Remarks of Robert A. McDowell, Director Division of Corporate Regulation, before the Regional Administrators of the Securities and Exchange Commission May 6, 1954 at Washington, D. C.

We will spend the balance of the afternoon discussing Chapter X of the Bankruptcy Act, and the Commission's duties and obligations thereunder.

I shall open the discussion by a general outline of our functions under the Act, a statement of how the work is broken down amongst the Regional Offices and within the Commission's staff in Washington, and the number of pending active cases. I shall also try to tell you what the current trend of the Commission's thinking is about participation in such cases, particularly in light of our prospective budget and personnel situation.

As you probably all know the Commission's function under Chapter X is to act as impartial representative of investors and as an expert adviser to the courts. If a federal judge in a Chapter X reorganization case requests the Commission to appear, the statute requires appearance. Moreover, even if not so requested, the Commission may on its own motion request the judge to permit it to appear. Once appearance has been entered, the Commission is a party for all purposes except that generally speaking it cannot appeal on its own motion. If another party prosecutes an appeal, however, the Commission frequently files a brief and argues in the appellant court. As will be mentioned later, with respect to the pending Chapter X reorganization in Pittsburgh Railways, there may be some exceptions from this no appeal rule in the case of a procedural order directly involving the Commission.

It has been the Commission's policy in the past to request permission to participate where a public investor interest is involved, and as a rough guide the Commission has considered that if $250,000 or more of securities are publicly held, this is evidence of sufficient public investor interest to warrant participation.

In addition to actual participation the Commission is required by Chapter X to review certain plans of reorganization and render reports thereon. A judge must submit every plan of reorganization to the Commission which he considers worthy of consideration, if the debtor's schedule of indebtedness exceeds $3 million. In addition he may submit plans if the schedule of indebtedness is less. Where a plan is submitted to the Commission the judge may not approve it until the Commission has filed its report or has notified the judge that it will not file a report and until the expiration of such reasonable time for filing as the judge has fixed. As a practical matter the Commission has written very few of these advisory reports and none has been in process this past winter.

Most of us are generally familiar with what the Commission and its staff does once it has filed notice of appearance in a case. The field staff conducts a full-fledged review of the factual situation

leading up to the reorganization, the relationship between the debtor and its creditors, and its officers, directors and other employees and points out to the trustee and its counsel any facts discovered in the course of this investigation which may provide a basis for reduction of claims against the estate or the prosecution of actions by the trustee against former management or other personnel for mismanagement in their operation of the debtor.

As I understand it, it has been the practice for staff personnel to attend practically every court hearing involving the reorganization, and to participate actively in drafting at least one of the plans of reorganization. The staff has been called upon both by trustees and creditors for advice as to the form the plan should take. Moreover, the staff has actively participated in drafting various of the other court documents involved in the proceeding. It is a fact, which we must all recognize, that many federal district court judges and their clerks are relatively unfamiliar with Chapter X reorganizations and the form of the various court papers in connection with them, and that trustees and counsel frequently are out of touch with current reorganization practice being involved in such cases only infrequently, and that as a result of all this Commission staff personnel are called upon to assist to a much larger extent than would otherwise be the case in the actual preparation of court papers.

It has been the Commission's practice to have most of the staff work done in the field, and since the war this has been primarily in the New York Regional Office, the Chicago Regional Office and the San Francisco Regional Office. At the present time we have at least three persons in the field who are particularly well versed in reorganization matters, namely, George Zolotar in the New York office, Kirk Windle in the Chicago office, and Stevens Tucker in the San Francisco office. The first two are here today and will engage in the presentation later this afternoon. George Zolotar in New York presently has a reorganization staff of 8, consisting of 3 attorneys, 3 analysts and 2 secretaries. Kirk Windle in Chicago has a staff of 6, consisting of 2 attorneys, 2 analysts and 2 secretaries. Stevens Tucker in San Francisco spends only part of his time on Chapter X matters and the San Francisco Regional Office does not have a separately established Chapter X section. Thus, throughout the country we have 13 professional and 4 secretarial personnel engaged in Chapter X work. This has been reduced by some 8 persons since the present Commission took office.

In Washington the Commission's Chapter X functions are handled at the administrative level by the Division of Corporate Regulation. Larry Greene, whom you all know, is an Assistant Director of that Division, and the man charged with the responsibility of maintaining proper liaison with Chapter X personnel in the field. Recommendations from the staff in the field should be sent to the Commission through Larry, who will then assign them, where necessary, to a lawyer and analyst in the Division of Corporate Regulation. That lawyer and analyst may be in any one of the three operating sections of the Division, of which two are engaged primarily in public utility work and the third, headed by Larry, primarily in Investment Company Act work. The staff in Washington, if the situation demands it,

will make up such additional memoranda with respect to a particular case as Larry and I consider necessary, and either he or I will then present the matter to the Commission for decision, if in our judgment Commission action is appropriate or necessary. The Division of Corporate Regulation is smaller now than it was a year ago, having been reduced in size from some 75 at that time to slightly under 60 today. We have had a busy winter in Washington, and the Division has had its hands full with public utility and Investment Company Act problems. There is no reason to believe that this work will let up very much, and therefore the staff in the field should not ask for or expect very much analytical help from the Washington staff in connection with Chapter X matters.

Our current workload in Chapter X consists of some 17 active cases, each of which is briefly outlined in the papers that have been passed out to you. If there is time left later today I plan to ask George Zolotar and Kirk Windle to discuss some of these cases in more detail than is set forth in that brief outline. The active cases include some which have been completed except for recommendations with respect to fees, some which have been completed except for pending litigation against former management for breach of fiduciary duties, and some which involve questions as to the correctness of the trustee's conduct while in office.

In addition to these active cases there are some 25 others in which the Commission has participated but where the bulk of the work has been completed and no final decree has yet been entered because of some minor open matter. These cases should not involve much additional work on our part. Then there is the list of active "watch" cases where there is some public investor interest but due to its small size or for some other reason the Commission is not actively participating. These are "watched" by the staff in the regional offices for unusual developments, but, generally speaking, no court appearance is made.

There is the problem of investigating practically all cases which come to the attention of the Commission to determine whether or not a public investor interest is present and whether Commission participation seems advisable. This aspect of the staff's work often takes a considerable amount of time since it involves a review of each of many situations.

Finally, there are the Chapter XI cases, which were mentioned to you earlier this week by Dave Ferber. At that time, as I understand it, it was suggested that a letter be written to the Clerk of each District Court requesting that the Commission be advised of each Chapter XI filing. I wish to state that through procedures worked out with the Treasury Department, the Commission is being currently advised of Chapter XI filings and that such a letter is not considered necessary or indeed proper in view of the fact that the Administrative Officer of the Federal Courts in Washington advised us some years ago not to write to any of the Federal Clerks to obtain this information.

As I am sure you have heard by this time, the Commission budget for 1954-55 as approved by the House Appropriations Committee is $300,000 less

than our budget for the current fiscal year, and this figure, in turn, is $125,000 less than the budget recommended for the Commission by the Bureau of the Budget. Our reduced budget has resulted in long discussions as to the best possible use of available personnel not only in Chapter X matters but in all other areas in which the Commission operates.

Generally speaking, I believe the present Commission feels that where it is reasonably satisfied that a competent trustee and competent trustee's counsel have been appointed by the court and where the amount of public investor interest is relatively small (but not necessarily smaller than $250,000), we are not to actively participate unless some unusual questions of law are readily apparent. In deciding whether to participate the fact that there has been a recent public offering of securities of the debtor duly registered under the 1933 Act would be an important consideration. In addition, we would consider whether there was any possible equity for the public security holders. In such a case, there would be no point to our participation unless on its face the case presented a real possibility of subordination of prior claims against the estate or recovery against former management or others sufficient in amount to give the public security holders more than a token participation in the reorganized company.

Dave Ferber I believe has already mentioned to you the problems presented by amicus appearances in Section 16(b) cases and in other cases involving interpretations of the Acts which we administer. I have had at least one similar repercussion in a Chapter X case, namely, the one involving the Las Vegas Thoroughbred Racing Association in Nevada. There Judge Foley specifically requested that we continue our appearance and continue rendition of assistance in bankruptcy even though the Chapter X proceeding itself had been consummated. The bankruptcy followed by some 7 or 8 months the consummation of the Chapter X plan. We advised the judge that we considered our duties terminated upon consummation of the Chapter X reorganization and that we considered we had no responsibility or authority under the statute to participate in the straight bankruptcy.

Obviously, when to participate and when not to participate is a very difficult question of judgment, but I think generally I should leave with you the impression that the Commission is not interested in jumping into every case, and wants careful consideration to be given, bearing in mind the situation as I have described it above, before recommendation is made to it by a Regional Office to participate. Once in we should impress the trustee and its counsel with our expectation that they are expected to do their full share of the work for which they will receive adequate compensation. We should not do their work for them, and we should not hesitate to place the drafting burden upon them to the fullest possible extent.

As a parting statement, let me say that the present Commission is not departing from any of the fiduciary standards established in the past for management and trustees, and expects to be advised, as in the past, whenever departures from these standards seem to exist. However, it reserves the right to make the final decision as to whether litigation should be instituted on the basis of alleged departures from fiduciary

standards, particularly where the successor trustee and its counsel have refused to institute litigation. This position would seem to me to follow automatically from our reduced operating force.

Obviously, if there should be a flood of new Chapter X work with 8 or 10 major new cases suddenly thrust upon the three Regional Offices engaged in these matters, serious consideration would have to be given both by the Regional Administrator concerned and by the Commission to such reassignment of personnel as seemed advisable in order to handle the situation. The Commission is well aware of this possibility and will handle it to the best of its ability should the need arise. I too am sympathetic to it, but do feel that lawyers and analysts working for the Commission must be expected to bear a full share of our work burden, and must operate on the principle that in any professional endeavor there are periods when the workload is much heavier than is the case at other times.

I shall now call on Larry Greene, George Zolotar and Kirk Windle. Larry will talk to you about possible new bankruptcy legislation pending before Congress; George and Kirk will discuss some of their pending cases.