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CORPORATE REORGANIZATIONS AND THE CHANDLER ACT

I

It is only a few years since corporate reorganizations entered the "public domain". Before Sections 77 and 77B of the Bankruptcy Act appeared on the scene in 1933 and 1934, the legal aspects of reorganizations were a fairly esoteric specialty. The subject had its high priests, and its inner mysteries were known to relatively few members of the Bar; indeed, one of its leading oracles is reported to have said that it was as hard to tell how to reorganize a corporation as it would be for a poet to tell how to write poetry.

About the present relevance of that remark, made nearly thirty years ago, to the solution of the financial and business problems that overrun any corporate reorganization of substantial size, I will have more to say later. I am sure it can be said that the statement is no longer true about the procedural aspects of reorganizations. The sharp onset of economic distress in the present decade, and the advent of Sections 77 and 77B, have developed a very natural interest in the subject on the part of lawyers. The depression stimulated this interest, and the statutes, which were in part a product of these economic conditions, have supplied the Bar with a handy blueprint of the applicable procedure.

An increasing legal attention to the subject is reflected in other recent phenomena. Let me remark on the fact that it is rapidly becoming a regular part of the curricula of our law schools. If this imprimatur did not suffice to evidence its coming-of-age, I would put you on notice of the further fact that in a valuable text recently published, both its procedural and substantive complexities have been refined into "principles". I have it on information and belief, however, that no Restatement of the subject has yet appeared on the horizon.

I can indicate to you briefly the premises which underly the more important of the so-called innovations contained in Chapter X of that Act. One need not look far to ascertain the source of the basic assumptions in the Act. You will find them clearly expressed in two opinions of the United States Supreme Court. They can be summed up in two sentences from these opinions.

Both opinions were written in reorganization cases. The first quotation is from Harkin v. Brundage* to the effect that " . . . *a receiver is an officer of the court and should be as free from 'friendliness' to a party as should the court itself.*" The author was the late Chief Justice Taft.

The writer of the second opinion was Mr. Justice Brandeis. He said in 1933 in the case of National Surety Co. v. Coriell:** *"Every important determination by the court in receivership proceedings calls for an informed, independent judgment."*

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*276 U.S. 36, at 55 (1928)

**289 U.S. 426, at 436.

Mutatis mutandis, what was thus said about receivers and receiverships should have been applicable, without any qualification, to proceedings under Section 77B of the Bankruptcy Act and to the appointment of trustees under that Section. In both of these vital respects Section 77B was, however, found wanting. The Congress, and special committees of the House and of the Senate, found it so. Recent studies by the Securities and Exchange Commission furnish additional corroboration of the fact.

Chapter X of the Chandler Act has now repaired these deficiencies, by requiring the designation of independent, disinterested trustees in all cases of substantial size, and, secondly, by the provision which it makes for supplying administrative assistance to the courts in order that they may be enabled to exercise an informed, and independent, judgment. These provisions are neither theoretical impracticalities nor are they innovations. They are measures implicit, as we shall see, in the basic assumptions -- clearly and forcefully expressed in the language of the Supreme Court which I have quoted. It is accurate to say that they have been honored for the most part in the breach.

Let me address my remarks for the moment to the second of these statements, that of Mr. Justice Brandeis. What are the sort of matters inevitably present in reorganization cases upon which the court must exercise an informe independent judgment? Initially, there must be stress upon the paramount importance of the financial and management problems which have to be solved if a reorganization is to be truly effective. The reorganization of corporations is primarily an exercise in corporate finance and management. We often forget that, only incidentally are, reorganization proceedings law suits. What is more, they are never law suits in the sense of procedures designed to settle simple issues between individual litigants. It has been appropriately said by the court conducting one of the Insull company receiverships that, "The conduct of any equity receivership is of necessity largely administrative: it involves more than a decision of 'yes' or 'no' upon a single issue or a multiple of single issues presented by appropriate pleadings."* This is no less true of proceedings under Section 77B.

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* "It involves decisions on matters of policy with nice gradations of refined reasoning and conservative judgment ... often ... questions of policies or courses of conduct concerning which two apparently equally consistent views may be taken. Such questions and situations constantly recur in the conduct of an equity receivership, giving to it a character requiring the exercise of administrative jurisdiction, as distinguished from decision of contraverted or litigated questions." Lincoln Printing Co. v. Middle West Utilities Co., 6 F. Supp. 663, at 682-683 (N.D. Ill., 1934).

Reorganization chiefly involves the problems of corporate finance and management; it requires an inquiry into the causes of the financial collapse of the corporation; and into its worth, if salvaged as a going concern; and, if reorganization instead of liquidation is determined upon, how can this best be accomplished upon a basis economically sound. The answers to these questions will necessitate inquiry, among other things, into general economic factors, competitive conditions in the industry, its trend of demand, and its price policies, as well as inquiry into more immediate questions such as involve the quality of its management. More narrowly, there will have to be inquiry into earnings in the past and the conservative prediction of future earnings, and on the latter basis, a determination of what would constitute a sound capitalization and financial structure.

These constitute the most important aspects of reorganization. They are not legal problems. Because they are not, they have been neglected in the evolution and construction of our legal reorganization machinery. The deficiencies of the latter will become apparent when these primary objectives are kept in mind. It is only after these broader economic and business issues are decided that attention is properly given to questions concerning the extent of participations to be allocated among former security holders, the problem of the "fair plan" as traditionally understood. But it is only with the latter that even reform measures have grappled in the past. The process of deciding the more significant of reorganization problems remained unaffected and uncontrolled by the legal machinery of reorganization until the advent of the Chandler Act.

To meet this need the Chandler Act has adopted a traditional expedient. In essence, it has made the Securities and Exchange Commission a standing "amicus curiae", with its technical facilities in business and financial matters at the constant and ready disposal of the Federal courts in reorganization cases. I say this is a traditional expedient, for innumerable instances can be adduced where the courts have made use of expert assistance in the solution of particularly knotty problems. Strangely, perhaps, little of such assistance has been made available in corporate reorganizations, whose problems will match any in complexity and difficulty.

Take, for example, what has been done in other situations where the facts of a case may be so complicated and involved that they are not readily intelligible to a jury. A court in such instances may refer the case to an auditor, to make preliminary investigations of the facts and report his findings to the court. The purpose in such cases is admittedly to simplify and clarify the issues. It is in aid and not in derogation of the judicial function. In technical patent cases, for example, references are frequent; they are frequent, to take another example, in condemnation cases.

Nor is the administrative arm of government a stranger to such functions. In seeking, for example, to insure impartial assistance to trial courts adjudicating psychiatric issues in criminal proceedings, state legislatures have provided for court-appointed experts, or examinations by state institutions. In adoption proceedings there is a noticeable trend toward mandatory references to welfare boards or to permanent administrative adjuncts of the courts themselves. The many other examples run a gamut all the way to plenary administrative scrutiny and approval of reorganization plans under the Railroad Reorganization Act and under the Holding Company Act of 1935.

Little purpose would be served by multiplying these examples. The common thread that relates all of them must be apparent. Each is a practical procedure devised to meet an immediate, pressing need on the part of courts -- a need for an adequate machinery of analysis, investigation, examination, and report, upon which the courts may base an informed, independent judgment. No inflexible pattern has determined the manner in which this assistance may be rendered; rather, the particular variety of procedure in each instance meets the pragmatic test of effective accomplishment of the end which is sought.

Now consider the task which confronts the judge when he undertakes, under Section 77B, to determine the fairness and equity, and feasibility, of a proposed plan of reorganization. For guidance on the host of questions, -- financial, business, economic and legal -- which present themselves, he must depend upon a biased debtor, a trustee who all too frequently is partisan, if a trustee has been appointed at all, and upon the committees for bondholders and stockholders. Occasionally the isolated creditor or stockholder may be represented, in good faith or for the sake of a nuisance value, if one can be created. One of two things will generally happen. The judge must set out on a search for the truth as it may be present in a welter of partisan charges, often bald misinformation, and exaggerated claims. His search and determination are reduced to the level of a guess as to the credibility of highly distorted and conflicting allegations. Or, as may happen more frequently, he finds a "united front" before him, with all seeming differences composed. If anything, this is even less effective as a test of the truth. Rarely will the judge be apprised adequately of the considerations which have made for compromise, or their effect upon the interests of investors.

Consider again the type of problems with which the judge is confronted. In the case from which I have already quoted, the decision of Mr. Justice Brandeis reversed in its entirety a decree approving a plan because the procedure pursued by the lower court was improper. The impropriety was described as follows: "The District Court had before it, in support of the plan, only informal inadequate and conflicting *ex parte* assertions unsupported

by testimony. It undertook to pass upon the wisdom and fairness of the plan of reorganization, and the rights of non-assenting creditors. *For the proper disposition of these questions definite, detailed and authentic information was essential. Such information was wholly lacking ."**

The following year (1934), Mr. Justice Brandeis, again in a unanimous decision of the Court, put renewed emphasis on the necessity for an informed, independent judgment on the part of the court, because of the special nature of reorganization proceedings. This was in First National Bank v. Flershem.** Again the Justice pointed out that: " . . *: the court stood in a position different from that which it occupies in ordinary litigation, where issues are to be determined solely upon such evidence as the contending parties choose to introduce."****

I do not wish to labor the point unduly. But the pertinent analogies come so readily to hand, that I will venture one more. The members of this Association are familiar with the invaluable labors of the Commissioners on Uniform State Laws. I think it is pertinent and instructive to examine the procedure they have recommended in their Uniform Expert Testimony Act. Their objective in that Act was to strike at the evil of biased and partisan expert evidence. A number of states have already adopted the Act. Now what the Act does in cases where the opinion of experts is appropriate, is to provide for the appointment of experts by the court. And under the Act such experts may also be required to prepare reports on the matters within their special cognizance, and these reports may be read at the trial.

In summary, there is ample corroboration for the belief that a qualified administrative agency has a proper and highly useful place in corporate reorganization proceedings. The burden imposed on the courts in the analysis of the fairness, equity and soundness of plans, the intricate financial and business questions involved, and the special knowledge required in their solution, make the facilities of a qualified administrative agency of particular value. Under Section 172 of the Chandler Act, where a corporation's indebtedness exceeds $3,000,000, the judge will automatically refer the plans he deems worthy of consideration to the Securities and Exchange Commission for its examination and advisory report. In smaller cases the judge is privileged to submit such plans to the Commission.

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* 289 U.S., at 436.
** 290 U.S., at 504.
*** Id., at 525.

It is significant, I believe, that the potential usefulness of the kind of advisory role which the Chandler Act gives to the Commission, has already been given recognition by the courts. Over the past year the informal assistance and advice of the Commission has been sought in a number of cases by the Federal District courts. These advisory functions will, of course, not be new to us, for by virtue of our duties under Section 11 of the Holding Company Act the Commission has gained a backlog of experience in the examination of reorganization plans. I emphasize, however, that the ultimate power and responsibility in reorganization proceedings under the Chandler Act are kept entirely in the hands of the court. The Commission shares no powers with the court. Its reports are purely advisory. Its function is limited to furnishing the court with administrative assistance and advice. The judicial power is not impaired.

Now the disinterested trustee -- the officer of the court free from "friendliness" to a party, to whom Chief Justice Taft had referred -- is no less indispensable than disinterested expert opinion on plans, to the adequate performance of the judicial function in reorganization cases.

Section 77B, as you may know, introduced what can only be termed an unfortunate novelty into the law. It was not merely possible under that Section for a court to appoint as trustee a person lacking the qualification of complete disinterestedness. It was also possible, and it was the practice in a majority of the cases, for the debtor to be left in possession and management of the corporation.

This was a re-installation of the "friendly receivership" with a vengeance. In equity reorganization, a receivership without a receiver would have been an anomoly. Yet, while the Supreme Court moved toward a housecleaning of receiverships, as evidenced, among other factors, by its insistence upon the appointment of independent receivers, Section 77B was interposed to give the sanction of statute to the very practice which the Court had justifiably condemned.

Now I do not question the very substantial improvements in certain aspects of reorganization procedure brought about by Section 77B. Those of you who are familiar with the equity receivership as a machinery for consummating reorganizations are aware how cumbersome, inept, and expensive it was. In the First place, by replacing the hocus-pocus of the friendly creditor's bill with a system permitting voluntary petitions by debtors, 77B frankly recognized the existence and desirability of reorganizations directly initiated by a debtor corporation. It was not the least part of this gain that it distinctly improved the moral atmosphere of reorganizations by making collusion in the instigation of receiverships unnecessary.

In the administration of estates Section 77B did much to reduce needless waste and to promote unified, and therefore more efficient, administration, by eliminating the necessity for ancillary receiverships. Again, by adopting what was, in part, the concept of bankruptcy compositions to corporate reorganizations, Section 77B made it possible to bind dissenting minorities to the terms of a fair reorganization plan. This rendered obsolete the fictional foreclosure or judicial sale of the corporate assets, whose purpose was to permit the accomplishment of a prearranged reorganization plan by clearing these assets of the claims against them.

Useful fictions (when fully recognized as fictions) are not to be scorned, but this one was unwholesome. It had long diverted the attention of the courts from consideration of the provisions of the reorganization plan. Instead, there had been a preoccupation with the technical details of the sale -- the mechanism for its accomplishment. But the sale was a mere form, for ordinarily none but committees of creditors would - or indeed could - purchase the assets when the sale was held. And it was equally useless as a means of setting a fair value and price for these assets out of which dissenters would be paid in cash. In practice, investors were driven to acquiescence in the plans proposed by dominant committees, yet there was little appreciation of the need for the fullest and most intensive scrutiny of the reorganization plans. Section 77B relegated this procedure to the rubbish heap, and substituted a more realistic procedure under which the plan itself was rightly the court's primary consideration.

All this Section 77B did, and more. *And all of this has been preserved without any substantial change in Chapter X of the Chandler Act.* But for the administration of any estate involving fixed and non-contingent indebtedness of $250,000 or over, that Act will require the appointment of a disinterested trustee -- a trustee free from "friendliness" to any party. That seems to me only right and just. When a corporation avails itself of the protection of the bankruptcy court, it is enabled to stave off its creditors. The court protects its property from dismemberment by executions and attachments. It has the benefit of what in equity was called the "chancellor's umbrella". But that umbrella should not be held by the debtor, but by the court through its trustee -- as the equity court did through its receiver.

Now I should be the first to agree that the mere precedent of equity practice is not *per se* a compelling reason for continuing to appoint trustees in reorganization cases. But when we explore the needs present in these cases, the needs of the court and of investors, I think it will be evident that in any case of substantial size the presence of independent trustees is indispensable. Let me therefore outline briefly the functions which the trustee should, and will, perform under Chapter X of the Chandler Act.

In every case the trustee, as a routine matter, is required under Section 167 to assemble the essential information relating to the property, liabilities and financial condition of the debtor, the operation of the business, and the desirability of its continuance. Without this basic data the court cannot exercise an informed judgment in the day-to-day administration of the case, and without it the formulation of a sound and thoroughgoing reorganization plan can make no effective progress. To the extent that such information has in the past been assembled at all for purposes of a plan, it has been done by various creditor, stockholder, and management groups, none of them impartial, and each of them to a degree duplicating the work of the others. Both expense and time will be saved when the trustee does this. And what is even more important, the trustee's facts will not be colored and distorted by reason of his own interests.

I should point out to you that the requirement of disinterestedness need not affect efficient operation of the corporate business while reorganization is pending. The trustee must be qualified as well as disinterested; he has the power to retain the services of any of the officers of the debtor; and in the unusual case, an officer, director, or employee of the debtor may be designated co-trustee for the purpose of aiding in the operation of the business.

The disinterested trustee's functions also include the preparation and filing of a plan of reorganization, a duty on which I shall comment at a later point. In addition, it will be the duty of the trustee, upon direction from the judge, to investigate the past acts and conduct of the debtor and to report upon them to the judge; upon authorization from the judge the trustee may examine the directors and officers of the debtor and any other witnesses concerning these matters; and he is required to report to the judge any facts ascertained by him, relating to fraud, misconduct, mismanagement and irregularities.

There are some who have not looked altogether kindly upon Chapter X of the Chandler Act. They have seized on these latter provisions as evidence that Chapter X is premised on a belief in the general incompetence and dishonesty of managements. Of course that is nonsense. Sound as well as unsound enterprise may be unable to withstand the shock of economic depression. There are honest as well as dishonest failures. But honest and competent management has nothing to fear from an investigation by the trustee.

Such management would invite the most painstaking scrutiny of its past conduct. It should be most anxious to do so, if only to dispel the cloud on its ability and integrity which inevitably results from the corporation's financial difficulties. If it were reluctant to do so, I would think that "res ipsa loquitur" ought to apply. But what is more essential, no corporation can be effectively reorganized unless assurance is supplied that its old management, which almost always will seek to be retained in office, is qualified to be left in charge. That assurance will only be supplied after the careful inquiry of a disinterested officer -- the trustee.

It has been alleged that there are many cases where a debtor -- meaning the management -- has remained in possession and in which the properties have been efficiently reorganized. No one can tell whether that is true. An investigation might have enabled the estate to recover large sums of money improperly diverted, or cut off huge obligations under contracts fraudulently or improvidently made. But nothing is known about the facts undisclosed when a debtor remains in possession. The judge is confronted with the grave responsibility of effectuating a sound reorganization. He should not be required to guess as to what the facts might have been. He should be permitted to know what they are.

But another function of the disinterested trustee under the Chandler Act deserves even more stress than the provision I have just discussed. It is the requirement that the trustee shall have the duty of preparing and filing a plan of reorganization, or a statement of his reasons why a plan cannot be effected.

There has been a good deal of misunderstanding, if not misstatement, about this provision of the Act. As I understand it, it is not destructive of the privilege of creditors and stockholders, in groups, committees, or individually, themselves to propose plans of reorganization. They will continue to do so, if anything more freely than under Section 77B, which limits the privilege of proposing plans to stated percentages of creditors and stockholders. For under the Chandler Act these percentage restrictions have been eliminated. The ability of interested creditors and stockholders to "trade out" the terms of a fair plan is not impaired by the Act. What it has done, in effect, is to provide a round-table - *within* the court - around which the bargaining will take place. And it has given the representative of the court -- the trustee -- a place at that table.

The advance which this will mark in reorganization ethics and procedure is apparent when it is contrasted with present and past practice. The basic function of formulating a plan will no longer be the exclusive province of managements and bankers and their chosen protective committees, possessing interests often (unavoidably) at odds with those of security holders. Section 77B has, if anything, strengthened the dominance over investors possessed in reorganization proceedings by that minority. Investors lack the information upon which to rest their participation; they lack the lists which would enable them to communicate with other security holders; yet under Section 77B they must obtain the acquiescence of a substantial number of their fellow creditors or stockholders merely to propose a plan.

By the terms of the Chandler Act any stockholder or creditor may submit a plan or suggestion for the plan to the trustee. Prior to that time the trustee will have transmitted to them his statement concerning the property, liabilities, and financial condition of the debtor, the operation of its business, and the desirability of its continuance. Creditors and stockholders will then be privileged to submit their proposals, as I have indicated. At this stage the trustee, as the representative of the court, will supply judicial participation in, and supervision, scrutiny, and control over, the formulation of a plan, which he will then report to the court. Under the Act a hearing on this plan will follow, upon appropriate notice, at which alternative proposals may be proferred by the debtor or any creditor or stockholder. The trustee will have furnished the initiative and drive in the most essential step in any reorganization, without derogation from the privileges of creditors and stockholders.

The process will be both more democratic and more efficient.

I believe this last aspect of the Chandler Act is worth further emphasis. In making the disinterested trustee the focal point of the proceedings, new opportunities have been afforded for intelligent investor participation in the reorganization process. As I have said, the trustee's investigation and report will have provided them with the data to keep them adequately informed about the status of their investment. The Chandler Act also insures that at least annually they will be supplied with reports on the operations of their company. The Act also provides that, as a general rule, before their assents may be solicited in favor of a plan, that plan must have received the approval of the court, and must be transmitted to them together with an opinion of the judge and report of the Securities and Exchange Commission, concerning its fairness and feasibility.

Now under 77B, a plan could be negotiated entirely outside the processes of the court and submitted to security holders for acceptance. There was no requirement in the statute that at any early stage in the proceedings it receive either the scrutiny or approval of the court. Frequently it was not until the last possible date that the reorganizers laid the plan before the court for examination and requested its seal of approval. At that late point in the proceedings, great pressure was brought on the court to accept the plan presented to it. The court found that it had a natural reluctance to withhold approval of the plan or to insist upon its drastic alteration. To do so might mean that the time, effort and money of the reorganizers have been spent to no avail and inevitably the consummation of the reorganization would be delayed.

These considerations were pressed upon the court, together with the even more impressive argument that the plan had met with the approval of creditors and stockholders. The history of reorganization indicates that this backing of the plan was in fact often illusory. It frequently did not represent the considered, informed judgment of those affected by the plan. In the first place, there was no machinery under 77B which insures that complete informative data concerning the situation would be submitted to security holders. Instead, the extent and character of this information was largely left to the determination of the reorganizers. In the second place, any acquaintance with solicitation techniques disclosed that unfair and oppressive methods were frequently employed. But in both 77B and equity reorganizations the argument was pressed, and it was often persuasive with the courts.

This tactic served to divert attention from the merits of the plan to its ostensible backing and to induce a natural reluctance to run counter to the apparent wishes of a large percentage of investors. It was not surprising therefore, that despite their occasional disclaimers to the contrary, there was a tendency on the part of the courts to regard the amount of approvals as strong evidence of fairness. The normal effect of the practice was approval of such a plan without substantial changes. As a result, the court's most important function, the scrutiny of a plan to determine its feasibility and its fairness, often became little more than a formality.

Chapter X of the Chandler Act puts an end to this. As I have said, before the *assents* of security holders are solicited, the court will give consideration to the plan and determine whether or not it is in the interests of investors. This it will do with all the necessary information before it. Under these provisions it will have a real opportunity to consider the plan prepared by the trustee and such other plans as may be filed directly with it by security holders or the debtor. No longer will the court be asked to approve a plan after it has ostensibly been approved by creditors and stockholders. No longer will the court be subject to pressure against rejecting a plan.

Another important provision in the Chandler Act concerns the management of the reorganized company, a subject on which I have already touched. This is a matter of paramount importance to investors. The Chandler Act in this connection requires, first, that the manner of the selection of the management shall be in the interests of investors and consistent with public policy, and second, that the judge in confirming the plan must be satisfied that the appointment of a particular management to office or their continuation in office is likewise in the interests of investors and consistent with public policy. 77B was silent on this point, though it is commonplace that the quality and integrity of management are as important to investors as the allocation of the company's assets and earnings among the various classes of security holders.

The provisions in the Chandler Act concerning trading in securities by those occupying a fiduciary position in the reorganization deserve brief comment. The Act provides that unless the judge expressly approves or consents to such dealings, he shall deny compensation for services to any person acting in a representative or fiduciary capacity who has purchased, acquired, or transferred any claims or shares of stock after the commencement of the proceeding. This should go far to discourage the shocking practice by protective committeemen and other fiduciaries of buying or selling the debtor's securities on the basis of their inside information concerning its condition and prospects.

I have time to mention only a few of the many other salutary changes in Chapter X. There is the elimination of the provision in 77B which permitted the reorganization petition to be filed with a court merely because its territorial jurisdiction included the state of incorporation. There is the provision permitting any stockholder or creditor to be heard on all matters arising in the proceeding. No persuasive reason has ever been given why the real owners of the enterprise should have been restricted in this right as they were under the terms of Section 77B. Of similar importance are the steps taken under Chapter X to enlarge the functions of the indenture trustees and enable them to take an active role in reorganization proceedings.

The late Mr. Justice Cardozo stated the objective of Section 77B to be that of establishing "a practice more open, more responsible, more efficiently and closely regulated, and withal, more surely valid",* than the equity receivership. In its improvement upon Section 77B, Chapter X has brought that objective a great deal closer to achievement.

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* Duparquet, Huot & Moneuse Co. v. Evans, 56 Sup.Ct. 412 (1936).

The Securities and Exchange Commission, as you may know, is especially concerned with the attainment of that objective. Pursuant to the direction of Congress, the Commission for a number of years conducted an intensive study and investigation, under the direction of Commissioner, (now Chairman) Douglas, of Protective and Reorganization Committees. To a great extent Chapter X of the Chandler Act is the result of the recommendations which the Commission made to Congress on the basis of that study and investigation. Hence it is in a real sense a culmination of substantial parts of the Commission's reorganization program. I must add that the Commission has been privileged to assist and cooperate with the Judiciary Committees of the House and Senate in the drafting and revision of Chapter X of the Chandler Act.

II

Since in its current report the Committee on Administrative Law of this Association has seen fit to comment upon the Securities and Exchange Commission, I feel that it is appropriate for me to comment upon that report. In it the Committee, of which Dean Roscoe Pound is Chairman, alleges that administrative bodies tend to make decisions on the basis of preformed opinions and prejudices; that administrative investigations "too frequently set out to make a case", and that often the reports of such administrative agencies "are not findings growing out of the facts objectively ascertained, with a guarantee of objectivity in that both sides were presented by representatives of each, but reports supported by gathering and marshalling all that can be said on one side, with at best a perfunctory concession to appearances by a public hearing not infrequently carefully staged with an eye to the predetermined result." To illustrate this point, your Committee quotes with approval an excerpt from an article in a law review which criticized as unfair the Reports (to which I just referred) made by the SEC with respect to Protective and Reorganization Committees.

Thus your Committee said, in effect, that SEC, in its Reports, was acting in a biased manner, and had conducted the hearings on which those Reports were founded so that they were "at best a perfunctory concession to appearances" and were "carefully staged with an idea to a pre-determined result." Other disinterested persons, actually acquainted, as a result of first-hand observations, with the activities of the Commission, have reached different conclusions as to the fairness of the SEC.

It is proper, therefore, to ask whether the members of the Committee of the American Bar Association, before thus making adverse findings on those reports of the SEC, themselves employed "any guarantee of objectivity", so that their findings "grew out of the facts objectively ascertained." In other words, did they observe the very standards of fairness which they purport to find absent in the work of SEC? To do so, to avoid the use of a "pre-determined result", it would have been necessary for the Committee to do the following: (1) to read the seven large printed volumes of the Reports of SEC on the subject of Protective and Reorganization Committees, (2) to compare those reports with the 18,000 pages of the testimony

at the hearings on which those reports were based, and (3) to make appropriate inquiries. Only thus could the Committee have adequately determined whether it would be justified in making statements to the effect that the SEC reports were biased, unfair, and not derived from facts objectively ascertained.

Now, I know that the Chairman of the Commiteee, Dean Pound, is a voracious reader, in almost every language (including, I believe, the Scandinavian), but I gravely doubt whether he and the other members of his Committee, performed that task, to which I have referred, which was indispensable to a fair appraisal by them of the SEC Reports. If they had done so, they would have found, for example, that where there were public hearings, full opportunity was given for counsel to be present and to put questions to the witnesses. In the 7th volume of the Commission's report on Protective Committees and Reorganizations there was one instance of a chapter based, not on public, but on private hearings, and to avoid any unfairness to the company there discussed, that portion of the report was submitted to its counsel before it was printed and their comments thereon were included in the Commission's report.

I venture to suggest that those leading members of the Bar who glibly criticize Government officials for lack of fairness, themselves owe the Government officials and the public the duty to exercise fairness. The word "critic", says the dictionary, means a judge. One who acts as a critic is, then, exercising a quasi-judicial function. Had the Committee acted with appropriate fairness, it would have found that the lawyer who made the adverse comments which it quoted with approval, had been a witness in the hearings before the Commission, upon which its reports were based, and had been given full opportunity at those hearings to make such statements as he chose with respect to his conduct in the reorganization proceedings which were considered in those hearings. The Administrative Law Committee might have suspected that perhaps the adverse comments of that lawyer were stimulated by the fact that the Commission, in its report, after quoting from that lawyer's testimony, reached conclusions that it should recommend to Congress legislation such as the Chandler Act and other legislation which might, in the future, prevent a repetition of those reorganization practices in which that lawyer had engaged, on the ground that experience showed that those practices were not in the best interests of investors.

In making that comment I want it to be clearly understood that the Securities and Exchange Commission was not criticizing, and that I am not criticizing, as immoral or wicked, those practices which the Commission found to have been injurious to investors. To make a moral condemnation of such past evils is to indulge in hindsight. The purpose of the Commission was not morally to judge what men had done, but to consider what men had done, often in the belief, at the time, that they were acting properly, often in accord with what was then the customary practice in reorganizations. The purpose of the Commission was, I repeat, not to condemn morally those past acts, but to assay the social consequences of those practices, and, having done so, then, in the light of what were shown to have been adverse consequences, to urge that prophylactic legislation be enacted which would prevent the recurrence of such practices. The objective of the Commission, was, in brief, to help to create new standards of conduct, so that, in the future, *after* the enactment of new legislation which the Commission recommended, those practices would be improper.

Inasmuch as those hearings occurred and those reports of SEC, which your Committee criticized, were prepared before I became a member of the SEC, my resentment at that most unfair criticism cannot be ascribed to personal pique. No, my resentment arises because your Committee's report defames Chairman William O. Douglas who (as I have said, and as is well known, and as the reports themselves disclose) conducted or directed those hearings and wrote or supervised the writing of those reports. I have known him some eight years and worked with him intensively some six months. A more honest, fair-minded man never lived. Patient justice is a quiet passion with him. I have seen him spend hours reading and re-reading the pages of the record of a hearing, to avoid doing any slight injustice to a citizen. In his dealings with the Stock Exchange he has been patient and fair, but firm. Richard Whitney may well have been disgusted with Douglas' sense of justice. But Bill Douglas has won the entire respect and the eager cooperation of those who today manage the Stock Exchange. As a member of this Association, I earnestly suggest that this Association owes it to itself to see to it that those remarks, which cast a slur on the character of Chairman Douglas, be stricken from the report of its Committee on Administrative Law. They cannot have been deliberately false. Doubtless the Committee will be glad to have such a careless but gross misstatement expunged from the record.

The SEC has been intensely interested in improving the operation of our economy under the profit system so that that system can survive, in order that America can flourish as a democracy within the frame-work of the profit system. Radical critics of our profit system insist that it unavoidably involves practices which run counter to the welfare of the people. The answer to those critics is not merely to deny the criticisms which they make, but to prove by action, not by mere angry denials, that practices gravely inimical to the welfare of most Americans, are eradicable and can be extirpated without departing from the profit system.

Whenever legislation designed to such an end is proposed - legislation designed to raise the standards of conduct with the purpose of eliminating aspects of the profit system which have proved seriously injurious to a large majority of our citizens - there are those who (often in entire good faith) assert that the suggested improvements are so extensive that they will make impossible the survival of the system itself. I have but to recall that, when the Securities Act was first enacted, many outstanding members of the bar asserted that responsible directors of responsible corporations would never thereafter be willing to take the risk involved in the flotation of securities. At the time I commented to some of those lawyers that, in magnifying those risks to their clients by calling to their attention the most extreme possibilities, they were doing much the same as a lawyer would do if he were to advise a client, about to become a trustee und a will, of all the most extreme possibilities of liability on the part of such a trustee, directing the attention of his client to cases, which can of course, be found in the books, in which trustees had been held liable for large sums. If all lawyers were thus to advise their clients with respect to the possible legal contingencies, at common law, attending any kind of business activity, they would so frighten business men that business activities would cease. I was reminded of the fact that when I was some five years old, my father told me that my tongue was wet, and that my shoes were full of feet, and how, for several weeks, I was in a state of anguish, when I discovered that what he said was true.

The dire results which were predicted as the inevitable with the enactment of the Securities Act have not materialized. And some of the very lawyers who made those dire predictions are now engaged in the lucrative practice, pursuant to that legislation, of registering millions of dollars of securities; many of those mistaken Cassandras are present at this meeting of the American Bar Association.

In the hearings on the Chandler Act, eminent counsel argued that the provisions for SEC examination of reorganization plans would so delay reorganizations as to be injurious to investors. Parrot-like, they repeated the statement that railroad reorganizations had been disastrously delayed as a result of the provisions of Section 77, requiring hearings on reorganization plans before the Interstate Commerce Commission. One eminent lawyer, well experienced in all types of corporate reorganizations, expressed himself with peculiar emphasis to that effect in the pages of one of our leading law reviews. He did not call attention to the fact that in July 1935 he had appeared before the Interstate Commerce Commission as counsel for one of our great railroad systems and had filed a plan of reorganization of a character certainly not required by Section 77 or the Interstate Commerce Commission: For nothing in Section 77 compelled him to present, as he did, a plan under which the reorganized company would issue many millions of dollars of new bonds imposing fixed interest obligations, when the plan itself disclosed the fact that in the first year after the company was reorganized - if it were reorganized pursuant to that plan - it could not possibly meet the interest charges required by that plan, and would need to borrow immense sums for essential needs in order to enable it to pay interest on its new bonds. Such a plan was seemingly unsound and there could have been little serious hope that it would succeed. So that someone might perhaps infer that that eminent counsel did not actually expect that the plan would be approved, but proposed it for purposes of delay. Such an inference cannot be verified, and would therefore perhaps be unfair. But the proposed borrowing of funds, which would ensure the payment of interest, depended upon a commitment from a lender, which commitment expired at the end of the year 1935.

And the record affirmatively shows that the counsel for the Debtor (the eminent gentleman who has complained that the injection into railroad reorganizations under Section 77 of the I.C.C. has caused unwarrantable delay), twice before the reorganization had progressed very far requested the Interstate Commerce Commission to delay and adjourn hearings on his plan, and that one of his associates, in the spring of 1938, admitted that "reorganization is now practically impossible" and asked the Commission, as an alternative to further postponement, to find that "no plan is feasible at this time."

Counsel for the mortgage trustee, in that same matter, recently stated that "right after the close of 1936 economic conditions took a decided turn for the worse and uncertainties of unusual nature appeared." The same counsel stated that a plan of long term adjustments "was presented for the first time in 1938", and that, even at that date, it was "problematical whether any permanent plan can be constructed from the limited material at hand".

It would seem too clear for words that, if anyone was to blame for the long delay, it was the eminent critic of the Interstate Commerce Commission, and not the Commission.

The eminent lawyers who phonographically repeated such criticisms of delays caused by the intervention of the I.C.C. under 77, never directed attention to the fact that there were several railroad companies which, *prior to the enactment of Section 77*, had gone into *equity receivership* and have not yet been reorganized, - yet, obviously, in those cases, the companies were not subject to the provision of Section 77, and there was and could be, no need for action by the Interstate Commerce Commission with respect to a reorganization plan. The plain truth of the matter is that a variety of economic circumstances, having nothing whatsoever to do with the legal aspects of reorganization, have prevented the reorganization of those railroads which got into difficulties as a result of the depression.

While the Chandler Act was pending a well-known lawyer addressed a memorandum to the Senate Committee predicting that monstrous delays in effecting reorganization would result. He cited, as illustrative, delays which had occurred in connection with utility holding company reorganizations as a result of the provisions of the Holding Company Act requiring the Securities and Exchange Commission to pass upon utility reorganization plans. In my office he explained to me that he was referring to a certain case then pending before the S.E.C. But when the reorganization plan in that very case was recently on hearing before the Commission, the counsel for the reorganization committee voluntarily made the statement, of record, that such delays as had occurred were due to the careful scrutiny of the plan by the Commission's staff, and that the recommendations which the staff had made (all of which, with one exception, were adopted by the reorganization committee) had led to invaluable improvements of the plan, so that, he said, the delay had been well worth while.

Delays are not inherently desirable or inherently evil. If a thirsty man is delayed in drinking what he thought to be a glass of water, but which a friend prevented him from drinking because it contained noxious poison, no one could warrantably say that the delay was undesirable. Inspection of meats by Government officers doubtless cause delay in meat packing and canning, but the health of the American people is surely worth that kind of delay. Speed in reorganization, if it involves great loss to investors, is surely not a blessing. To emphasize speed and to decry all delay in reorganization is the equivalent of attempting to ascertain the worth of a corporation by looking at its gross assets and objecting that a scrutiny of its liabilities will cause needless obstruction and waste of time. It is the net worth of making haste slowly in reorganizations that must be judged.

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