks it is bound to annoy some persons. For there are always those who want to conceal their ailments, who want to use rouge to create the appearance of health instead of medicine to cure ill-health. Indeed, they accuse the doctor of creating the diseases to which he calls attention. And so the S.E.C. is abused, recurrently, by some of its patients who call themselves its victims.

The lot of the S.E.C. -- like that of Gilbert's policeman -- is not a happy one. At times we are forced to examine a pathological case. We do so with no relish. We much prefer to look at economic health. At other times we are called upon to engage in a certain amount of surgery. That seldom fails to bring a loud squawk from the patient. The things people say about us when we do a little necessary cutting reminds me of a story a medical friend of mine tells his students. "You should always remember," he tells them, "that some patients will always describe a surgeon as a man in a white robe who drugs his victim, ties him down on a table, and cruelly sticks a knife in him until the blood spurts."

In order to deal effectively with the present and future financial functioning of our economy, we are required at times to study and report its past. That past is often ugly. In terms of present consequences, in 1938, what happened in the 1920's often sounds shockingly dishonest and indecent. It makes unpleasant reading. We do not ask you to read it because we are morbid-minded. We do not say that the men who did the things we talk about were wicked men bent on wrong-doing. After all, virtually the whole country applauded those doings. As we now see them, those deeds were stupid, not wicked. The stupidity was a shared stupidity, one in which most of us gladly acquiesced. And the hind-sight judgment that those acts were stupid is not a malicious judgment. It is reluctantly voiced in order that we may avoid such stupidities in the future.

The New York Stock Exchange used to gnash its teeth when we diagnosed some of its traditional habits as erroneous. But times have changed. And we rejoice that, on the basis of our new understanding, soon it will join us in eliminating those ancient errors.

The rectification of the financial structure of the public utility industry still lies ahead of us. That is a vast job, calling for infinite patience and all the wisdom we can command. The task demands public understanding, and we, therefore, want to be sure that our endeavors are not misunderstood. There are bound to be reorganization proceedings in which we will have to bring to light the unpleasant fact that some so-called security holders have in fact no security. Sometimes we shall be obliged to refuse approval of the continued payment of dividends because there are no earnings justifying their payment; and in such instances we shall be obliged to reveal unsavory corporate histories and disclose that, in a prior period, dividends were illegally paid. But the important point is that we don't do those things to malign anybody or to hurt anyone or merely to preach a sermon. We are definitely not muck-raking, and if an unpleasant past doesn't contribute anything to the future, we are only too glad to draw a veil of charity over it.

If some of the tasks we inherit are unpleasant, that is not of our doing. In fact, through no fault of our own we not infrequently get an unsavory mess dropped into our laps.

Occasionally there is an incident to provide a sort of tragi-comic relief, as, for example, the following grim but amusing story. As you know, in the old days some utility holding companies used to induce the employees of their operating subsidiaries to sell stock to the customers of the local electric light companies. One local plant manager had been selling preferred stock around town. When the collapse came, the local citizenry started to take it out on the company's property. This manager became so frightened that he sent this report to the home office:

"When anyone mentions preferred stock to me I feel like dodging. This is a very serious subject. The thing that has kept us from having serious trouble with consumers who own stock in our company is that we have not told the people that own stock that their money is lost. You know that it just takes one person to do damage to either an employee or the system. This is a lawless place; the people do not think anything of a killing. We have something like 15 to 20 murder cases every court. Nothing is done with one for murder. I am serious when I tell you that for the company the preferred stock holders must be taken care of.

"When you go to collect a bill and the party brings out some stock to pay with, it keeps one nervous. I have been in some tough places myself, having been shot some eight times. The next might be the one that would take me away. I want to keep all the consumers friends of mine and the company's. This Preferred stock is dangerous."

I have adverted to the occasional need for surgery. Again I ask for understanding where such an operation is necessary in dealing with the utility problem. We perform such an operation, not out of a desire to be ruthless, but only when it is the clearly indicated sound course. Let me be more specific.

Many people today hold securities of some public utility holding companies which were unsoundly financed in the 1920's. These people are in a difficult situation. Plainly stated, many of them hold securities for which they paid a lot more than the securities were worth. Though in most cases they do not know it (for the simple reason that people simply won't face unpleasant realities), these people have taken their beating in every way except formally. They still may have a stock certificate which says \$100 on its face; but this stock may never have been worth \$100, and may never be. The certificate may still recite that it entitles the holder to \$7 a year in dividends; but there may never have been \$7 to pay him lawfully, and there may never be. It is simply impossible to earn profits on water no matter how much may have been paid for the water originally.

To its owner, however, we all recognize that a stock certificate has a psychological significance. Some people are reluctant to exchange a 7%, \$100 par value share of preferred stock for a no-par share of common even though the latter may have a real value twice that of the preferred. To make the exchange may be an admission of error -- an abandonment of hope. Similarly, the company which sold the preferred stock is reluctant to recognize the truth. Any reorganization involves a loss of face for the management, and the risk of loss of control. Moreover, reorganization carries a threat that the common stock, by which the management keeps itself in power, may be wiped out or reduced.

This threat to the common stock of a company in reorganization is double-barrelled. It involves, first, a loss of a possible speculative value, however remote. Hope springs eternal, and regardless of how insolvent the company may be, the management is reluctant to relinquish a possible claim on future earnings, however slight. In addition -- and more importantly -- if the common stock is cut down or eliminated, a new set of investors will be enfranchised. The new votes may or may not keep the old management in control, and if the old management is ousted, it loses the emoluments of control. Most important of all -- it loses power and prestige, things sometimes much more cherished than money.

These, then, are among the chief obstacles to utility reorganizations -- the desperate clinging by investors to the corporeal reminder of a mirage that was once a hope; and the determined clutch of management upon the common stock from which it derives its power of control.

The continued existence of these exhausted claims upon non-existent earnings -- these worthless stocks -- raises a problem of grave national importance. A ponderable proportion (by no means all) of the utility industry is at present in no position to do further financing -- equity or otherwise. The blockade to new issues by many public utility companies is not government competition, or governmental restrictions, nor is it that the future of the utility industry is such as to make it a speculative risk. It is the presence of worthless securities resulting from over-bonding, over-borrowing and over-stocking. And that condition existed long before the government was ever called into the picture.

That water must be eliminated from those companies in that condition. Unless and until that is done, these companies will not be able to rebuild, expand and modernize, and they will not be in a position to contribute their share toward national recovery. They will not be able to make the progress which those investors, who have a really worthwhile interest, have a right to expect.

I should add, at once, that, in determining what is value and what is water, cautious judgment must, of course, be exercised. The word "value" drips with ambiguity. In varying contexts it has varying meanings. A multitude of factors must be considered. Among them, reasonably prospective earnings must be given considerable weight.

In the process of reconstructing some utility companies, some people are going to be hurt but others will be benefitted. As the water disappears, the interests of those people whose securities are a claim on the water, and on nothing else, must also disappear. The people who are eliminated in this process are not really damaged. At most, they will be deprived of a claim on something which does not exist. They received their beating years ago, when they were sold valueless securities. But those whose claims are upon the solid dry land which remains, will face a new era of constructive growth, with a revitalized industry relatively free from the financial perils which have existed in the past.

I want to emphasize this fact: I have referred to pathologic cases. I don't want, for a moment, to give the impression that all the companies are in that shape.

Our hope is that we can help to construct a healthy, profitable industry which can progress soundly in the future without the troublesome interludes which have too frequently beset some of our great industries - notably the railroad industry. We cannot lose sight of the frequency with which security holders in that great industry have been put through the wringer of reorganization, almost always losing their priorities - often losing their entire investment. We don't want to see that happen in the utility industry; and we firmly believe that within the framework of our present statute lies the formula which can protect the future investors in that industry from such recurrent calamities.

I say *future* investors. It would be wholly unfair of me not to admit that we cannot but see places in the present situation where existing so-called investors must finally be brought to the recognition that the paper they have been clinging to is and has been worthless almost since the day it was sold to them. That is too bad, but, if it were not true, the chances are that S.E.C. would not be in the picture today.

Without doubt, one of the most encouraging happenings of the past few months has been the growing interest which the managements of the great holding company systems have been taking in the job of reconstruction which lies ahead. It is encouraging because it means that American industrialists are beginning to assume that proper role of progressive leadership which is essential to the health of our profit system. Our friendly conversations with these men have become more and more frequent. On both sides there is an increasing recognition that mere differences of opinion on details must not be permitted to stand in the way of constructive cooperation. We need the help of many of these men who have grown up with the utility industry. Some of those who constructed the giant holding company systems have the skill and the power to reconstruct them along lines which can give permanent health to this vital portion of our national economy.

As doctors, we are in the happy position of knowing that we have not appeared too late on the scene. We know that our job is not to provide comfort in the last fleeting minutes of life, but to restore to health a vigorous body which is merely ailing. And we are beginning to experience the encouragement which comes to all doctors when they find out that they have a cooperative patient - a patient who wants to get well and stay well and live long. It has at last become apparent that the SEC is, for the utility industry and for finance, a life extension institute.

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