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of

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The Legal Problem of Control over Protective Committees for Municipal and Quasi-Municipal Obligations

Widespread municipal as well as irrigation, drainage and other special district defaults have now been with us for almost a decade. At the outset, they presented an unfamiliar problem. Even the banking fraternity was inexperienced in use of the various techniques for effecting municipal debt readjustments. But the defaults, as well as the negotiations and conflicts occasioned by them, have now continued for a sufficient period to render more familiar the peculiar problems to which they give rise. Much of the experience of previous eras of local government default in this country has been recapitulated. There is a wider understanding of the limitations, as well as of the uses, of the various remedies at law and equity of the creditor of a local government debtor. Certain patterns of behavior for the promotion of debt readjustment in this field have become typical.

There even appears to be a rather general agreement - up to a point. It is agreed that the most important process in debt readjustment is negotiation of its terms. Few will dissent from the proposition that in all save the simplest situation the ordinary remedies of mandamus and injunction are useful only as ancillary to this main process of negotiating interim and final compromise agreements with the defaulted governmental debtor. Few will dissent from the conclusion that this process of negotiation should be conducted openly and honestly by bona fide representatives of the debtor and of the creditors; nor can there be disagreement from the conclusion that when a fair agreement is reached by a process of give-and-take between such bona fide representatives upon the basis of a full disclosure of all material facts, there should be some machinery for putting it into effect.

But these propositions, which I conceive to be obvious, bristle with controversial issues of ways and means, and disputed questions of interpretation. Should the process of negotiation be conducted on an entirely voluntary basis; or should it be subject to the scrutiny and regulation of an impartial judicial or administrative agency? Who are "bona fide representatives" of creditors, and how may assurance be had that those who presume to speak and negotiate for creditors are their bona fide represenentatives? How may all material facts be made available to parties negotiating a readjustment? How may an equitable readjustment plan fairly negotiated, be made effective? What protection, on the one hand, and what disabilities, on the other, should be given dissenting minority groups? Upon each of these matters, reasonable men may arrive at widely differing conclusions. But if the existing defaults are to be cleared up in the most orderly and equitable fashion, and if a proper foundation is to be laid for dealing with a possible recurrence of widespread default, an answer to these questions must be found.

Many of the problems have been heretofore discussed before you. A year ago, Mr. Dimock read a paper 1/ before you on "Legal Problems of Financially Embarrassed Municipalities," in which some of the perplexing issues were ably analyzed. The extent to which orderly debt readjustment negotiations are rendered difficult, if not blocked for long

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1/ Reprinted in summary of proceedings of First Annual Meeting of the Municipal Law Section of the American Bar Association, July 16-17, 1935.

periods of time, by shifts in the political alignment of local government administrations and by divided responsibilities; the extensive pulling and hauling often necessary before current operating expenses and revenue collection practices can be put on a reasonably efficient basis; and the difficulty of obtaining adequate and accurate information upon which to predicate a judgment as to the capacity of the city to pay, have all been touched upon in recent discussions of municipal problems. Suffice it to say that those matters were all recanvassed and illustrated in the hearings before the Securities and Exchange Commission in the course of its Protective Committee Study. At this time, I wish to lay before you for discussion, two important phases of the problem which are intimately related: (1) the problem of the minority creditor group; and (2) the problem of the majority creditor group normally represented by a protective committee.

I.

Since your last session, and, indeed, since the Securities and Exchange Commission submitted to Congress its Report on Committees for the Holders of Municipal and Quasi-Municipal Obligations, an event of the greatest importance has happened in this field, which has accentuated the difficulty of dealing with minority groups. I refer to the case of Ashton v. Cameron County Water Improvement District No. 1. 2/ On May 25, 1936, the Supreme Court of the United States handed down a five to four decision, holding unconstitutional the Municipal Debt Readjustment Act, viz., Sections 78 to 80 of the National Bankruptcy Act.

This case and its background are well-known to you. Holders of a very small minority interest may, and in some instances have, by refusing to participate in settlements acceptable to the great majority of creditors and to the debtor, effectively blocked municipal debt settlements and prolonged defaults with all their attendant injury to both creditors and debtor. How is this possible? It must be borne in mind that any plan of compromise acceptable to the majority of creditors will necessarily involve a close matching of the *certain* liabilities for debt service on the refunding securities to be issued thereunder and for operating expenses against *less certain* anticipated revenues. The margin will be close. The taxes called for by the plan will presumably be as high as the debtor local unit deems feasible. Where a dissenter's holdings consist of already past-due or presently maturing principal in any substantial amount - however small its percentage of the total indebtedness outstanding - their disruptive possibilities may be readily appreciated. For the dissenter can retain his old securities. After others have accepted a compromise, he can go into court and demand a writ of mandamus for the levy of taxes to pay his matured securities in full, and this on top of tax levies required under the plan. The result in a given case may easily be a doubling or trebling of the tax levy for debt service in a particular year, defeating the whole purpose of the plan, if not precipitating another default.

That minority obstruction along these lines had materialized in numerous situations to block settlements as early as 1932, is now history. Many pertinent instances were cited in the Congressional

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2/ 297 U. S. ____, 80 L. ed. 910 (1936).

hearings on the Sumners-Wilcox bankruptcy bill. 3/ As observed by Mr. Justice Cardozo in the minority opinion in the *Ashton* case: 4/ "Experience makes it certain that generally there will be at least a small minority of creditors who will resist a composition, however fair and reasonable, if the law does not subject them to a pressure to obey the general will."

In one case, at least, this problem led to an interesting and ingenious arrangement. In the process of readjusting the debts of the City of Coral Gables, Florida, the city made an arrangement with a protective committee representing a bare majority of the bonds to keep the city's cash box cleaned of funds which could be reached upon mandamus. It arranged to pay over to the committee all surplus funds as soon as received so that there would be no money on hand which could be reached by bondholders who brought suits. 5/

But this sort of arrangement is not an answer to the minority problem. In the first place, there are practical difficulties, which I shall not pause to relate, which restrict the applicability of the device; in the second place, the scheme may be unfairly prejudicial to the non-depositing bondholders. They are deprived of any remedy unless and until they deposit; and they are being coerced into acceptance of the committee's services and its plan without regard to the quality of the committee or the fairness of the plan.

The only efficacious and fair way of dealing with minority dissenters is through a compulsory process comparable to that embodied in Sections 77 and 77B of the Bankruptcy Act. There is a framework which, in broad outline, exerts reasonable coercion on minorities for the good of all. Of the same general nature was the Municipal Debt Readjustment Act. Its plan was simply to permit any local government unit which might be insolvent or unable to meet its debts as they matured, voluntarily to file a petition in bankruptcy. Involuntary petitions could not be filed. And a saving clause provided that nothing in the Act should be construed to limit or impair the power of any state to control any political subdivision in the exercise of its political or governmental powers, including power to require the state's approval of the filing of a petition in bankruptcy and of any plan of readjustment. In other words, the petition had to be voluntary; and, if the state law so required, it had to be accompanied by the consent of the state. The Federal Court, sitting in bankruptcy, would thereafter be empowered to confirm the plan, if it found it to be fair and if the required percentage of the creditors approved. Upon confirmation, the plan would be binding upon minority, as well as majority, creditors, and upon the debtor.

By the close of 1935, many states had passed enabling legislation to permit any of their local subdivisions which might be insolvent to invoke the provisions of the Sumners-Wilcox Act. Seven cities, six towns, one village, one county and thirty-one irrigation, drainage, reclamation and levee districts had filed petitions under the Act. Thirteen different

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3/ Hearings before a Subcommittee of the Senate Committee on the Judiciary on S. 1868 and H. R. 5050, 1934 73d Cong., 2d Session at 14-15.

4/ 297 U. S. _____, 80 L. ed., 910, 915 (1936).

5/ Securities and Exchange Commission, Report on the Study and Investigation of the Works, Activities, Personnel and Functions of Protective and Reorganization Committees, Part IV, Committees for the Holders of Municipal and Quasi-Municipal Obligations (1936) at 98.

states were represented. Sixteen readjustment plans had been confirmed by final order; twenty-eight cases were pending; and two of the petitions had been dismissed. But in all probability, these figures do not measure the effect of the Act. The existence of the Act, and the possibility that it might be invoked against minorities, acted as a weapon by which majorities could offset the leverage of minorities. The mere possibility that the Act might be invoked doubtlessly averted or discouraged minority opposition in many cases.

A few months later, the constitutionality of the Act was brought in question before the Supreme Court of the United States. The petitioner in bankruptcy was the Cameron County Water Improvement District No. 1, embracing some forty-three thousand acres in Texas, and organized under the laws of that state in 1914. The plan submitted by that petitioner in 1934 was for the readjustment of eight hundred thousand dollars par amount of bonded indebtedness, bearing six per cent interest, on a basis of forty-nine and a fraction cents on the dollar out of funds to be borrowed from the Reconstruction Finance Corporation at four per cent. More than thirty per cent of the bondholders had filed acceptance of the plan along with the petition. The district alleged that more than the requisite two-thirds would do so in the course of the proceedings. Owners of something over five per cent of the bonds outstanding contested the petition on constitutional and other grounds. The trial court dismissed the petition on the ground, *inter alia*, that the Act was unconstitutional. 6/ The Circuit Court of Appeals, however, found the Act constitutional. 7/ While the case was pending in this court, a Texas Statute had been enacted, authorizing any political subdivision of the state, including the petitioner, to invoke the Sumners-Wilcox Act. The case then came before the Supreme Court on *certiorari*.

The ensuing decision of that Court came as a shock to many students of the problem and to many experts in constitutional law. It was not that many were unaware of the possibility that the inclination of a majority of the Court would be unfavorable to the Act. Rather, the shock came because of the ease with which the many obstacles in the way of holding the Act unconstitutional were overcome.

The majority predicated their decision on two grounds: First, that the Act was an interference by the Federal government in the fiscal affairs of political subdivisions of the states, and therefore an attempted impairment of their sovereignty; and second, that the states could not circumvent the constitutional prohibition against their impairing the obligation of contracts by granting permission to Congress so to do.

If this is to remain the law of the land, it disposes of any possibility of effectively utilizing the bankruptcy power of the Federal Government in the field of municipal or quasi-municipal debt readjustments. And so long as this remains the law of the land, it may be that no complete answer to the problems which they present can be found. To be sure, regulation of the means and methods of negotiating debt settlements can still be effected; protective committee personnel and procedure can be cleansed, purified and made more effective, and the level upon which

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6/ In re Cameron County Water Improvement District No. 1 (S.D. Texas, 1934) 9 F. Supp. 103.

7/ Cameron County Water Improvement District No. 1. v. Ashton, 81 F (2d) 905 (C.C.A. 5th, 1936).

negotiation and compromise procedure can be raised, as I shall hereafter discuss. But the problem of minorities is one of great difficulty. So long as the majority's opinion is a correct statement of the applicable law, it may indeed be true that "municipalities and creditors have been caught in a vise from which it is impossible to let them out", 3/ to use the words of Mr. Justice Cardozo. Let us examine this for a moment.

If Congress cannot presently extend relief in the form attempted in Sections 78-80, have the states power to do so? So far as debts incurred prior to the enactment of state legislation to that end are concerned, the decision in *Sturges* v. *Crowninshield* 9/ renders it doubtful. A bankruptcy act for drainage districts enacted by the Mississippi legislature in 1932 was recently held unconstitutional by the Supreme Court of that State in *Pryor, et al., Comm'rs of Sabougla Drainage District* v. *Goza*, 10/ on the ground of impairment of contract. Both majority and minority opinions in the *Ashton* case, indeed, appear to foreclose that possibility. That of the majority adopts as a premise the proposition that no state could accomplish for its subdivisions the end sought by Congress in the Sumners-Wilcox Act, "under the form of a bankruptcy act or otherwise." 11/ The minority opinion contains this observation: 12/

> "Nor was there hope for relief from statutes to be enacted by the states. The Constitution prohibits the states from passing any law that will impair the obligations of existing contracts, and a state insolvency act is of no avail as to obligations of the debtor incurred before its passage. *Sturges* v. *Crowninshield*, 4 Wheat, 122. Relief must come from Congress if it is to come from anyone."

Nor does the broad language of the majority opinion in the *Ashton* case permit of more than a slight hope that the case can be honestly "distinguished", so as to permit a decision upholding a similar statute without overruling the *Ashton* case. A bill (H. R. 12963) introduced in the House of Representatives by Congressman Wilcox is applicable only to debts incurred prior to its enactment. Apparently, the hope is that the Supreme Court will consider this less of an interference with the financial affairs of the State. Perhaps this will be effective, perhaps not. A glimmer of hope for disposing of the *Ashton* decision might be seen in the fact that the invalidated Act did not affirmatively require the consent of the state to the filing of a petition; such consent was necessary only if required by local law. Would a statute requiring affirmative consent be upheld? Against the argument of the majority in the *Ashton* case, this distinction would be merely a straw in the wind, for it must be remembered that in the *Ashton* case, Texas had authorized the filing of such petitions. And although this may not be the same as if the statute had required such consent, the language of the majority of the Court indicates that such requirement would have made no difference. The Court said: 13/

3/ 297 U. S. _____, 80 L. ed. 910, 920 (1936)
9/ 4 Wheat. 122, 4 L. ed., 529 (1936)
10/ 172 Miss. 46, 159 So. 99 (1935)
11/ 297 U. S. _____, 80 L. ed., 910, 914.
12/ 297 U. S. _____, 80 L. ed., 910, 916.
13/ 297 U. S. _____, 80 L. ed., 910.

"Neither consent nor submission by the States can enlarge the powers of Congress; none can exist except those which are granted. * * * The sovereignty of the States essential to its proper functioning under the Federal Constitution cannot be surrendered; it cannot be taken away by any form of legislation."

In addition, the second argument upon which the court proceeded was that the Act amounted to an impairment by the States of the obligation of contract. Mr. Justice Cardozo, and others, have indicated the flaw in this argument. The contract is impaired by decree of the Federal Court; that the state consents thereto does not make it the impairing agent. The act of the State is remote and indirect; it is no more the operative cause of the impairment of contract than is the petitioner who files under the Act.

But whatever lawyer or layman may think of the majority's argument, it stands at least for the present, as controlling. Its weaknesses are important only because they will be a constant invitation to a Court, differently constituted, to overrule the result. And I suppose that most or all of those who are earnestly and without prejudice seeking a practicable method for handling defaults in this field will hope that the *Ashton* case is overruled. In the orderly course of events, a decision the logic of which is unsound when judged in the light of our constitutional structure of government and of contemporary facts, cannot survive.

By this, I do not mean to say that the Municipal Debt Readjustment Act, in the form in which it appeared, was an answer to all the problems in this field, or even that it was adequate within its limited sphere. Those of you who are familiar with the Commission's Report to Congress on this subject will recall our criticism of the Act -- a criticism not elaborated because the *Ashton* case was then pending before the Supreme Court. Some of its deficiencies are obvious. The Act left practically untouched the problem of supervision and control presented by protective committees. To be sure it required that a committee file with the court lists of the creditors represented and a copy of the agreement between such creditors and the committee. There also was a provision for disclosure of all compensation to be received by such committee. Yet even in the cases where the Act might have been invoked, such provisions would afford but very inadequate supervision. For the Act, as drawn, permitted the filing of a petition only after a plan had been agreed upon between the debtor and a large percentage of the creditors. The interval between default and that point in the regulation is likely to be lengthy. Quite frequently it is a matter of years, rather than months. But protective committees are organized at the outset. The court would thus acquire the very limited jurisdiction over committees contemplated by the Act only when a committee had almost reached the end of its duration and activities. Where resort was not had to the Act, the court would acquire no jurisdiction at all. The Act also contemplated a certain amount of scrutiny of the affairs of the debtor -- necessary in a bankruptcy statute designed to be sufficient unto itself. Upon the filing of a petition, the court was empowered to stay all suits for the enforcement of judgments against the debtor. Under certain conditions, it might declare a proposed plan temporarily operative. The court could require the taxing district to file such schedules and submit

such other information as might be necessary to disclose the conduct of its affairs, and the fairness of any proposed plan. It was also provided that "no fees, compensation, reimbursement, or other allowances for attorneys, agents, committees or other representatives of creditors shall be assessed against the taxing district or paid from any revenues, property, or funds except in the manner and in such sums, if any, as may be provided for in the plan of readjustment." 14/

I shall not stop at this point to indicate the inadequacies of these regulatory provisions. Comparison of the Act with the analysis of the situation in our Report to Congress will reveal the areas which the Act did not touch or only partially treated. But it seems clear to me that an Act could be drafted providing effective machinery for dealing with most of the problems of these default situations. Many problems would remain which could not effectively be treated in the bankruptcy proceedings: For example, the formation of protective committees might frequently antedate the institution of bankruptcy proceedings; negotiations might proceed to an advanced state before there was resort to bankruptcy. And many defaults would be handled on a voluntary basis, without the assistance of the bankruptcy court. Regulation of practices in these situations would have to be sought otherwise than through a bankruptcy statute. But with the aid of bankruptcy legislation, comprehensive and carefully designed, the overweening power of dissenting minorities could be tempered, and serious defaults could be speedily and effectively handled in an orderly way. But with this avenue of escape from the dilemma, temporarily at least, cut off, what other ways are left open? Can some progress be made in other directions? Can the remedies available to dissenters be cut down or eliminated?

In this connection let me lay before you an interesting suggestion--not as the program of the Securities and Exchange Commission but as an idea worthy I believe of the serious discussion and deliberation of your group. The proposal is that the Federal courts be deprived of or greatly limited in their power to issue writs of mandamus and mandatory injunctions directing city officials to pay holders of obligations of the city who are dissenting from a debt readjustment plan which has been found to be fair and equitable. More specifically, the proposal is that after a specified percentage of creditors -- say 66-2/3 per cent -- and the debtor have signified acceptance and approval of a debt readjustment plan and that plan has been found to be fair, the Federal courts should be deprived of their power or jurisdiction to issue writs of mandamus and mandatory injunctions for the benefit of any creditor of a class affected by such plan. This would necessitate a federal statute limiting Federal courts in their power or jurisdiction to issue such writs and injunctions. That such a statute could be brought within constitutional limits seems fairly clear. So far as the Federal District Courts are concerned, Congress would have the power to withdraw this jurisdiction completely. Having that power it would seem to have the lesser power of withholding jurisdiction to issue writs of mandamus and injunctions on stated contingencies. That would be nothing more nor less than the power to regulate the power which it grants. The objective of such proposal would be to weaken the disruptive power of minorities (once the plan was adjudged fair and equitable) by withholding the power

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14/ 48 U. S. Stat., 798 § 80(c), 11 U. S. C. A. § 303(c)(8) (1934).

of Federal courts to assist them in collecting cash from the debtor instead of accepting the new securities offered under the plan. Such procedure would go far in accomplishing one of the indispensable purposes of a municipal bankruptcy act, viz., the elimination of the terrific leverage of minority dissenting groups. It is obvious, however, that it would not serve all of the high functions of bankruptcy procedure. Among other things it would not eliminate default and forgive the debts of these local units as would exercise of the bankruptcy power. But by depriving minorities of their remedies in Federal courts it would tend to coerce them into accepting the treatment specified in a fair and equitable plan which had been approved. If such a program were coupled with comparable state limitation on the mandamus remedy the disruptive effect of dissenting minorities could be substantially abolished.

But, as I have indicated, measures of this sort, even if legally valid, would have to be coupled with procedure assuring creditors that they would be deprived of orderly and appropriate legal remedies only if and when a fair and equitable plan of reorganization had been devised. It is to this problem that I now direct your attention and invite your discussion.

II.

The problem of control over municipal protective committees is in large measure a phase of the problem of control over municipal debt readjustment plans. To state it otherwise, effective control over municipal debt readjustment plans to the end that they are fair and equitable necessities some control over the agencies of the security holders (protective committees) who negotiate these plans. Fairness of a plan is not always ascertainable by examining the terms thereof. Normally it will be necessary to inquire into the background of the plan and the activities of the negotiators to ascertain if the antecedent and collateral phases of the plan are free of overreaching and coercion.

Conspicuous among such matters is the method by which assents to plans have been obtained. The basis of municipal debt readjustment is contractual. As a matter of law and practice readjustments rest upon voluntary agreements between security holders and the debtor. And even the staunchest advocates of laissez faire would agree that this agreement should be free and open. In other words, consents to a readjustment plan should be solicited and received only after complete disclosure of all material facts and they should not directly or indirectly be obtained by coercion or the use of unfair pressure devices. Traditionally one of the criteria of a fair plan has been the number of consents which have been obtained. But unless consents have been obtained openly and freely this essential hallmark of a fair plan can exist only in form, not in substance. The reorganization field is replete with instances of coercive practices whereby consents have been obtained and of oppressive methods by which security holders have been whipped into line behind particular plans. But whether or not a particular plan appears in and of itself to be oppressive, if assents to it have been obtained as a result of unfair and inequitable policies, it cannot itself escape the odium of unfairness.

Another instance is the matter of compensation and expenses of committees. The plan itself may make no express provision for compensation and expenses. That may be provided for in collateral agreements (usually deposit agreements) between committee and bondholders. These agreements may or may not have a limitation (in terms of a percentage of the face amount of deposited bonds) on the aggregate amount which the committee can claim for compensation and expenses. And even if there is such a limitation it may be effective only as respects the right of a committee to assert a lien on the deposited bonds, thus making it possible for a committee to claim an indefinite sum for fees and expenses and to deduct that from the amount of debt service remitted by the municipality. Add to this the fact that these committees are normally the sole arbiters of the worth of their own services and it becomes apparent that the toll paid by the bondholders may be oppressive. Hence unless these fees and expenses have been subjected to impartial scrutiny in connection with a review of the fairness and equity of the terms of a plan, any determination that the plan is fair will be only partial and inconclusive. While it may be wholly fair for bondholders to accept 50¢ on the dollar, it may be grossly unfair if that figure is reduced to a net of 45¢ by virtue of the committee's deductions.

Closely related to the matter of compensation and expenses of committees is the practice of trading in securities by members of committees and their affiliated interests. Committees which are trading in the securities and using inside information for their own profit are not only violating ancient standards for trustees and fiduciaries. They are also indulging in a practice which might well disqualify them from receiving compensation for their services. To allow them to retain their trading profits and at the same time to receive compensation for their committee service might well be so oppressive to the security holders as to make an otherwisefair plan inequitable. Hence control over such trading becomes an integral part of control overfairness of plans.

These three instances are illustrative of one phase of the relationship between committee activities and fairness of municipal debt readjustment plans. Committee personnel and committee affiliations have an equally important bearing. Committee members who are directly or indirectly interested in property located in the particular taxing district will normally not be fiduciaries with undivided allegiance to the creditor group. Committees which have directly or indirectly acquired the defaulted securities at default prices may make handsome profits by settlements ostensibly fair but which those who had purchased at par would never concede. Committees formed as joint ventures or syndicates will tend to be more interested in quick and easy settlements with their resultant profits than will bondholders bent solely on protecting their investments.

Sometimes the effect of matters of this kind on the quality of a plan which is negotiated will be apparent. Yet by and large they are and will remain subtle and mischievous factors whose effect is definite but not easily demonstrable. To safeguard against their insidious influence, preventive measures are required which will provide high standards for committee membership.

I need cite no more examples to demonstrate (1) that control over the fairness of municipal debt readjustment plans entails more than an examination of the terms of the plan itself; and (2) that such control must antedate even negotiation of the plan and be so pervasive as to extend back to the time when these self-appointed committees are being organized and constituted. The question is, how can effective control over these committees and these plans be realized? It is to that issue that we invite your discussion and deliberation, with the hope that practicable and constitutional methods may be found which will provide the necessary protection to investors in these distressing situations.

If the bankruptcy machinery were available, it would be a relatively simple matter to envisage a special statute constituted along the lines of Section 77 or Section 77B which could furnish a large measure of the necessary control over the various salient phases of municipal debt readjustments. But with that ruled out - at least for the present - by the Supreme Court, what others remain? I will submit for your consideration three somewhat different techniques or methods which illustrate varying approaches to the problem.

In the first place, there is registration under the Securities Act of 1933. You are all familiar with the exemption afforded municipal protective committees under that Act. You are likewise aware that the difficulty of obtaining the requisite data and information concerning the taxing districts served as one of the major reasons for affording these committees the stated exemption. Nevertheless with the accumulation of experience and knowledge in this field it will be apparent to all of you that registration requirements for these committees could now be designed which would not be onerous and which would make mandatory full and complete disclosure of all material facts respecting the personnel, activities, affilations, powers, etc. of the committees. None can deny that this would constitute a great forward advance over contemporary practices. Such disclosure should prove to be a healthy deterrent to excessive practices, in this, as in other, areas of finance. I mention this mode of procedure in passing because it is in a sense the bare minimum which could be expected. It superimposes no arbiter over these committees. It outlaws no practices which have proved vicious. It affords no barrier to any scheme which the committees themselves desire. It merely requires the disclosure of the truth.

Since registration under the Securities Act is a bare minimum it may be hoped that more thoroughgoing and pervasive measures may be devised. To the latter end the other two procedures, which I will mention, relate. Each of these entails (as does the Securities Act of 1933) the use by Congress of its powers over the mails and over interstate commerce. One would, without more, provide certain minimum standards for these committees without any other governmental administrative control than that invested in the Commission over registrants under the Securities Act of 1933. That is to say, so long as the minimum standards were met and complied with, the registering committees would not be subject to governmental administrative supervision. These minimum standards could cover a wide range of matters. Under appropriate penalties they could outlaw practices shown by experience to be incompatible with the stewardship of committees. Included are such matters as trading in the securities by committee members and their affiliated interests; and contracts engineered by the committee members whereby their

affiliated interests obtain the valuable business patronage which flows from the strategic committee position. Embraced also in this category are certain obvious conflicts of interest of committee members and counsel to the committee - such as ownership of securities acquired at distressed prices; affiliations with the debtor; substantial interests in property in the taxing district and the like. Another type of minimum standards could require that the committee provide itself with the necessary independent review of its own activities. Certain committees - as we have indicated in our Report on Committees for the Holders of Real Estate Bonds - have provided such self-imposed independent review not only as respects the reasonableness of their fees and expenses but also as respects the fairness of a proposed plan. The matters which could be brought within the purview of this independent review are numerous - assessments, if any, on withdrawal; time limits for deposit; fairness of treatment of non-depositors; pledge of deposited securities to secure loans; and the like. Over and above these types of standards, provisions could be required, limiting the aggregate amount which could be claimed for compensation and expenses; requiring regular and systematized accounting by the committees; safeguarding rescission rights or fraud claims against houses of issue; permitting free withdrawal on certain contingencies; and providing that depositors have some voice in formulation of policies of the committee.

These matters are only exemplary of the kind and degree of control which is embraced within this second suggestion. The control would be largely self-executing with only a residual power in the hands of an agency like the Commission to issue stop orders should the minimum standards at any time not be met or be violated.

The third suggestion would likewise provide minimum standards for these committees of the same general kinds and types as those mentioned above with power in the Commission to enforce compliance with them. The difference would be the substitution of a governmental agency - such as the Commission - to review and supervise the activities of the committees. This would entail vesting the Commission with broader powers than it has, for example, under the Securities Act of 1933. To supervise adequately these committees it would need not only power to issue stop orders but also power to exercise scrutiny and supervisory powers not unlike the powers of Federal courts under Section 77B of the Bankruptcy Act. Thus public hearings on fees and expenses could be provided with power in the Commission to make findings of facts and to enter appropriate orders. Publi hearings on fairness of plans could likewise be provided with power in the Commission to review the plan and render advisory opinions for the benefit of security holders.

This third suggestion, like the other two, includes no control over the municipal debtors. Rather it is restricted exclusively to control over the representatives of the creditors. In that sense it is only a partial answer to the perplexing problems in this field. Yet I only indicated that progress could be made in spite of the adverse decision in the *Ashton* case.

In sum, part of that progress is perhaps indicated by a program for Congress which combines something like either my second or third suggestions for control over protective committees with my earlier suggestion for limitation of the power or jurisdiction of Federal District Courts to issue writs of mandamus or to enter mandatory injunctions for levy and collection of taxes.

III.

It is apparent that the foregoing proposals, linking as they do control over protective committees with a delimitation of the power of Federal District Courts to issue writs of mandamus and to enter mandatory injunctions, are limited and restricted in scope and fall short of a pervasive system of control over municipal protective committees. They likewise fail to include regulation of municipal debt readjustment plans sponsored without use of the familiar committee device. Recognition of these facts will make it apparent that I do not believe any such program sets the limits of appropriate Federal regulation in this field.

Federal control over municipal protective committees is worthy and appropriate irrespective of its dependency on a limitation of the power of a Federal District Court to issue writs of mandamus and to enter mandatory injunctions. In the last analysis the justice or injustice of a readjustment plan will be the result of the character and ability of those who negotiate the plan and of the terms and conditions under which they operate. Indeed if the choice were necessary between scrutiny of the final readjustment plan and control over the personnel, terms and conditions of readjustment, I would suggest that the interest of investors and debtors would be best served by the latter alternative. The history of reorganizations and readjustments, not only in the municipal field but elsewhere contains, I believe, ample support for this conclusion. To say this is not to minimize the benefits of scrutiny of a readjustment plan in the public interest but rather to emphasize the necessity, if we are adequately to safeguard that interest, of making paramount control of the process by which readjustment plans are formulated.

I mention this merely to indicate that even though the power of Federal District Courts in these situations is in no way disturbed, a pervasive system of control, founded perhaps on the third of my suggestions in the preceding part of this paper, contains the essential characteristics and indicates the scope and quality of that control.

So far I have mentioned only the contingency of negotiation of municipal debt settlement through protective committees and the control of these readjustments through control over committees. At least two other contingencies exist: (1) debt readjustment proposed directly by municipalities to their creditors without the intervention of a protective committee; and (2) readjustment plans offered through a bond house as agent of the debtor without intervention of a protective committee. It should be remembered that the *Ashton* case entered a broad caveat against so-called interference by the Federal government with municipal debtors; a caveat which would apparently place some limit on attempts at thoroughgoing pervasive Federal administrative supervision of readjustments which are proposed by municipalities in those ways. I do not propose at this time to ascertain what those limits are or may be or what the practical considerations in the formulation of such a program of control would be, for the reason that those matters fall outside the scope of the topic assigned to me. It is, however, clear that no treatment of the problems in this field would be complete unless it embraced this phase of the problem. Although I may be

slightly departing from my topic, I do not wish to close without clearly indicating to you our hope that either here or on other occassions we may receive the benefit of your mature judgment on the appropriate and practical controls which are available for the so-called voluntary municipal readjustment--whether by way of extension of maturity, reductions of interest or principal, or refunding.

So in conclusion let me say that we invite your discussion and criticism of the foregoing proposals which are admittedly tentative; and welcome this opportunity to receive your mature judgment on these issues before submission of our definitive recommendations to Congress.