PROTECTIVE COMMITTEES AND REORGANIZATION REFORM

The activities of protective committees in corporate reorganization have provoked recurring criticism and sporadic reform. Equity receivership reorganizations were frequently characterized by the failure of protective and reorganization committees to perform their theoretical function of negotiating a reorganization plan insuring the maximum return to their dependent constituents. This circumstance was principally attributable to the subservience of the committees representing the various claimants to banker or management groups, or a combination of the two, whose chief concern was the perpetuation of profitable business associations, the preservation of a particular class of claims in which they were pecuniarily interested, or the whitewashing of past irregularities to save prestige or to avoid legal liability.2

Where so inclined, “inside” groups normally found it a relatively easy matter to consummate a reorganization to serve their own purposes. Since

1. See Rodgers, Rights and Duties of the Committee in Bondholders' Reorganizations (1929) 42 Harv. L. Rev. 899, 907.

they could generally control the conduct of indenture trustees, who even on default could be compelled to act only in the unlikely event of a demand by a substantial percentage of security-holders, "insiders" were usually able to institute consent receivership proceedings at their own convenience. They were thereby enabled to choose the most favorable jurisdiction and to secure the appointment of a friendly receiver who would not interfere with their program. By virtue of advance knowledge of the debtor's affairs and practically exclusive possession of the indispensable bondholders lists, hand-picked "inside" protective committees generally could present to investors a distorted version of the situation long before anyone else could provide a more accurate picture. Uninformed and helpless, the great majority of security-holders generally deposited their claims with such committees under agreements which bound depositors to any plan their representatives might adopt unless onerous terms of withdrawal were followed. Since most courts literally enforced these agreements, independent committees, initially handicapped, found it almost impossible subsequently to gain support. Banker-management committees consequently were generally able to confront the court with a plan previously accepted by a great majority of investors. And although plans prepared under such conditions called for careful scrutiny, the courts, influenced by practical considerations, as a rule readily sustained the fairness of any proposal thus crystallized, and often manifested a tendency to place technical procedural obstacles in the paths of objectors.

5. S. E. C., op. cit. supra note 2, Part I, at 872.
6. Id. at 869.
7. Id. at 876.
8. See Comment (1935) 35 Col. L. Rev. 905, 906; S. E. C., op. cit. supra note 2, Part I, at 877. Motions to compel insiders to disclose their lists met with occasional success in New York. See Comment (1935) 44 Yale L. J. 498. But even where successful the petitioning parties generally acquired them at too late a stage in the proceeding to be greatly benefited. Id. at 504. In In re International Match Corporation a federal court denied such a motion on the ground that the court should remain neutral where two rival committees were competing for deposits. 59 F. (2d) 1012 (S. D. N. Y. 1932), (1933) 42 Yale L. J. 984.
10. See 2 Gerdes, Corporate Reorganizations (1936) §1005; (1933) 42 Yale L. J. 984.
11. See S. E. C., op. cit. supra note 2, at 888 et seq.
15. See Moore and Levi, supra note 3, at 600 et seq.
In addition to the inducement of control, the opportunities that a reorganization afforded for lucrative emoluments in the form of fees and patronage were also a powerful incentive for a protective committee sponsorship by inside as well as other groups.\textsuperscript{16} Despite their theoretical fiduciary capacity,\textsuperscript{17} committees framed oppressive deposit agreements endowing themselves with virtually unlimited discretion, including the right to fix their own compensation and that of their personally selected agents, and to pledge or otherwise dispose of deposited securities.\textsuperscript{18} And committees often took advantage of their familiarity with the probable course of a reorganization to trade in defaulted securities against uninformed investors.\textsuperscript{19}

While these abuses contributed somewhat to the movement for legislative reform of reorganization machinery,\textsuperscript{20} Section 77B of the Bankruptcy Act\textsuperscript{21} was enacted primarily in response to the demands of those who felt that reorganization leadership was properly a function of the underwriters and the management.\textsuperscript{22} From the point of view of this group, majority representatives were unduly hampered and "strikers" unwarrantedly encouraged by the cumbersome procedural machinery of equity receiverships and by the requirement that dissenters be paid in cash.\textsuperscript{23} Since 77B incorporated provisions simplifying reorganization machinery\textsuperscript{24} and binding minorities to plans approved by majorities,\textsuperscript{25} even where such approval preceded the commencement of proceedings,\textsuperscript{26} it enhanced the need for regulating majority com-

\begin{itemize}
\item \textsuperscript{16} See S. E. C., \textit{op. cit. supra} note 2, Part I at 136 \textit{et seq.}, 864.
\item \textsuperscript{17} See (1933) 43 \textit{Yale L. J.} 330, 332.
\item \textsuperscript{18} See Rohrlich, \textit{Protective Committees} (1932) 80 \textit{U. of Pa. L. Rev.} 670, 676-678; S. E. C., \textit{op. cit. supra} note 2, Part I at 888 \textit{et seq.}
\item \textsuperscript{19} See S. E. C., \textit{op. cit. supra} note 2, Part I at 155.
\item \textsuperscript{21} 48 Stat. 911 (1934), 11 U. S. C. §207 (1934).
\item \textsuperscript{22} See Dodd, \textit{supra} note 20, at 1110.
\item \textsuperscript{23} See Swaine, \textit{Corporate Reorganization Under the Federal Bankruptcy Power} (1933) 19 \textit{Va. L. Rev.} 317, 323 \textit{et seq.} (suggesting elimination of mandatory receivers, ancillary receiverships, judicial sales, and cash payments to dissenters). With regard to "striker" activities, see Comment (1934) 34 \textit{Col. L. Rev.} 1303, 1317 \textit{et seq.}
\item \textsuperscript{24} Thus the necessity of a judicial sale is eliminated. § 77B(h). The debtor itself may file a petition and propose a plan. § 77B(a) \& (d). The court has jurisdiction over the debtor's property wherever situated. § 77B(a). The debtor may be left in possession. § 77B(c)(1).
\item \textsuperscript{25} §§ 77B(e) \& (g). By these provisions the consent of two-thirds of the creditors and of a majority of the stockholders is sufficient for the effectuation of a plan binding upon all affected classes. And if certain conditions are complied with, a plan may be consummated without such consent. §§ 77B(b)(4 \& 5), 77B(e)(i). See Comment (1936) 46 \textit{Yale L. J.} 119.
\end{itemize}
mittees and for affording independent groups the opportunity to function effectively.  

77B attempted to protect the investor against exploitation by subjecting protective committees to judicial supervision after their appearance in the proceeding as representatives of the investors who had been persuaded to accept their leadership, by neutralizing the advantages possessed by "inside" committees, and by requiring court approval of plans. But the vital functions of preparing plans and enlightening security holders as to their content remained within the province of protective committees, and no effort was made to prevent conflicts of interests between the committees and their constituents.

With the exception of a single case where the court removed a fraudulent obstructionist committee by resorting to its "scrutiny" power under 77B(b)-(10) to disregard the provisions of a deposit agreement, courts have exercised no direct control over committee personnel. One limited method of control over committees whose interests conflicted with those of their constituents did subsequently develop under the statute, when the S. E. C. interpreted Section 77B (h) to exempt from compliance with the registration provisions of the Securities Act only those securities which were issued pursuant to a confirmed plan. Hence committees contemplating the issuance of certificates of deposit are required to register with the Commission unless they gain exemption under Section 3 (a) (10) of the Securities Act by obtaining court approval of the terms of their deposit agreements in advance of solicitation, or unless the legal effect of a deposit is equivalent solely to the bestowal of authority to accept a plan. But "inside" activity has not been perceptibly hampered by the S. E. C.'s requirement that registrants completely disclose their past affiliations and the circumstances surrounding


28. In re Schroeder Hotel Co., 86 F. (2d) 491 (C. C. A. 7th, 1936). The court used the device of "disregarding" the provisions of the deposit agreement empowering the committee to represent depositors. Cf. In re Rosenbaum Grain Co., 13 F. Supp. 600 (N. D. Ill. 1935), where the court, in response to the debtor's unique request, appointed representatives to serve on the creditor and stockholder committees and assumed general supervision over their work. But in In re Fox Metropolitan Playhouses, Inc., 74 F. (2d) 722 (C. C. A. 2d, 1935) a court denied a petition under § 21 (a) of the Bankruptcy Act for an examination of the "motives and intent" of an "inside" committee.

29. See S. E. C. Release No. 296 (class C) Feb. 15, 1935, C. C. H. Bankr. Serv. ¶ 3272. See Legis. (1934) 34 Col. L. Rev. 1348. This construction has been criticized as unwarranted by the language of the statute. See Developments in the Law—Reorganization under Section 77B of the Bankruptcy Act (1936) 49 Harv. L. Rev. 1111, 1158.

30. For a comprehensive discussion of this exemption in corporate reorganizations, see Comment (1936) 45 Yale L. J. 1050.

their organization. Many committees entirely exempt themselves from the Securities Act by soliciting only assents or proxies. Others which have secured exemption by obtaining judicial approval of their deposit agreements, have found that the courts apparently do not inspect committee personnel. Even where committees have registered, the value of disclosure seems doubtful, for, unlike the prospective investor who may buy or not as he chooses, the holder of defaulted securities frequently has no real choice except to follow the leadership of an “inside” committee regardless of his opinion of the quality of service likely to be rendered.

The application of the Securities Act to protective committee securities has perhaps had a greater impact with respect to the regulation of the terms of deposit agreements. Some committees which seek exemption by obtaining court approval of their deposit agreements have thereby possibly been induced to seek narrower powers. On the other hand, the practice of securing exemption through the submission of deposit agreements for judicial approval has probably diminished the effectiveness of the authority vested in the judge, under the “scrutiny” clause of 77B, to restrain a committee from exercising any power which he deems unfair or inconsistent with public policy. Since the court hearing must necessarily precede solicitation, there is little likelihood of substantial opposition, and such hearings have apparently been cursory ex parte proceedings at which judicial approval has followed as a matter of course even though deposit agreements generally embrace the same fea-

32. For the form of statement required by the S. E. C. in connection with the registration of certificates of deposit, see C. C. H. Fed. Sec. Act Serv. ¶ 6901 et seq. Registration has been denied to committees which omitted to reveal the existence of rival plans. In the Matter of Howard, 1 S. E. C. 6, 18 F. T. C. 626 (1934); In the Matter of Commonwealth Bond Corp., 1 S. E. C. 13, 18 F. T. C. 635 (1934). One court, in sustaining a plan, declared immaterial the failure of a committee to inform depositors of the existence of a competing plan. See Warner Bros. Pictures, Inc. v. Lawton-Byrne-Bruner Ins. Agency Co., 79 F. (2d) 804, 820 (C. C. A. 8th, 1935).

33. Although there has apparently been no instance as yet in which proxies have been held to be “securities” within the meaning of the Securities Act, “it is possible that some proxies . . . vesting substantial powers in the holder” may be so construed. Fortas, The Securities Act and Corporate Reorganization (1937) 4 LAW & CONTEMP. PROB. 218, 222 n. 30. For an analysis of this question, see Comment (1934) 34 Col. L. Rev. 1348, 1349. Proxies or assents solicited in 77B reorganizations are also exempt from § 14(a) of the Securities Exchange Act, whereby the S. E. C. is vested with a rule making power with regard to proxies relating to securities listed on national exchanges. Securities Exchange Act Release No. 461, Jan. 21, 1936, C. C. H. Stock Exchange Service, ¶ 2754.01.

34. See Fortas, supra note 33, at 230; cf. Dodd supra note 20, at 1122.
35. See Fortas, supra note 33, at 232 et seq.
36. See Spaeth and Freidberg, Early Developments under Section 77B (1935) 30 Ill. L. Rev. 137, 147.
37. See Comment (1935) 45 Yale L. J. 1050, 1055.
tures as formerly. And once a court has approved a deposit agreement, it probably would be reluctant to upset it subsequently under the "scrutiny" power. Whether because of this factor or because of the traditional sanctity of private contracts, the "scrutiny" clause is apparently not being utilized to curtail the rigid committee control over depositors.

Thus at least two courts have countenanced clauses which imposed burdensome conditions upon the depositor's right to withdraw, although investors who had otherwise expressed their disapproval of a plan would thereby be counted among those ratifying. There has even been a refusal to resort to the "scrutiny" power to prevent a committee from making exploitive profits at the expense of investors. In one case where a committee had sold deposited securities to an apparently collusive group at a 60 percent discount after foreclosing a competitive bid by withholding information essential for its submission, the court unequivocally sustained the sale on the ground that the deposit agreement authorized the committee to sell to whom it pleased.

Moreover, 77B's attempt to curb committee dealing in affected securities was nullified by the court's ruling in the same case that it could not limit the claims so purchased to the consideration paid, because Section 77B(b)(10) authorized it to adopt such a course only with regard to claims filed by committees. At least one other court reached an identical conclusion with respect to claims filed by a corporation which had acquired them from investors with the aid of a committee. Courts have for the most part invoked the "scrutiny" clause to disregard stipulations permitting committees to determine their own or their agents' compensation.

39. See In re Saenger Theatres, Inc., C. C. H. Bankr. Serv. ¶¶ 2328.01-02, 3081 (E. D. La. 1935); Fortas, supra note 33, at 228, 237.
43. In re McCrorey Stores Corp., 91 F. (2d) 947 (C. C. A. 2d, 1937); In re Spruce Apartments, C. C. H. Bankr. Serv. ¶ 4346 (E. D. Pa. 1936); In re Republic Gas Corp., C. C. H. Bankr. Serv. ¶ 3721 (S. D. N. Y. 1935). In another case where the court disregarded a committee's authority and refused to permit it to release tort claims against the mortgage trustee, the court was in reality acting pursuant to its duty to examine the fairness of a reorganization plan under § 77B(f). In re 1775 Broadway Corp., 79 F. (2d) 108 (C. C. A. 2d, 1935).
44. Under § 77B(c)(9) the court "may allow" specified parties to the proceeding, including committees, "... reasonable compensation for services rendered and reimbursement for ... necessary expenses incurred"; by § 77B(b)(5), the court must pass
Section 77B has probably reduced reorganization costs, although it is impossible accurately to gauge the extent and effect of the practice of boosting petitions in anticipation of subsequent reduction. Requested allowances have invariably been cut down, and on at least two occasions courts have refused any allowances to committees guilty of trading in the securities they represented. In determining whether an allowance from the debtor's estate should be granted, courts have generally been guided by the contribution of the claimant to the debtor's estate or to the plan adopted. Some courts have expressed the view that compensation should be denied to persons who undertake to act in behalf of a class of security holders already "adequately" represented. Application of such standards may reduce reorganization expenses only at the cost of discouraging independent participation. Compensation from the estate may be denied to parties whose activities consisted of an unsuccessful endeavor to procure the adoption of an alternative plan, or whose services were of value with regard to the rejection of an "unfair" plan or portion thereof, or to intervenors whose efforts induced greater circumspection on the part of the proponents of the successful plan. That this is a real danger becomes clearer when it is considered that ordinarily independent committees are more dependent than inside committees on allowances. For to compete on more equal terms with their opponents, independents generally solicit proxies because they are more easily obtainable, whereas insiders are able


to solicit deposits on which a lien may be enforced for services held not compensable from the debtor's estate.

And ineffective in encouraging independent participation has been Section 77B (c) (4), which authorizes the court in its discretion to require the debtor or the trustee, if one is appointed, to prepare security-holder lists for inspection by any creditor or stockholder. Even though the production of such lists is ordered, the independents will generally obtain them only after they have already been used by "insiders." But however valuable this power may be to independents in proceedings involving small corporations, it is of little use where the proceeding involves a large corporation with a substantial number of bearer securities or indeed any securities other than stock. In such cases the only comprehensive lists are frequently in the possession of the indenture trustee, underwriter or paying agent, who will ordinarily supply them solely to banker-management committees. The failure of the statute to vest the judge with a broader jurisdiction over lists would thus seem to leave practically unimpaired the advantages possessed by "insiders." Although one court in a proceeding under Section 74 of the Bankruptcy Act attempted to overcome this deficiency by directing a protective committee to disclose its lists in an order issued under Section 21(a) of the Bankruptcy Act, a 77B court subsequently stated that the purpose of this section was to aid in collecting assets. The 74 court's action in compelling the committee to disclose its lists could conceivably be justified, however, on the basis of the power vested in the courts under Section 2 (15) to make all orders necessary for the enforcement of the Bankruptcy Act. But its efficacy seems doubtful, for lists of the parties to be circularized submitted to the S. E. C. by committee registrants have apparently been incomplete. Moreover,

50. See S. E. C., op. cit. supra note 2, Part I at 883 et seq.
54. See 2 Gerdes, CORPORATE REORGANIZATIONS (1936) 1595.
55. See S. E. C., op. cit. supra note 2, Part I, at 877.
56. Ibid.
57. In re Landquist, 70 F. (2d) 929 (C. C. A. 7th, 1934) (subpoena duces tecum).
60. See Fortas, supra note 33, at 232.
since the statute permits only plans previously accepted by a substantial number of investors to be formally submitted to the court, the limited jurisdiction over lists appears particularly inadequate to stimulate the presentation of plans by independents.

Hopes of curbing selfish "inside" dictatorship of reorganization proceedings were founded chiefly on the clauses directing the court to conduct hearings for the consideration of all proposed plans and to confirm only such plans as, after an additional hearing, it found fair, equitable and feasible. But 77B courts are seldom in a position to form an intelligent judgment on a reorganization plan, for they are infrequently equipped with the necessary grasp of the financial condition, potential assets, and business prospects of the enterprise, and the past conduct of its management. Understanding of a complex business organization can be acquired only through the medium of an objective investigation. The statute, however, does not provide the judge with an independent fact-finding agency. And the court's power to require the debtor or trustee to submit information necessary "to disclose the conduct of the debtor's affairs and the fairness of any proposed plan" is of little moment, for debtors "commonly have been left in possession" and friendly trustees frequently appointed. Since such parties obviously cannot be relied upon to furnish unbiased recitals of the pertinent facts, particularly with reference to the debtor's past history, the judge has been altogether

61. § 77B(d). This section imposes no such requirement on the debtor.
62. See Hearing before Committee on Judiciary on H. R. 6439 (reintroduced and reported as H. R. 8046), 75th Cong., 1st Sess. (1937) 170; Dodd, supra note 20, at 1116-1117.
63. See Foster, supra note 14, at 925.
64. § 77B(d).
65. § 77B(f).
67. See S. E. C., op. cit. supra note 2, Part I at 309 et seq.
68. At least one court has commented on the absence of such an agency. See In re Peyton Realty Co., 18 F. Supp. 822, 823 (E. D. Pa. 1936).
69. § 77B(c)(4).
70. See statement of S. E. C. Chairman Douglas in Hearing before Committee on Judiciary on H. R. 6439 (reintroduced and reported as H. R. 8046), 75th Cong., 1st Sess. (1937) 172. See, also, id. at 177.
72. See Dodd, supra note 20, at 1114. In In re Utilities Power & Light Corp., C. C. H. Bankr. Serv. ¶ 4646 (C. C. A. 7th, 1937), where the debtor was left in possession, the court appointed a "special investigator" to examine into mismanagement claims. In the Standard Gas and Electric Co. reorganization Judge Nields has appointed a special trustee to litigate a $100,000,000 mismanagement suit upon the recommendation of the special masters. See N. Y. Times, Nov. 27, 1937, p. 35, col. 6.
dependent upon the statements of interested parties. And since the statute tends to discriminate against the proposal of plans by independent parties, courts may often be deprived of the enlightenment they might otherwise have derived from a comparative analysis of alternate plans. The supervisory power is also deficient in another respect. Since the hearing for confirmation occurs only after the requisite investor support is garnered, the judge is not relieved from the pressure of disrupting virtually consummated proceedings.

Though ordinarily less qualified than the judge to assess the validity of the statements of the parties dominating a proceeding, investors are equally dependent on such statements. Indeed, the context and tenor of committee solicitations and circulars may unduly delay or thwart entirely the consummation of any plan, especially where the field is divided between rival groups, each of which is bombarding investors with an assortment of conflicting declarations. A few courts, even in the absence of statutory sanction, have endeavored in such cases to protect investors by prescribing or inspecting the contents of committee circulars, or by enjoining communications likely to affect adversely the interests of investors, or by presiding over conferences attended by the various groups in an effort to reconcile their differences. But these cases serve mainly to throw into bold relief the complete failure of 77B to provide any assurance that the parties ultimately supposed to decide the terms of a reorganization will be equipped with the basis for an intelligent judgment.

As a result of the failure of 77B adequately to safeguard the interests of investors, remedial legislation, sponsored chiefly by the S. E. C., was presented to the last session of Congress in the form of three separate, but complementary measures: the Lea Bill to amend the Securities Act, which will be considered only as it relates to bankruptcy reorganizations, Chapter X of the Chandler Bill to amend the Bankruptcy Act, and the Trust Indenture or Barkley Bill, which is beyond the scope of this Comment.

---

74. Dodd, supra note 20, at 1117.
75. See In re New Rochelle Coal and Lumber Co., 77 F. (2d) 881, 883 (C. C. A. 2d, 1935); Downtown Investment Association v. Boston Metropolitan Buildings, 81 F. (2d) 314, 321 (C. C. A. 1st, 1936); In re Peyton Realty Co., 18 F. Supp. 822, 824 (E. D. Pa. 1936); Spaeth & Freidberg, supra note 36, at 155; Comment (1936) 31 Ill. L. Rev. 505, 519, 525; Hearing before Committee on Judiciary on H. R. 6439 (reintroduced and reported as H. R. 8046), 75th Cong., 1st Sess. 183. The problem is intensified by 77B(e)(1), which recognizes assents garnered in advance of the proceeding; for debtors have thus been enabled to utilize assents obtained in an unsuccessful attempt to effectuate a voluntary reorganization. See Campbell v. Allegheny Corp., 75 F. (2d) 947 (C. C. A. 4th, 1935). See S. E. C., op. cit. supra note 2, Part I at 323 et seq.
76. See cases collected in (1937) 46 Yale L. J. 1391.
The Chandler and Lea Bills attempt to remedy the deficiencies of 77B by encouraging activity on the part of independent groups; by terminating “inside” dictatorship of reorganization proceedings; and by providing independent agencies to supervise the formulation of reorganization plans and to provide investors and courts with the basis for an intelligent judgment as to the merits of proposed plans.

The Chandler Bill's effort to stimulate independent participation is framed in light of the difficulties encountered by independents under 77B. The Bill seeks to strengthen judicial jurisdiction over security holders' lists by making the filing of lists mandatory and by directing the judge to order any person possessed of information necessary for this purpose to supply it. Similarly the policy of the Chandler Bill with respect to compensation and reimbursement from the debtor's estate is primarily designed to overcome the discouraging effect on independent participation of the criterion in general use under 77B. Allowances would be made from the debtor's estate to committees for services rendered and costs properly incurred either in connection with the administration of the estate or in connection with the submission of any plan "approved" by the court, whether or not ultimately accepted or confirmed. Freer participation would also be encouraged by the specific direction to allow similar payments to creditors and stockholders whose services contributed to a confirmed plan, or to the refusal to confirm a plan, or were beneficial in the administration of the estate.

These proposed amendments merely carry somewhat further theories of reform embodied in 77B; but the provisions of the Lea Bill go beyond the disclosure theory of the Securities Act. By the terms of the Lea Bill any committee or person who wishes to solicit any authorization endowing it with discretionary power, whether in the form of proxy or deposit, would be required to file a declaration with the S. E. C. revealing all facts deemed relevant by the S. E. C. for the protection of investors or appropriate in the public interest. A declaration would not become effective to permit solicitation if a committee were formed by the management or underwriter, or their representatives, or any other parties whose interests were likely to conflict with existing or prospective constituents. Authorization agreements would have to be framed to include provisions insuring the adherence of those acting in

82. § 165.
83. § 242(1). For the definition of an “approved” plan under the Chandler Bill, see p. 241 infra.
84. § 243.
85. Lea Bill, § 303 (14) (15).
86. § 305(a) (1), 306(a). The registration requirements of the Securities Act would not apply to “any solicitation as to which a declaration was effective; or any transaction in any security evidencing the deposit of a security pursuant to” such a solicitation. § 305(b). A prospectus would have to precede or accompany a solicitation. § 305(a) (2).
87. §§ 307(a), 308(3), (4), (5) & (6), 311 (a) (5) (B), 311 (b) (1).
a representative capacity to a high fiduciary standard. Finally the permissible purposes for which deposits could be solicited would be limited to those which are necessary under the plan or essential to enable the solicitor to sue or make collections on behalf of investors.

But since the Chandler Bill provides for independent agencies to perform the principal functions currently fulfilled by protective committees, there would probably be little occasion for the invocation of the Lea Bill's sanctions. The reorganization system incorporated in the Chandler Bill would inhibit the present ability of "inside" groups to capitalize on both courts' and investors' lack of information and so push through a reorganization plan. Under the Chandler Bill the court would be required to appoint a disinterested trustee for all debtors with a scheduled indebtedness exceeding $250,000. After a thorough investigation of the debtor's property, financial condition, possible causes of action, irregularities in past management, and the desirability of continued operation, the trustee would submit a comprehensive report of his findings to the judge. Subsequently he would be required, in such form as the judge prescribed, to dispatch to all creditors, stockholders, indenture trustees and the S. E. C., a brief statement of his findings, and to creditors and stockholders a notification that they may present suggestions for plans to him. For these purposes he would have at his disposal all essential lists. After consulting with such parties it would be the trustee's duty, within a time fixed by the judge, to present a plan, or the reasons why he could not effect one. At the hearing on this plan the debtor, creditors, or stockholders might offer objections thereto or submit alternative proposals. Where the corporation's liabilities exceeded $3,000,000 the judge would be obliged to forward any plans he deemed "worthy of consideration" to the S. E. C., for advisory reports thereon within a time fixed by himself; and in other cases might do so at his option. In all cases, however, the S. E. C. would be given notice of all steps in the proceedings, and would be a party in interest entitled to intervene as to all matters upon the filing of

88. § 311(a) (1)-(4).
89. § 311(a) (6).
91. Chandler Bill, § 156.
92. § 167, (1) & (3).
93. § 167 (5).
94. § 167 (6).
95. § 165.
96. § 169.
97. § 169.
98. § 172. By § 11f of the Public Utility Holding Company Act, however, [49 STAT. 803 (1935), 15 U. S. C. § 79 (Supp. 1936)] the approval of the S. E. C. would be necessary for a plan to become effective in any case involving a registered holding company or a subsidiary thereof.
99. § 265(1).
After receiving the Commission's report or, where no plan had been submitted to the Commission, after the aforementioned hearing, the court would fix a time for the acceptance of those plans it approves as "fair, equitable, and feasible." Plans so approved and summaries thereof, the judge's opinion, and the S. E. C. report would then be sent by the trustee to all affected creditors and stockholders. Prior to this time all parties would be forbidden to solicit acceptance or authorities to accept, and solicitation thereafter would be permitted only in connection with approved plans.

After the requisite investor majorities have approved, the judge, as under 77B, is to confirm a plan if inter alia it is "fair, equitable and feasible." Before bestowing his approval, however, he is specifically directed to examine the qualifications of the reorganized corporation's management with respect to its appropriateness for the protection of investors or for the public interest. If a debtor whose liabilities did not exceed $250,000 were left in possession, the court might appoint a disinterested "examiner" with any or all of the trustee's powers and duties regarding investigations and the formulation of plans. If no such appointment were made, the procedure would differ only in that plans might originally be proposed at a court hearing by the debtor or any creditor or stockholder.

The enactment of the proposed legislation would doubtless strongly deter the organization of protective committees to participate in reorganization pro-

---

100. § 208.
101. § 174.
102. § 175.
103. § 176.
104. §§ 77B (b) (4) & (5) which set forth the manner in which non-asserting classes may be bound are also retained. § 216 (7) & (8). In this connection, see Comment (1936) 46 Yale L. J. 116. But whereas under § 77B (e) (4) all "affected" allowed claims were included for the purpose of determining the requisite majorities, under the Chandler Bill, only claims filed by the holders thereof would be counted. § 193. Hence claims filed by indenture trustees on behalf of their "cestuis," as allowed by the same section, would not be included for the purpose of determining the requisite majorities. Moreover, if an acceptance or failure to accept were not in good faith, the judge, after a hearing, would have the discretionary power of disqualifying such "claim or stock..." for the purpose of determining the requisite majority for the acceptance of a plan. § 203; § 221 (3). In Texas Hotel Securities Corp. v. Waco Development Co. [87 F. (2d) 395 (C.C.A. 5th, 1936)], it was held that claims purchased for the specific purpose of obtaining a veto over plans could not be denied the voting privilege under § 77B (f) (6), which states that before confirming a plan the judge shall be satisfied that the offer of a plan and its acceptance are in good faith.
105. § 178; § 221 (1)- (4).
106. § 221 (5).
107. The appointment of a trustee is discretionary in such cases. § 156. Where the debtor is retained the court may at any time replace it with a trustee or may similarly restore the debtor to possession if a trustee has been appointed. § 159.
108. § 168.
109. § 170 (1)-(3).
ceedings under the Bankruptcy Act. The mechanism proposed by the Chandler Bill for the promulgation of plans would largely extinguish one of the most powerful incentives for their formation, the possibility that the dominant committee or its sponsors could dictate the adoption of a self-serving plan.\textsuperscript{110}

The principal remaining motives for the formation of committees would be eliminated by the provisions of the Chandler Bill precluding a committee from acquiring the power to bind its constituents during the negotiation of a plan or to fix its own or its agents' compensation.\textsuperscript{111} There would thus be almost no valuable discretion which a committee would be able to obtain. Hence the Lea Bill would infrequently be called into play, for it applies only to authorities involving the exercise of discretion. The Lea Bill, however, does not apply to solicitations of simple consents to a plan or of authorities to accept a plan. Committees might thus still be formed to solicit assents for this purpose, especially when more than one plan was submitted to investors,\textsuperscript{112} or for the purpose of soliciting authorizations simply to propose a specified plan.\textsuperscript{113} The Lea Bill also exempts solicitations for the purpose of enabling twenty-five or fewer security holders to act jointly.\textsuperscript{114} Despite the sweeping character of the Chandler Bill's restriction on the solicitation of assents, this type of committee might prove popular, for it is designed to facilitate the cooperation of large investors, who would probably be able to work on the basis of tacit understanding rather than formal agreement.\textsuperscript{115}

\textsuperscript{110} Despite the destruction of this possibility it is at least questionable whether the enactment of the proposed system would induce a substantial revival of the equity reorganization or increased use of the voluntary reorganization, for receivership reorganizers, in addition to being faced with equity's disadvantages, [see p. 231 \textit{supra}] would be subject to the sanctions of the Lea Bill. And not only would voluntary reorganizers be unable to bind dissenters but they would have to conform, even with respect to the solicitation of assents, to only slightly milder requirements of the Lea Bill, and would be restrained by the Bill from utilizing assents to a voluntary plan in a subsequent judicial reorganization.

\textsuperscript{111} §§242, 243 (1) (court to determine allowances from the debtor's estate), §221 (4) (court to pass on reasonableness, remuneration from other sources).

\textsuperscript{112} Such solicitations presumably would not involve the exercise of discretion subjecting them to the Lea Bill, which does, however, apply to the solicitation of assents in voluntary reorganizations. §303 (13). But in any case involving a public utility holding company registered under the Public Utility Holding Company Act, [49 Stat. 803, 15 U. S. C. §79 (Supp. 1936)] or a subsidiary thereof, the solicitation of assents would have to be conducted in accordance with the rules promulgated by the Commission pursuant to §11 (g) of that statute. The Commission in such cases requires the filing of a declaration similar to that which the Lea Bill prescribes. S. E. C. Regulations 12E-3(d), 4 & 5, C. C. H. Securities Serv. §8402B(d), C & D.

\textsuperscript{113} Cf. S. E. C. regulation 12E-3 (c), C. C. H. Securities Serv. §8402B(c) (promulgated pursuant to §11 (g) of the Public Utility Holding Company Act).

\textsuperscript{114} §304(a)(11).

\textsuperscript{115} Similarly exempt from §77p of the Bankruptcy Act, such committees have frequently appeared in railroad reorganizations. See Comment (1937) 47 \textit{Yale L. J.} 247, 257. Section 77, however, contains no proscriptions concerning the time of the solicitation of assents within such groups.
from the Lea Bill, however, would not be entirely unsupervised. Thus, under the Chandler Bill, any person undertaking to represent twelve or more investors would be required to file with the court a statement disclosing the terms of its authorization agreement, the circumstances which prompted its participation, the amounts of claims or stock it owned when it commenced operation together with the cost and date at which acquired, and any dealings therein subsequent to its employment. It would also be necessary to set forth the amount of the securities represented and either an averment that the holders thereof acquired them at least one year before the filing of the petition or a statement of the times of acquisition. And any person guilty of trading in securities affected by the reorganization would be ineligible for an allowance from the estate.

While protective committees would thus probably be largely eliminated as the controlling agency in the negotiation of plans, their traditional sponsors would in all likelihood continue to have an effective voice in the negotiation process. Since it is improbable that committees will be formed which would be affected by the Lea Bill, banker-management groups would be able to participate in reorganizations on substantially equal terms with all other parties. Stimulus for active participation on their part would not be lacking. Many banker or management groups would likely be motivated by a sincere sense of responsibility to investors or by a desire to retain their good will. Others would primarily be actuated by more concrete considerations. They would frequently possess personal investments in the debtor which they would be anxious to protect and generally would be eager to absolve themselves of responsibility for the debtor's collapse or to preserve profitable affiliations with the reorganized venture. And in view of their prestige and familiarity with the enterprise, they would probably exercise an influential voice in the informal bargaining process over which the trustee is expected to preside. Since "inside" knowledge of the debtor's affairs would likely be available, there appears to be no reason to question the efficacy of the proposed mechanism as a medium for the preparation of plans by adequately informed parties.

116. The Chandler Bill would extend the "scrutiny" clause to include stockholder committees. § 212.
117. § 211.
118. § 249.
119. See, e.g., Hearing before Committee on the Judiciary on H. R. 6439 (reintroduced and reported as H. R. 8046) 75th Cong., 1st Sess. (1937) 234 et seq. (statement of Alfred N. Hueston, representing bankruptcy committee, Bar Ass'n, City of N. Y.); Hearing before Committee on Interstate and Foreign Commerce on H. R. 6968, 75th Cong., 1st Sess. (1937) 153 et seq. (statement of John A. Prescott representing Investment Bankers Ass'n).
120. H. R. Rep. No. 1409, 75th Cong., 1st Sess. (1937) 44. Even in the unusual situation where "insiders" could not meet the security ownership with respect to the submission of plans to the trustee, they might still utilize the debtor's privilege to present a plan. Chandler Bill, §§ 169, 170 (1).
After his investigation, the trustee would generally be equipped with a competent grasp of all relevant information. Nor would the interests of investors be left completely in the hands of self-seeking "insiders" or of a trustee with only a recent acquaintance with the debtor's problems. Large investors, particularly institutions, would certainly be vigilant to press their claims at the trustee's conferences, and thus would protect the interests of other security holders of the same class. Should the Barkley Bill be passed, inden- ture trustees, undiverted by interests adverse to those of their "cestuis," would be obligated to protect the claims of the latter. Moreover, the S. E. C. would be empowered to intervene generally as a party in interest, and would therefore presumably in appropriate cases be able to participate in the negotiation of plans on behalf of parties otherwise unrepresented.

A question may be raised, however, as to whether the system is adapted to the reasonably expeditious consummation of reorganization proceedings. Perhaps as a result of the delay engendered by the I. C. C.'s failure to rec-ognize that plans handed to investors from "above" would be unlikely to gain the requisite investor support, the Chandler Bill contemplates the formulation of plans through the medium of an informal bargaining process. The theory apparently is that this would facilitate the procurement of investor consent by producing a compromise measure which the negotiating parties would regard as their own handiwork. But the proscription of the solicitation of assents until the judge has approved a plan raises doubts concerning the compatibility of the suggested machinery with a true bargaining process. It may prove troublesome for the opposing parties to strike a bargain where many of them would be incapable of promising definite investor support in return for con-cessions by the other side. And even if an agreement were arrived at under such circumstances, difficulty might subsequently be encountered in marshalling the requisite number of assents to support it. If, therefore, some system could be devised which would enable qualified parties to bind those they represent without opening the gates to "inside" domination, it might be advisable to revise the Bill accordingly.

122. Barkley Bill, § 7(b).
123. Barkley Bill, § 7(h). Even the direct participation of small investors might be encouraged by the Chandler Bill's requirement that the petition be filed at the debtor's principal place of business. C. X, art. IV, § 128.
124. See Hearing before Committee on Judiciary on H. R. 6439 (reintroduced and reported as H. R. 8046), 75th Cong., 1st Sess. (1937) 179.
125. See Comment (1937) 47 Yale L. J. 247, 257.
127. See Foster, Book Review (1933) 43 Yale L. J. 352, 357.
128. Ibid.
129. For a discussion of the various alternatives see, Comment (1937) 47 Yale L. J. 247, 258 et seq.
Endowing the S. E. C. with the power “to review” reorganization plans might in some cases delay still further proceedings which are probably destined in any event to be extremely protracted.\(^{120}\) Despite the “advisory” designation of the Commission’s report, many judges would be reluctant to assume the responsibility of approving a plan encountering the disapproval of the S. E. C., and, regardless of the judge’s conclusion, an adverse report by the Commission might well dissuade the acceptance of a sufficiently large number of investors to block the consummation of a plan. The S. E. C. might be inclined to the viewpoint of a technician concerned with the promulgation of a plan embracing the capital structure most likely to insure the successful future operation of the corporation, and thereby protecting future as well as past investors. Should it adopt this point of view, the Commission might well persuade the judge to withhold his approval from a more speculative plan which holds forth the possibility of a greater return to past investors and which would on that account be more acceptable to security-holders already disappointed in their investment. Such an outcome, however salutary, besides involving the hazard of protracting a reorganization, appears to be inconsistent with the ideology of a system based on the premise that the plan adopted shall be the one most satisfactory to the real parties in interest. But S. E. C. participation in the negotiation process would decrease the danger of its failing to recognize the practical need of framing a plan in the light of the necessity of securing investor consent.\(^{131}\)

Perhaps the most vulnerable feature of the proposed system lies in its dependence on the disinterested trustee, who would be charged with the three-fold duty of investigating the past history of the debtor, operating it as a going concern pending the reorganization, and guiding the formulation of the reorganization plan. Disqualified from service in this capacity would be all persons who had underwritten any of the debtor’s securities within five years preceding the filing of the petition, or who were, or within two years

\(^{120}\) Thus where the debtor’s liabilities exceed $3,000,000, the necessary successive steps would include a hearing on the trustee’s qualifications, the trustee’s investigation and his conferences concerning the plan, a hearing on the trustee’s plan, an examination thereof, and possibly of other plans, by the S. E. C., the solicitation of acceptances, and the final hearing on the confirmation of a plan. See Hearings before Committee on Judiciary on H. R. 6439 (reintroduced and reported as H. R. 8046), 75th Cong., 1st Sess. (1937) 281, 287, 322.

\(^{131}\) In examining plans under the Public Utility Holding Company Act, [see note 98 supra] the Commission has thus far manifested an appreciation of the practical problems inhering in the formulation of reorganization plans. See the commission’s report and opinion on the voluntary reorganization plan submitted by the International Paper and Power Company. S. E. C. Releases Nos. 641, 670 (Holding Company Act), May 5, Aug. 3, 1937; (1937) 47 Yale L. J. 289. On the 77B Plan submitted by The People’s Power & Light Co., S. E. C. Release No. 885 (Holding Co. Act) Nov. 16, 1937. Its attitude in holding company reorganizations may be influenced, however, by a desire to stimulate compliance with the Act. For a general discussion see Comment (1935) 45 Yale L. J. 468, 483.
prior to such time had been, affiliated with the debtor or any such underwriter, or who were directors or stockholders of the debtor, or whose interests for any other reason materially conflicted with those of any class of security holders.\textsuperscript{132} History has clearly revealed that neither the debtor nor a friendly trustee can be depended upon to exact a full accounting from the old management and seems clearly to indicate the advisability of entrusting supervision over the preparation of plans to independent agencies.\textsuperscript{133} But while 77B in authorizing the retention of the debtor in possession unduly subordinated the investigation of the debtor's past management to operation at maximum efficiency pending reorganization,\textsuperscript{134} a serious question may be raised as to whether the Chandler Bill does not swing too far in the opposite direction.

The proper fulfillment of the management function requires not only a person of superior ability, but one equipped with a thorough grasp of the corporation's particular problems. The difficulty of finding a person so qualified outside of the debtor's management is apparent, and the disqualification of creditors, stockholders, underwriters and attorneys still further delimits the potential sources of such parties. At the very least, the trustee should be equipped with a comprehensive understanding of the debtor's industry. Generally, however, such a person would be in the employment of other organizations in the same industry; and if he were available, past or present connections with competing firms might render inexpedient his appointment to the temporary stewardship of the debtor. Indeed it might even prove troublesome in periods of economic depression when reorganizations multiply, to procure the services of individuals who lacked experience in the industry but were yet endowed with the capacity and integrity to manage a sizeable business organization more efficiently than the old management.

Should the trustee, despite his ignorance of the business, officiously undertake to manage it, the potential prejudice to investors would seem to outweigh any possible benefits which might accrue to them. More usually, "disinterested" trustees, however capable, would decide to rely on the services of the past management—services the statute authorizes him to retain. Where this is the case little will have been gained by the disinterestedness requirement. And where a single trustee is appointed, he might conceivably find that his "investigatory" function embarrassed his management of the enterprise by kindling resentment among his subordinates. Such a contingency might be avoided by the mandatory appointment of two trustees, one to administer the business and another to perform the investigation and "plan-formulating" functions.\textsuperscript{135} If this division of duties is accompanied by a relaxation of the

\begin{itemize}
  \item \textsuperscript{132} Chandler Bill, § 158.
  \item \textsuperscript{133} See note 72 supra; S. E. C., \textit{op. cit. supra} note 2, Part II at 11 et seq.; \textit{Hearing before Committee on Judiciary on H. R. 6439} (reintroduced and reported as H. R. 8046), 75th Cong., 1st Sess. (1937) 343.
  \item \textsuperscript{134} See Dodd, \textit{supra} note 20, at 1114.
  \item \textsuperscript{135} See \textit{Hearing before Committee on Judiciary on H. R. 6439} (reintroduced and reported as H. R. 8046), 75th Cong., 1st Sess. (1937) 303 et seq. (Statement of Professor Gerdes).
\end{itemize}