

SUMMARY OF ADDRESS

by

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to

Federal Bar Association of New York,
New Jersey and Connecticut

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THE INTEREST OF THE DEPARTMENT OF JUSTICE

IN SECTION 77B

The successful operation of the recently enacted corporation reorganization provisions of the Bankruptcy Act is a matter of interest and concern to the Department of Justice as well as to all other agencies interested in the proper administration of justice. The hopes held out by these sections that speedy, inexpensive and reasonably equitable reorganization of embarrassed corporations shall be possible is in the hands of the bench and bar. Some of the symptoms of delay, obstructive tactics, patronage and use of these provisions for purposes of doubtful legitimacy cause concern and disappointment. It will require the vigilance of courts and a high sense of professional honor on the part of the reorganization bar if these sections really eliminate the abuses aimed at and, with the amendments needed from time to time, become useful instruments of our legal and economic development. Failure would cut deeply into the prestige of the courts and the bar. Meetings like this encourage the hope that the bar is trying to meet its responsibility.

You will remember that these provisions represent what was finally enacted of a more comprehensive bankruptcy revision brought to the attention of the Congress by Solicitor General Thacher. While the complete revision met opposition, the depression speeded enactment of the railroad and corporation reorganization provisions.

The equity receivership, which had been the usual vehicle for reorganization of embarrassed corporations and had been resorted to by railroads, so it is said, over a thousand times in sixty years, broke down under the weight of the depression. It was very costly and the period of time that the property remained in the hands of receivers had lengthened with each decade. Ancillary receiverships were necessary and frequently the proceeding had its origin in arrangements that were close to collusive. Chief Justice Taft commented rather unfavorably on the receivership practice (*Harkin vs. Brundage*, 276 U. S. 36) and Mr. Justice Cardozo warned that "the remedy in such circumstances is not to be granted loosely, but is to be watched with jealous eyes". (*Shapiro vs. Wilgus*, 287 U. S. 348; also see *Michigan vs. Michigan Trust Company*, 286 U. S. 334. Lawyers became fearful of its legal soundness.

Bankruptcy had likewise proven an unsatisfactory method of reorganization. It was adapted only to liquidation.

The embarrassment in which many corporations found themselves and the effects of that embarrassment upon employees, creditors and society generally speeded the adoption of more liberal systems of reorganization with a safer basis of jurisdiction and nation-wide power over assets of the debtor. The constitutionality of the reorganization plan can hardly be doubted. (*Rock Island Case*, 294 U. S. 648). However, the United States Circuit Court of Appeals for the Sixth Circuit

on February 13th of this year, in Tennessee Publishing Company case has held some of the provisions authorizing adjustments of debt without the consent of the creditors to be in conflict with the Constitution. Further legislation may be required as to details. That the plan as a whole is likely to survive seems unquestionable.

Where the Government is not a creditor, it has no part in reorganization proceedings under Section 77B. Where interests or claims of the United States are affected, they must be paid or the consent of the Secretary of the Treasury must be obtained. He is thus made the representative of the Government in claims by any of its branches. Unless litigation follows the Department of Justice has little direct contact with reorganization cases and litigation has been exceptional.

The Treasury, charged with the burden of representing the Government, set up a section in the Office of the General Counsel to handle reorganization cases. I was a member of the Legal Staff at the setting-up of this section and can say that it was designed by Secretary Morgenthau to give quick answers, to be business-like, to be fair and to proceed without favor. Lawyers engaged in reorganizations may approach the Treasury with full confidence in this policy.

Over three thousand separate petitions have been filed under the reorganization section 77B and over twenty-five percent of those corporations involved were indebted to the

Government. It was found that there were fifty-seven different agencies or offices of the Government which might have claims against such a corporation and the Treasury undertakes to ascertain all of these claims and to represent all of the agencies. So far, the claims against corporations in reorganization have aggregated over twenty million dollars. Reorganization proposals have been received at the rate of three hundred per month, the largest number, of course, originating in New York and Chicago.

I shall not speak of the Treasury policy or procedure in handling these proceedings since Mr. Hill, Head of the Section, is here to represent it. Experience suggests this advice to the bar engaged in reorganizations: By all means submit information as to proposals promptly to the Treasury to avoid delay; see that your information is complete not only as to the plan but as to any background which should be understood to enable an intelligent decision. This will save you delay pending investigation. Make your disclosures complete, for partial disclosures breed want of confidence and that is fatal to reaching a fair understanding.

It should be borne in mind by courts, lawyers, and creditors that neither the Government nor the Secretary of the Treasury performs any function of guardianship in connection with reorganization proceedings. The consent of the Secretary of the Treasury to a reorganization and his investigation of the proposals extend only to the interests of the

Government. His consent does not mean that the equity of the plan as between different classes of creditors or stockholders or its merits as a workable plan has been approved or even investigated. Any representation that approval by the Secretary carries with it a general endorsement of the plan is wholly unwarranted.

The most apparent vice in the procedure for reorganization of insolvent or embarrassed corporations is the vice that seems inherent in the laws governing minority and majority relationships within the corporations. No matter how lacking in equity, the minority stockholders or creditors can build up a nuisance value which will be largely in proportion to the recklessness, persistence and lack of professional spirit of his advocate. The "strike" case is ever with us. On the other hand the minority interest with a legitimate grievance finds the road to relief so long, so beset with expense and technicality, and so often traveled at a cost out of all proportion to results, that honest minorities are often oppressed and "frozen out" by ruthless majorities.

It challenges the best talent of our profession to strengthen the position of an oppressed minority without increasing the arsenal of weapons at the disposal of the strike suit promoter. Perhaps it can best be done by more vigilant administration.

If Section 77B is allowed to fall into discredit it will provoke more drastic reforms which will not be to the advantage of the bar.