CHAPTER XVI

THE NEED FOR REFORM IN CORPORATE REORGANIZATIONS

This is an address delivered in June, 1937, before a convention of the National Association of Credit Men in Chicago. Although it is primarily a discussion of the various reforms embodied in the then-pending Chandler Bill, [FN 1] it constitutes in effect a brief summary of the findings of the Protective Committee Study with respect to corporate reorganizations.

From the viewpoint of investors, reorganization is a critical process. By that process values are either salvaged for investors or appropriated, in whole or in part, by reorganizers. As a result of that process, the business is subjected to a healthy reconditioning influence and launched on a sound and conservative basis, or the new business emerges carrying within it the causes of the breakdown of the old. The integrity and efficiency of that process are the investors' only protection. They are largely helpless to help themselves. They need minimum assurances that those who actually, though perhaps not legally, determine their fate are held to fiduciary standards. These matters are important not only from the viewpoint of prevention of capital exploitation and waste; they are also important in restoring confidence in the integrity and honesty of the reorganization process and in the credit structure of corporations. These are especially important in view of the aura of disappointed hopes which surrounds the average reorganizations. There is, to be sure, no magic formula in law or in business to restore or create values where none exist. But there are constructive measures which can go far toward curbing excessive practices, which can prevent racketeering groups from seizing on reorganization chaos to exact tribute, which can create confidence in the integrity and honesty of the reorganization procedure. Investors will not be satisfied with less. Government cannot meet its responsibilities with less. In final analysis it is government which creates the courts whose imprimatur reorganizers eagerly seek for their plans. The least which government can do is to require that the instruments of government not be exploited for the benefit of reorganizers and to the detriment of investors. Until that challenge is met, government has not done its task. Until that challenge is met, legitimate business continues to suffer from the disintegrating influences of irresponsible reorganizers. The effects on our capital markets and on our financial processes are profound.

For these reasons, it is important for us to consider the pending proposal, in the form of Section 12 [FN 2] of the Chandler Bill, to amend Section 77B of the Bankruptcy Act. [FN 3] Section 77B, as well as the pending amendment, was drafted primarily for the corporation which is publicly owned—that is to say, which has securities outstanding in the hands of the public. The Chandler Bill makes it

clear and unambiguous that businesses which need to be liquidated, or which can obtain adequate relief by composition proceedings under other provisions of the Bankruptcy Act, cannot seek reorganization under Section 12. These provisions are generally adequate to take care of the small or individually owned business in financial distress and should go far toward eliminating the so-called "hot dog stands" from the shelter of this complicated reorganization statute. But increasingly within the past generation, the publicly owned corporation has preempted the fields of manufacturing and wholesaling; and it has made substantial inroads in other fields including the retail field. The protection and preservation of the public stake in these enterprises are of chief concern to the health and well-being of our national economy.

The Stake of Business in Sound Reorganization

Business has a stake in the conservation of investors' funds. Business is concerned that investors' funds be available in abundance to supply it with capital for development and growth. And business has a direct and selfish concern that management be efficient and that its stewardship of corporate assets be honest and prudent. Efficient and prudent corporate management, sensitive to its high obligations, is essential to success and progress. If the management of corporations is conducted in accordance with the highest traditions of trusteeship, the result will be increasing vitality. The all-important sources of capital—necessary food for such vitality—will be conserved and multiplied; capital will not be squandered in reckless schemes or in operations profitable only to a few insiders. Investors will get a square deal—and getting a square deal, they will continue to invest, and their funds for investment will multiply. At the same time, investors will have the wherewithal to pay their debts and to make new purchases of the goods which invested funds produce. Efficient, far-sighted, and faithful corporate management will also result in a square deal to labor. And in turn labor will have the funds to pay its debts and purchase more goods. This may be an oversimplified statement. But in its simplicity lies an abiding truth, that the integrity and competence of management are a *sine qua non* of our national vitality.

A Thorough Appraisal of Management

The proposed amendment of Section 77B should have an effective influence within its limited scope, in encouraging and promoting efficient and faithful management of corporations. Primarily, it is directed toward obtaining fair and thorough reorganizations of distressed corporations—reorganizations which will salvage for creditors and investors, in fair proportion, whatever there is of value in the enterprise; reorganizations which will not be oppressive to those who have devoted themselves to its success; and reorganizations from which the corporation will emerge with new health and vigor under a management which

either has accounted fully and has been found not wanting, or has given way to a new management. Secondarily, this amendment, by providing for a thoroughgoing process of reorganization, under judicial supervision, in which an accounting must be made for stewardship and in which an opportunity is afforded to all interested in the enterprise—investors, labor, creditors, and others—to be heard, will exert a generally beneficent influence upon corporate management. This amendment, if it becomes law, will constitute notice to corporate managers that when reorganization comes, they will stand or fall upon the basis of their record. Honest and competent management will have nothing to fear; but those who have played recklessly with other people's money will. The Chandler Bill requires that in every reorganization proceeding a disinterested trustee shall inquire into and report to the court upon the past conduct of the business, including the activities and achievements of the management. No longer will management be able confidently to rely upon the unlikelihood of inquiry and the likelihood of perpetuation in control through many defaults and reorganizations. [FN 4] On the contrary, throughout the life of the corporation, they will have to conduct themselves prudently and faithfully, so that if default comes and they seek reorganization their record will bear detailed scrutiny.

Under Section 77B as it now stands, there is no duty, and no real opportunity, to make an examination and appraisal of the management of the debtor. The debtor may remain in possession of the property; or one of its officials may be appointed trustee for the debtor. As a matter of fact in over a majority of cases the debtor remains in possession, a strange and novel privilege for debtors in a bankruptcy proceeding or even in a receivership proceeding. The debtor may propose a plan without conference or negotiation with any of the persons whose money is involved. No other person is so privileged. Investors must get 25 per cent of a class and not less than 10 per cent of all classes of security holders in order merely to propose a plan. If the debtor can get the consent of 66 2/3 per cent of each class of creditors and of a majority of each class of stock, and approval of the court, its plan becomes effective and binding upon all interested parties. By use of this machinery, perpetuation in control of the company's assets, absolute power over the funds of investors and the fate of creditors, is relatively easy for the debtor, with the aid of its investment banking and other allies, to gain. [FN 5] With the debtor so securely in the saddle, there is no possibility of genuine appraisal of the management's virtues or shortcomings, of its honesty or culpability, or of the desirability of continuing it in control. Anything that a creditor can do in a 21 (a) examination [FN 6] of the affairs of a large, publicly owned corporation is apt to be superficial and ineffective. By use of the present machinery, reorganization can be effected, with sacrifices perhaps only on the part of investors. The debtor continues in power perhaps without sacrifice or change in personnel or policy, and with practical immunity, whatever be its acts of omission or commission.

Now what is the debtor? The legal answer is simply a person known to the law as a personality separate and distinct from those whose money is invested in it and those who manage it. But however necessary and useful this legal answer may be, it cannot blind us to the fact that for purposes of reorganization the debtor is the management. To give the debtor a status is to give it to management. To allow a debtor to propose a plan is to allow the management to do so. To place barriers in the way of proposals of plans by investors and to place none in the way of the debtor is to give management a special privilege and prerogative over investors. Why should management *qua* management receive this preference? The company having failed, it would seem more natural and equitable, if special privileges are to be awarded, to award them to the real owners of the enterprise.

To be sure, there are occasions upon which this procedure of leaving the debtor in possession may work and has worked without hardship or injustice. The corporation may have been overwhelmed by misfortunes beyond the control of its management. We all know that there are honest and nonculpable failures, where the management has been efficient, prudent, and faithful. The plan of reorganization which it proposes may be fair and wise. But there are no fixed criteria by which these matters can be determined. Such issues can be resolved only after, and not before, study and investigation. They cannot safely be assumed. Or again, the debtor may find itself in that rare sort of reorganization where the creditors and stockholders may be organized in effective, bona fide groups. In these comparatively rare cases, changes in the management's plan may be secured or imposed by the court or at the instance of groups of creditors or investors; or what is still more unusual, the record of the management may be carefully examined. It may be made to account for its past activities; and its qualification to continue in control may be closely appraised.

But, generally, this is not what happens. Management usually remains in dominance of the situation during and after reorganization, as before. It meets only casual scrutiny, at most; its plan is adopted; it does not account. Good, bad, or indifferent management continues in the saddle. It is beyond question that in many cases which are matters of public record this state of affairs has resulted in hardship and loss. And I believe it equally beyond question that the present method promotes and induces superficial, surface reorganizations which leave uncured dangerous diseases in the corporate body; and that this superficiality of method thwarts the objective of reorganization—the production of a fair and equitable plan and the launching of a vital business enterprise under able, faithful management.

The importance of this problem of management is difficult to overemphasize. A corporation cannot exceed in quality the character of its management. This is the reason why reorganizers commonly insist that management should not be disturbed even on the advent of default or insolvency. They urge that the

paramount importance of management makes it essential that all efforts be made to have management free from the practical limitations and restrictions of supervening bankruptcy. That philosophy is premised on the theory, more often than not born of selfish interests and desires, that those in control should stay entrenched, so that the least possible disturbance will result. But from the viewpoint of investors it is paramount that those in control stay entrenched only where they are competent and faithful stewards. This latter philosophy requires that reorganization provide for a careful scrutiny and appraisal of management. Since management is so all-important, a reorganization, which does not inquire into the quality and character of corporate management, is indeed superficial. It is then not rehabilitation; it then falls short of dealing with the fundamental, all-important part of the corporation—its management.

Let me emphasize that genuine opportunity for appraisal of management, and for displacing it if it is unacceptable, usually comes, if at all, only upon reorganization. Management is by and large self-perpetuating due to its undoubted monopoly over the proxy machine. Furthermore, in the ordinary history of a corporation, investors are likely to get only formal information, if they get anything. They frequently lack information upon the basis of which they can form an intelligent judgment of the policies, good faith, and skill of the management. They are the abject subjects of an authoritarian government which has virtually complete control of the information they get, and against which they can accomplish little. Generally speaking, it is only when this authoritarian government admits defeat and appeals to government—*i.e.,* the courts—for reorganization, that an opportunity is afforded for examination of its policies and practices, and for an intelligent, informed, and effective decision to continue it in office or replace it.

It is not a simple matter, under the existing system, to make sure that in reorganization there will be this examination and appraisal. The management and its investment bankers exercise control over the sources of information; and they are in a strategic position, directly or indirectly, so to dominate the court proceedings, the activities of protective committees, and the reorganization plan, as to make thoroughgoing examination and appraisal difficult, if not impossible. [FN 7] It is for this reason that examinations under Section 21 (a) of the Bankruptcy Act, though sometimes salutary, have so frequently proved inadequate. The quality and integrity of management cannot be discovered by asking the corporate officers about it. Generally, it cannot even be discovered by an audit of the company's books. To make an intelligent judgment concerning it, one must have complete and unhampered access to all its records; and one must become thoroughly familiar with its business details. So long as the management is in control, it is futile to expect that a genuine accounting for its past activities can be had, or that its record can be thoroughly analyzed and appraised.

The Chandler Bill remedies this deficiency. It makes it certain that in every reorganization under its provisions there will be a thorough inquiry into the quality of the corporation's management. It makes it certain that investors will have access to all facts relating to the corporate management and to the administration of the funds which they entrusted to it. It accomplishes this by requiring the appointment of an independent, disinterested trustee in every case. This trustee, an officer of the court, becomes upon appointment the nominal and legal head of the corporation. He has free access to its books and correspondence; as nominal head of the corporation he can become thoroughly conversant with the details of its business; he can become acquainted with its employees. He can, with permission of the court, institute suit. He can, both theoretically and practically, check on the policies, contracts, and practices of the company and require changes where changes appear necessary. He is, in short, in a position to become thoroughly familiar with the business—not by a hit-or-miss process, but through daily association in a position of responsibility, and through the study and analysis which he is required by the bill to make. And on the basis of such familiarity he must report to the court and the investors, facts and judgments upon the basis of which they can intelligently decide the future of the company. All these are old powers which have always been vested in the trustee by the Bankruptcy Act. Nothing here is novel. In fact, to any bankruptcy student it is extremely novel not to have a trustee appointed but to leave the debtor in possession.

There are tasks to be done in reorganization which it is absurd to ask the management to undertake. It is absurd to expect the management to require itself to account for past acts; to investigate itself; and to appraise its own fitness to continue. A management—no matter how reckless—cannot be expected to oust itself from power. And it is absurd to expect that if the debtor or one of its officers is made the appointee of the court to do these things, that they will be well and thoroughly done. Elementary knowledge of human nature and only a casual acquaintance with reorganization history would carry conviction of the truth of this observation. Similarly, it is idle to expect that a trustee, affiliated with any one set of interests in the debtor—such as a class of stockholders or creditors, or the underwriter—can or will do a job that is thoroughgoing and impartially fair to all. A trustee who is a stockholder or a creditor, for example, can hardly be expected to take action which may result in invalidating or impairing the worth of the stock of the debtor or of his claim against it, regardless of the advantages of such action to the estate as a whole. A trustee who is affiliated with special interests cannot be expected to recover for the estate assets which those interests have wrongfully diverted or appropriated or to destroy or impair the other stakes which such persons may have in the

enterprise. The record of reorganizations in the past decade and before bears ample witness to these propositions. In short, a trustee charged with the exacting duty of discovering and recovering all assets of the estate—in the form of causes of action or otherwise—must be disinterested. The obvious soundness of this conclusion cannot be obscured by generations of practice embracing a contrary theory.

The Chandler Bill docs more than require an investigation of the antecedents of the failure. It goes further than merely requiring that the plan of reorganization contain provision for fair selection of management of the new company. The Chandler Bill, by reason of the requirement for the appointment of an independent trustee will make these mandates possible of attainment. In other words, it not merely provides that reorganizations shall be thoroughgoing and fair; it sets up machinery and conditions to enable achievement of these objectives.

The objection has been made that the provision for an independent trustee in every case will deprive the estate of the benefit of an experienced management familiar with its problems. This criticism indicates a misconception both of the purpose and of the effect of the independent trustee requirement. The Chandler Bill does not prevent the retention of worthy members of the old management to assist in the conduct of the business while the reorganization proceedings are going on. It expressly provides that the trustee may employ officers of the debtor at a rate of compensation to be approved by the court. All that it says is that the old management shall not be vested with fiduciary powers and duties which it is not shown to be qualified to fulfill. If the members of the old management do not find sufficiently attractive the opportunity to serve their real principals—the creditors and stockholders—at a fair salary fixed by the court, unless the additional opportunities are afforded of covering up possible causes of action against themselves, of controlling the reorganization process, of insuring their retention by the reorganized company (and these are the only opportunities of which the members of the old management are deprived by the requirement of an independent trustee) they certainly have no claim to act in a fiduciary capacity.

The foregoing supply one reason why the provision for mandatory appointment of an independent trustee is the keystone of this program for improvement of reorganization procedure in the interests of investors. But there is another reason, equally, if not more important, which makes the independent trustee provision the most important aspect of the Chandler Bill. By terms of the bill the independent trustee will serve as the focal point for formulation and negotiation of a plan of reorganization. This important function under the present system has been left to the inside few. That normally has meant leaving it to the management and the investment bankers. It should no longer be left in these

hands, since those persons too often have interests conflicting with those of the investors. The content of the plan is the all-important item in the whole proceeding. Its preparation and negotiation should be carefully scrutinized and supervised. Placing this function in the hands of the independent trustee also means that greater opportunity for investor participation in the preparation of the plan can be afforded. Under the bill proposals of plans are not restricted to the favored few; it forsakes the tradition of leaving all of these matters to the insiders. By its provisions any investor can prepare, or submit proposals for, a plan. Thus greater democratization in these proceedings is assured; and more of the investor point of view is injected into them. At the same time the dangers of "town meetings" are avoided by placing on the trustee the duty to head up the formulation of a plan and to report out a plan to the court within a reasonable time. That is to say, the Chandler Bill is designed to cause the independent trustee, as a representative of the court, to play an active role in the formulation and negotiation of plans and to supply scrutiny and control thereof in the interest of creditors and stockholders. The provision for the independent trustee would provide a forum where creditors and stockholders could be heard. In handling the suggestions of proposals for plans, the independent trustee would act in an informal administrative manner. He is made the active head of the reorganization process. In short, vital functions which in the past have been performed by inside groups, or by protective committees seeking personal profit, will be vested in the trustee—with the advice and consent of creditors and stockholders and subject to court supervision. No longer will the basic, all-important phases of reorganization be performed by groups which have a selfish interest to protect and promote. Heretofore these groups have thrived because they have provided leadership for investors where otherwise there would be anarchy; because they have seized the reins and produced action and provided direction—regardless of their destination. Under the Chandler Bill, these functions will be performed by a disinterested person appointed by the court with the opportunity to interested persons to express their views on the appointment.

This unquestionably means that the responsibility of the independent trustee under the Chandler Bill will be great; and unquestionably his power will be substantial. With such power and responsibility, it would be an enormity if the trustee were not required to qualify as impartial. Any less requirement would be a violation of that rule of elementary decency which requires that a fiduciary be free of any interests competitive with those of any persons toward whom he bears responsibility. A disinterested person, fully qualified to act as an officer of the court, can alone be entrusted with such responsibility. Any other conclusion involves approval of the proposition that the debtor can act as trustee for the creditor; and that a man interested in one side of a transaction should be armed with the power of the court in his dealings with persons on other sides of the bargain.

The wisdom and necessity of placing these greater powers and responsibilities upon the trustee is, I believe, beyond question. The record of corporate reorganizations of the past—and particularly those of the recent depression—is not pleasant. It shows the absolute control exercised over reorganizations by the inside few; it shows the financial well-being of investors, and the public sacrificed to the insiders' desires for protection and for further profit. It shows corporations struggling to reorganize for many years; returns denied to investors; labor injured, and business damaged by the resulting uncertainties and instability. It shows that these delays, these futile prolongations of the agony of reorganization, were frequently due to deliberate sabotage by a group which had something to gain and was unwilling to compromise, or to the lack of motive power necessary to draft a feasible plan and procure its acceptance. The record also shows, with overwhelming proof, that plans of reorganization were frequently dictated by a single interest—by a closely knit inside group; primarily in the interests of that group and of dubious wisdom so far as interests outside the inner circle were concerned. These conclusions have indeed become so generally accepted and so widely known as to be commonplace. These conclusions indicate that something must be done to provide impartial, capable control over reorganizations; to produce impartially fair and sound plans of reorganization; and to provide effective motive power which will lead to the production and consideration of reorganization plans. The Chandler Bill is designed to do these things for bankruptcy reorganizations; and it does them for the most part through a disinterested trustee appointed by the court.

These functions of the independent trustee are difficult to overemphasize. They have profound philosophical and practical aspects. To summarize briefly: In the first place, the trustee would be required to assemble the salient facts necessary for a determination of the fairness and equity of a plan of reorganization. He would assemble the necessary ingredients, so to speak, of a plan. For the first time such information would be available to the court and the investors as a routine matter. On the basis of such information, the court and the investors could intelligently decide whether or not proposed plans were fair, equitable, and sound—whether assets were being wasted or overlooked; whether there was a complete accounting for the old venture before the new one was launched; whether the old management should be restored to power; whether the allocation of assets, earnings, and control was fair. Through an impartial trustee, such facts could be assembled and appraised. Only through some such method could the court be in a position to exercise an informed judgment and to afford a critical scrutiny and supervision of the estate at all times. Without its own agent being fully informed the court would remain too much at the mercy of the competence, vigilance, and integrity—or lack of them—of those who happened to be active in the case. In sum, the independent trustee would put the court in a position to perform its functions adequately.

In the second place, it is necessary to have an arm of the court perform the functions which the Chandler Bill places on the independent trustee, if there is to be greater democratization in these proceedings. That the trend toward democratization is essential and desirable in the interests of investors, few will deny. But no significant progress can be made toward that end unless machinery is provided in these proceedings whereby investor participation can be provided, the investor viewpoint can be articulated, and the investor interest be represented. It would be idle for example to provide that any bona fide investor may propose a plan without likewise providing machinery for handling those proposals when they are made. It would be idle to provide that protective measures be adopted without likewise providing the means whereby such protection can be afforded. It would be futile to profess a desire to return these bankrupt estates to the real owners without providing the mechanism whereby the real owners could come into possession and power. In other words, democracy in reorganization cannot be expected to work unless there is power and responsibility in the hands of a qualified representative of investors. Otherwise chaos and disorganization would result. To state it otherwise, any endeavor to effect greater investor participation and opportunity will remain largely idealistic and academic, until and unless the investors are afforded a "focal point" for organization. In the words of reorganizers, there is an essential need in these cases for a "spark plug." Investors, no more than re-organizers, can function without one. Such a device as the independent trustee furnishes them with one. Without it, the desired power will not lie in investors' hands; it will rest where it always has, outside the proceedings in the hands of reorganizers. For that reason, if there is no requirement for an independent trustee the other parts of the Chandler Bill begin to crumble.

In the third place, the device of the independent trustee gives assurance that the great power hitherto exercised outside the proceedings will be exercised within the proceedings by and for the benefit of investors. There are great increments of value inherent in that power. [FN 8] Those who have possessed it in the past have been able to employ it advantageously to serve their own ends. That power means control; control means profits. There is not only the business patronage incidental to every reorganization; there are also valuable emoluments within reach of those who emerge with control over the new company. This is not theory; it is a fact. Those who have shared the spoils of reorganization know how valuable such power is. The central problem in reorganization is to see to it that that power is not exploited by reorganizes but appropriated for the benefit of investors. With that power resting outside the court, the difficulty of employing that power for the benefit of investors is increased many fold. So long as it can be governed by the conventions of a few dominant parties, there is great likelihood that that power will not inure to the benefit of the estate. There is greater assurance of its being done if it is placed where it belongs, in the court. It then becomes an asset, so to speak, of the estate. No such shift in power has

resulted without a great effort. It will always be bitterly opposed. But I suggest to you that such a shift in power, inherent in the device of an independent trustee, is basic and fundamental if the reorganization system is to be reconstituted in the interest of investors. These are the profound philosophical and practical aspects of the Chandler Bill. In comparison the other proposed reforms are and can be only indirect toward protection of investors.

The Opportunity to Appraise a Proposed Reorganization Plan

I have discussed these provisions of the Chandler Bill at such length because I sincerely believe in their great importance. I do not wish to leave with you the impression that this is the sole modification of importance which the bill proposes. In many other respects, the bill embodies provisions which I believe will be a great boon to business and investors alike. It is impossible for me to discuss all of them in the short time left to me. I think it is important, however, to comment briefly upon a few.

In a variety of ways, the bill seeks to make it possible for courts and investors to exercise more intelligent and better-informed judgment concerning the merits of reorganization plans. Under the present system, the situation is so completely controlled by the insiders that the hands of persons whose money is at stake—and often even the hands of the court—are tied. No matter what an investor may suspect, or what facts he may know, he often has little opportunity to act upon them. Likewise, the amount of information the court may have, and its own opinion of the inadequacies of the plan of reorganization may be of little practical use. Reorganization plans are frequently presented to the court after a long period of negotiation, and after time, effort, and money have been spent in obtaining the necessary consents from creditors and stockholders. Courts are then extremely reluctant to withhold approval of a plan—or to require its modification. If the court disapproves the plan or requires substantial amendment, the time, effort, and money of the reorganizers may have been spent to no avail. A new plan may have to be negotiated; creditors and stockholders may have to be resolicited. Waste and additional expense result.

Experience and the decisions of the courts themselves show this to be true. When a plan of reorganization is presented to the court with the approval of two thirds of the creditors and a majority of the stockholders, that plan is virtually approved. The act of approval by the court, in such cases, is likely to be little more than a formality. The court is reluctant to cause additional delay and expense; it cannot, under the present scheme, be sure of its judgment concerning the plan, because it has not the time or facilities to make the necessary detailed inquiry. Therefore, it accepts the fact that a large percentage of creditors and stockholders have approved it, as raising a strong presumption of fairness. Now, most courts probably realize that the consent of creditors and

investors to a reorganization plan is frequently not the expression of a considered, matured judgment; that sometimes it is approval obtained in an oppressive way or merely the evidence of a habit of executing proxies to the management; and sometimes merely the result of bitter realization of the futility of opposing the program of the insiders. But the stage has been so set in favor of the insiders that the court is content or under great practical compulsion to approve the plan to which the necessary consents have been obtained. [FN 9]

The Chandler Bill seeks to change this. It seeks to vitalize the consent of creditors and stockholders and the approval of the court. It seeks to make them more significant. It seeks to make it possible for these acts which put the seal of approval on a plan of reorganization, to be the expression of informed judgment freely exercised.

In the first place, it prohibits the solicitation of consents to a plan until after the court has approved it as fair and equitable and feasible. The court will not be asked to put its imprimatur on a plan which comes to it only after it has already been approved by creditors and stockholders. It will have a real opportunity to consider a plan which has been reported out by its trustee and to compare that with plans submitted directly to the court by stockholders or creditors. It will then approve for submission to creditors and stockholders such plan or plans as it finds to be fair and sound. Free from any artificial presumption of fairness; free from the overpowering disinclination to reject a plan at a late stage in the proceedings; and aided by full information, a court can make and put into effect careful and frank judgments on the merits of plans. In this respect the Chandler Bill is designed to free the judiciary from shackles which our reorganization procedure has placed upon it. It will liberate the courts to use their power and judgment in favor of investors. It will put an end to streamlined proceedings which sacrifice thoroughness and honesty for speed.

The Right to Be Heard

Further to enable the courts more effectively to perform their functions, the bill enlarges the right of parties in interest to be heard. The debtor, the trustee under an indenture for any securities of the debtor, any stockholder or creditor is given the right to be heard on all matters. They may appear before the trustee or the court; they may give information; they may comment upon a reorganization plan. In short, they are given the right to appear either in defense or in promotion of their own interests and to assist the trustee and the court. Labor unions and employees' associations, representative of employees, also are given the right to be heard on the economic soundness of plans and on provisions thereof affecting the interests of labor. The advisability of this provision is clear. Just as the management has an interest in the enterprise which the reorganization plan may vitally affect, so labor is concerned with the soundness of plans. Their jobs,

their livelihood depend upon a sound capital structure and a healthy business structure. They often receive the direct impact of default, for that often means labor displacement. The employees are likely to be primarily concerned with the economic soundness and feasibility of the plan, so that the current reorganization will not be the forerunner of another disastrous collapse. Consequently, it is highly desirable that the court and the trustee have the benefit of the suggestions and criticism of representatives of employees with respect to the reorganization plan. And, it is only simple justice that these groups, which are vitally affected by the collapse of business and which are essentially concerned with the stability of business, should have an opportunity to express their opinion on the economic soundness of plans and other aspects which affect their interests.

The Place of the Securities and Exchange Commission

There is another important feature of the bill which I wish to mention briefly. This is the provision vesting the Securities and Exchange Commission with advisory power in reorganizations. Its functions are those, so to speak, of an expert, administrative agency which acts in an advisory capacity to the court and thus indirectly to interested parties in the reorganization. It can intervene in and become a party to any bankruptcy-reorganization proceeding. In any case, the court may refer proposed plans of reorganization to the Commission for report; and in cases of national importance—cases in which the scheduled debt exceeds $5,000,000—the court is required to submit such plan or plans as it regards worthy of consideration, to the Commission for investigation and report, before the court approves or disapproves the plan. The report of the Commission on any plan is advisory only; it does not bind either the court, the trustees, or any interested party. There is thus avoided the possible attendant delay and confusion if the power of the courts was shared with an administrative agency. By reason of these advisory reports and intervention of the Commission the court will have the benefit of expert and disinterested advice to aid it in the solution of the complicated financial and legal problem involved in the typical large reorganization. This should fill a long-felt need and be welcomed by both courts and investors. It should provide a further check on the exercise of reorganization powers and give additional assurance that the interests of investors will be served.

"Shopping Around" for Jurisdictions

There are other important aspects of the bill on which, if there were time, I would dwell at greater length. One such is the provision which, in my opinion, will bring an end to the pernicious practice of "shopping around" for friendly jurisdictions in which to initiate and consummate the reorganization proceedings. The wide latitude which the present Section 77B gives to reorganizers in this respect has little justification, in practical necessity. And it is susceptible of great abuse. The

only valid criterion for jurisdiction seems to me to be the company's principal place of business, or the place of location of its principal assets. Selection of any other jurisdiction usually means conducting the reorganization at great distances from the place or places where the corporation does its business. It means putting investors to great expense and difficulty if they wish to appear and participate in the proceedings. It means, as I have said, that inside groups who may be in control of a reorganization are able to search around for the jurisdiction in which they estimate it is least likely, for a number of reasons, that their conduct of the corporation will be examined; that they will be exposed to liability, and their perpetuation in office endangered. These abuses and defects have been met and corrected by the Chandler Bill, in limiting the venue of reorganization proceedings to the principal place of business or the location of the corporation's principal assets, for the greater part of the six months preceding the filing of the petition.

Speculation in Certificates of Deposit

Another significant provision in the Chandler Bill is the one which gives the court power to deny compensation to persons in reorganization proceedings who use the advantages of their favorable inside position to buy and sell securities and certificates of deposit, of the debtor corporation. This has been an evil particularly characteristic of protective committee members. These persons, supposedly acting in a fiduciary capacity as representatives of security holders, have frequently taken advantage of inside information about the affairs of the corporation, which they are in a strategic position to obtain, to speculate for their personal profit. They are in a position to know the course of negotiations with respect to a plan; the favorable or unfavorable developments impending; the likelihood of liquidation on the one hand, or of successful reorganization on the other. They may themselves create these developments. Trading in the securities by these persons, and those in similar positions, is undeniably a violation of their duties and responsibilities to security holders. In penalizing those who indulge in such practices, the Chandler Bill moves toward a much-needed reform.

A New Emphasis

The essence of the amendments to Section 77B incorporated in the Chandler Bill constitutes, first and last, a recognition that reorganization is not solely a legal but a business and administrative problem calling for greater power and more express and specific mandates to the courts. Our reorganization procedure in the past was conditioned by the fact that it took place in court. The fact that the typical reorganization plan was merely an incident of—a sort of appendage to—a conventional receivership had important results. The courts were too prone to regard the reorganization receivership as a lawsuit or litigated matter. Issues of

fact and law were from time to time presented to the court; the court would hear argument and make its decision. The legal issues presented in this fashion, though numerous, were restricted. The courts did not assume broad administrative control over these estates. Some state courts to this day do not feel called upon or entitled to pass upon the fairness of a reorganization plan. The courts, after they began to pass upon reorganization plans, frequently seemed to take the view that if there were nothing illegal or oppressive in the plan, they would approve it. As to the subtler questions of fairness and of soundness and feasibility of a plan, they would frequently make no decision. To the activities of committees and other agencies purporting to represent security holders they would be apt to give scant or only superficial attention. They acted preeminently in a judicial role; administrative functions were rarely assumed. This is no criticism of the courts. The machinery was so geared and the procedure so designed that the courts could hardly do more than attempt to prevent illegality or the grosser forms of inequity.

Under 77B there was something of a shift in emphasis. The court was given broader and more express powers. But the improvement was slight, although clear. The court was still largely the judge and arbiter of issues, carefully selected and nicely framed so as to present a justiciable matter. The life, the essence of reorganization flowed in other channels. It did not come to the court. What came to the court were particularized, desiccated problems. The debtor frequently remained in possession of the property. No method was provided for conveying to the court a vital impression of the corporate situation and problems. The reality of reorganizations was something that took place out of court. It was dealt with by the groups in control—generally the management and its investment bankers—who frequently had their own interests to serve.

With this system in operation, the courts could do very little. They could offer investors and creditors little protection. They were crippled by a reorganization system which was based upon the theory that reorganization was a procedure wherein the legal matters were left to the court, the business matters to the re-organizers. Obviously reorganization is not strictly a legal problem. It is a business and administrative matter of great complexity. And even though the courts wanted to exercise a broader conditioning influence over the whole process, they frequently were in no position to do so, since they did not have nor were they in a position to get the facts. The Chandler Bill recognizes this weakness in the system. It makes it necessary for the courts to deal with the business and administrative problems of reorganization. It makes it possible for the courts to do so by giving them administrative and expert assistance. In that way it vitalizes the role of the courts. In a variety of ways it brings the court into association with the facts of the business; it assures that the court will be fully informed; it places in the court power to give impetus to a reorganization—to see that a plan is drafted and that moves are made to get the support of investors;

and it gives the court genuine power to see to it that the reorganized company is provided with good management and a sound capital structure. These are necessary and important changes if confidence in our reorganization system is to be restored. In the public eye the courts already have the responsibility; what the courts need are ample powers commensurate with their actual or ostensible responsibility. It would be error to conclude that these powers are adequate by measurement of them in terms of a procedure designed for simple litigated matters.

In the ways I have mentioned, and in others which there is not time now to mention, the Chandler Bill provisions on corporate reorganizations will, in my opinion, promote abler, more intelligent administration of estates in reorganization and at the same time make for greater democratization in these proceedings. They give for the first time in reorganization history, full and definite recognition of, and a significant status to, the widespread and national investor interest in such proceedings. And they supply assurance that the new venture—the ultimate end of the entire process—will be soundly, economically, and expeditiously launched.

[FN 1] "House Report 8046." A bill to amend the National Bankruptcy Act. Enacted June 22, 1938. (Public No. 696—75th Congress, 3d Session.)

[FN 2] Now Chapter X of the Bankruptcy Act, as enacted June 22, 1938. (Public No. 696—75th Congress, 3d Session.)

[FN 3] The Securities and Exchange Commission had submitted a series of recommendations for amendment of Section 77B. S.E.C. Report, Part I at 898-903.

[FN 4] S.E.C. Report, Part I, section i; Part II, sections ii, iv.

[FN 5] S.E.C. Report, Part I, at 290-312.

[FN 6] Section 21 (a) of the Bankruptcy Act provides that, upon order of the court, the debtor's officers may be examined at a hearing concerning its acts, conduct, and property.

[FN 7] S.E.C. Report, Part I, section ii.

[FN 8] S.E.C. Report, Part I, section i.

[FN 9] S.E.C. Report, Part I, section ii.