Michigan Law Review

Volume 39 | Issue 6

1941

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A BOOK by a Justice of the Supreme Court of the United States would be important under any circumstances. Such a publication is of special significance when its author is the youngest member of the Court, with many years of service ahead, and is endowed with unusual character, ability and earnestness of purpose. In these days of change such a book supplies valuable insight into the mental processes and attitude that will enter deeply into the shaping of our institutions.[1]

Most of the writings of Justice Douglas, recently published under the title *Democracy and Finance*, were completed before the author was elevated to the Supreme Court. In the main they consist of addresses and pronouncements by him as a member, and later chairman, of the Securities and Exchange Commission, and in some cases the papers have been enlarged. There are also a few occasional addresses, particularly on government and legal education. What the collection necessarily lacks in continuity is more than made up for by the vitality springing from grappling in official position with great problems of the day.

Justice Douglas' book is no dry treatise or exposition of the new statutes which he had such an important part in administering. It is rather a statement of their philosophy, purpose and tendencies, and an expression of the author's own robust faith in the possibility of saving improvement in the American economic and political procedure.

* DEMOCRACY AND FINANCE. By *William O. Douglas*—Justice of the United States Supreme Court. New Haven, Conn.: Yale University Press. 1940. Pp. xiv, 301. $3.

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[1] It is interesting to see how the views expressed in this book are finding their way into the Supreme Court reports through the opinions of Mr. Justice Douglas. For example, see Case v. Los Angeles Lumber Products Co., 308 U. S. 106, 60 S. Ct. 1 (1939) (voluntary reorganizations); Pepper v. Litton, 308 U. S. 295, 60 S. Ct. 238 (1939) (obligations of corporate directors and managers); American United Mutual Life Ins. Co. v. Avon Park, (U. S. 1940) 61 S. Ct. 157 (position of the fiscal agent in municipal debt readjustments); and Woods v. City National Bank & Trust Co., (U. S. 1941) 61 S. Ct. 493 (conflicting interests of protective committees, and of their counsel).

Justice Douglas' approach to his subjects is not one which sets the reader running to the law books. Indeed there is little which has to do with the discussion of precedents, which now count for so much less than in earlier days. There is, however, much pertinent counsel on matters of legal ethics. Legal problems in the old sense the Justice puts in a secondary place, stating:

> "The national problems of the future will be economic and business problems. They will lie in the realms of industry and finance."[2]

With such of those problems as fell within his official field, Justice Douglas deals vigorously, if not relentlessly. The Justice regards himself as not in any sense a radical, but as working for the conservation of essential social values. He looks forward to the achievement of an economic democracy of greater stability and security, but does not hesitate to say in words that would not alarm any Chamber of Commerce:

> "Our main efforts lie along the lines of making as certain as possible that honest business has opportunity to make honest and substantial profits."[3]

The basic economic thesis of Justice Douglas is that evils in finance and in corporate development and practice have impeded and sapped the economic life of the nation. He declares:

> "Of the many forces which breed insecurity, perhaps the most dangerous are the exploitation and dissipation of capital at the hands of what is known as 'high finance.'"[4]

The term "high finance" is not defined, but is used to include major activities in past years in the issue and sale of securities.

Justice Douglas recognizes that in a competitive capitalistic system business failures are always inevitable, going on to say, however:

> "But dissipation and exploitation of capital . . . relate not to progress but to tribute at the hands of those who may be accurately termed financial 'termites.' . . . In the eyes of high finance, business becomes pieces of paper—mere conglomerations of stocks, bonds, notes, debentures."[5]

[2] DOUGLAS, DEMOCRACY AND FINANCE 266 (1940).
[3] Id. 79.
[4] Id. 7.
[5] Id. 8, 9.

He maintains broadly that high finance has loaded the economic machine with excessive costs, promoted unsound security issues, unwise mergers, unfair and shaky reorganizations, and created business structures that were bound to crash. In his judgment, high finance was enabled to accomplish these disastrous results because bankers, particularly investment bankers, came to have far too much control over the actual conduct of business enterprises, placed themselves on both sides of the security issue bargain, and directed the businesses with a view to their own immediate profit. Finance became "the master" rather than the servant of business. It helped to develop "a specious brand of morality for corporations." [6]

It is the view of the author that such evils have very far-reaching consequences. He says:

> "These groups, collectively divorced from social responsibility, are the chief agents through which our economic and financial blunders accumulate until the next blood-letting process. This is called a crisis. But it is nothing more than the rhythmic breaking out of the pent-up forces of abuse, mismanagement, and maldistribution of economic effort and income. Academic economists . . . have cleverly washed the hands of high finance. . . . But the cycles and crises thus created are not inescapable." [7]

Associated with the evils of high finance there has also been strongly operative in the mind of Justice Douglas what Justice Brandeis long ago referred to as the "curse of bigness." Of the effects of the development of great, far-flung national enterprises, he says:

> ". . . bigness taxes the ability to manage intelligently. The energies and abilities of man are limited. No single man or group of men can intelligently conceive, promulgate, supervise, and execute from day to day intimate business details necessary for the intelligent operation of big business. . . . They build themselves an elaborate bureaucracy to run the business. . . . they are . . . removed from the actualities of their business.
>
> ". . . bigness concentrates tremendous economic and financial power in the hands of a few. . . . [It] tip[s] the scales on the side of prosperity or on the side of depression, depending on the decisions of the men at the top." [8]

[6] Id. 56.
[7] Id. 11.
[8] Id. 14, 14-15.

In the mind of Justice Douglas, remedy for the evils of high finance and bigness lies in what he refers to as follows:

> "The key to the solution of current industrial problems is to be found in large measure in a process of democratization of industry. . . . Ways must be found to make management responsive to the desires and demands of the real owners of the business."[9]

That ownership is now widely distributed, as the author points out, through the vast increase in security holdings.

A vital part of the remedial process which Justice Douglas visualizes is to do away with conflicts of interests in all branches of corporate and financial procedure by which the same men have sat on both sides of the financial bargain.

The democratization of finance and industry which the Justice visualizes is to be brought about largely through the intervention of the government, acting mainly through administrative agencies. The original Securities Act requiring fullest disclosure in the case of the sale of new securities; the Securities and Exchange Act, providing for the regulation of stock exchanges under the commission; the Public Utilities Act, with the death sentence provision; the Chandler Act, providing for the participation of the commission in corporate reorganizations; the Barkley Act, regulating indentures and indenture trustees, are, in the opinion of the Justice, but steps in the process of bringing the individual security holder into real participation in the management, and bringing the whole process under the fullest government supervision.

It is the belief of Justice Douglas that with the aid of these acts investment bankers can be ousted from a monopolistic and dominating position and made servants only in financial operations; "no trespassing" signs on financial empires can be taken down; the corporation and investor alike can be freed from dependence on the underwriter—especially as there is a development of competitive bidding for security issues; full-time paid directors can make managements more responsible and effective; managers will cease to be "under the whiphand of New York finance, paralyzed into inaction";[10] the size and power of economic principalities will be made to correspond with social and economic facts.

Justice Douglas is particularly hopeful for the improvement of

[9] Id., 41, 44.
[10] Id. 131.

the process and result of corporate reorganizations under the new statute, enacted as the Chandler Act, urged by him, supplemented by the Lea Act. Of the reorganization of distressed corporations, he rightly said:

> "These matters are important not only from the viewpoint of prevention of capital exploitation and waste; they are also important in restoring confidence in the integrity and honesty of the reorganization process and in the credit structure of corporations. . . .[Until reform] legititimate business continues to suffer from the disintegrating influences of irresponsible reorganizers. . . . The record . . . shows corporations struggling to reorganize for many years; returns denied to investors; labor injured, and business damaged by the resulting uncertainties and instability."[11]

The abuses which Justice Douglas stresses have resulted, he finds, from the continuance in power of old managements and bankers, the covering up of their shortcomings and wrongdoings, and the dominance of the reorganization process by the very persons who are responsible for the difficulties of the corporation and who stand to gain illegitimately by prescribing the terms of the reorganization. This results in the concealing of liabilities, and promotes "superficial, surface reorganizations which leave uncured dangerous diseases in the corporate body."[12]

These evils are to be eliminated by requiring in all cases, as now provided for in the Chandler Act, an independent trustee for the estate in reorganization utilizing the old management only as such trustee finds advisable, making a most rigid appraisal of past management, assuring truly independent committees "in the hands of qualified representatives of the investors," not dominated by any special interest making the independent trustee the focal point for building the reorganization plan, permitting such plan to be presented to security holders only after prior approval by the court, and in all cases of financial importance bringing in the Securities and Exchange Commission as a disinterested expert adviser in formulating the plan.

Foreshadowed in the papers of Justice Douglas is the breaking up of large businesses, even beyond the public utility holding companies, so that they will be more compact and regionally responsive. There is also foreshadowed a larger and larger participation by government

[11] Id. 173, 174, 185.

[12] Id. 179.

agencies, not only in control, but in actual management of industry. In the view of the Justice

> ". . . [administrative agencies] share with private management certain definite responsibilities."
>
> ". . . effective control calls not for the slower and heavier method of the judicial process but for the more subtle and more sensitive control of daily administrative direction."[13]

As to the participation of the lawyer in achieving the desired social ends, Justice Douglas does not appear to be very hopeful. He agrees with Justice Stone that too often lawyers have been the "obsequious servants of business." He remarks that

> "Throughout the entire field of finance one sees a system designed by lawyers, whereby persons win their profits by reason of the fact that they are on both sides of the bargain."[14]

And as to making progress, he says:

> ". . . my formula on *modus operandi* is to leave the lawyers out of it."[15]

Undoubtedly Justice Douglas hopes that if the lawyers catch his deep convictions about avoiding conflicts of interest they will be more helpful in the future in assisting men to steer a safe and desirable social course in the forest of modern statutes.

Turning now from this brief exposition to comment:

No one would question the prevalence in the past of evils in finance and industry of the type which Justice Douglas so ably specifies, nor the need of their eradication. One may question, however, whether those evils have been quite so extensive, or their effect so far-reaching, as he maintains.

While Justice Douglas does not point this out, the fact is that there have in the past been many soundly financed enterprises which have made great economic and social contributions, and that there have been many effective and just reorganizations, benefiting alike investors and the public. Finance and management did succeed in making positive contributions to the economic life of the country. And finance, and even bankers, have great further contributions to make.

Justice Douglas himself observes:

> "In a competitive, capitalistic system business failures are in-

[13] Id. 257, 252.
[14] Id. 239.
[15] Id., 168.

> evitable. In any system of free enterprise investors will always be forced to pay the price of progress and competition. . . . The onward rush of technology, the displacement of old devices by the new and more efficient, makes certain that this phenomenon will be constantly repeated."[16]

In spite of this observation, Justice Douglas seems at times to lose sight of the fact that the so-called free enterprise system is no mere profit system, but a profit *and loss* system, and that all the losses are by no means to be attributed to bad finance or bad management.

Aside from the ups and downs due to technological advance, there are impediments in the operation of the free enterprise system which lead at times to the slowing down of business, but which lie wholly outside the realm of finance. These include not only difficulties due to wars, politics and catastrophes of nature, but also obscure, yet recurring, maladjustments of purchasing power to production.

The failure of the economists to find the cause of business crises in the misdoings of high finance, which Justice Douglas rather regretfully points out, has certainly not been due to any desire on the part of the economists cleverly to "wash the hands of high finance." The particular evils which Justice Douglas holds responsible could hardly have brought about the debacles in 1837, 1857, 1876, 1893, 1907 and 1921. Even the debacle of 1929 was undoubtedly brought about in large part by maladjustments flowing from the World War.

Evils in finance demand eradication because of their own injustice and because they are undoubtedly a contributing cause of business deterioration, like rackets, like artificial trade restrictions. It is, however, too much to hope that their elimination will in itself solve the problem of business stability and security. It must be steadily remembered that, as the Justice himself says:

> "Whatever changes may be made . . . [cannot] insure against the risks of loss which are an inevitable ingredient of any kind of human dealings in any . . . market place."[17]

And one might add, inevitable in any system in which the invaluable main spring of private enterprise is utilized.

It may be doubted too whether the remedies for the evils in finance which Justice Douglas advocates are quite so comprehensive and so free from defects as he seems to assume.

[16] Id. 7-8.
[17] Id. 73.

The broad pattern outlined by Justice Douglas, giving title to the book, is democratization, by which he means a much larger participation in corporate management and action by individual investors, as opposed to a large degree of reliance upon those who actually run the business. Decisions upon detailed questions of business policy, even the fairness of corporate setups, are exceedingly difficult, and many of them are far from lending themselves to successful handling by methods of the town meeting. What the Justice remarked as to social questions has still stronger application to business questions:

> "Most of the issues of human and social relationships are not of the black and white variety. Right and wrong, sound and unsound, are elusive in the complexities of modern business and finance."[18]

Difficulties in the way of satisfactory business solutions through the democratic process are recognized in a quotation from Justice Brandeis, which in a different connection, the author includes in a note:

> "For a small investor to make an intelligent selection from these many corporate securities—indeed, to pass an intelligent judgment upon a single one—is ordinarily impossible. He lacks the ability, the facility, the training and the time essential to a proper investigation. . . . he needs the advice of an expert."[19]

The position of the investor has undoubtedly been improved by the Securities Act of 1933, by the requirement of full disclosure of all material facts under the new statutes. That is not so much because the investor actually reads and studies the ponderous prospectuses which that act generates, and still less the exhaustive registration statements, but because of the restraining influence created by the requirements of those documents, and the possible liabilities for errors and omissions.

The placing of the stock exchange on a business basis, to which Justice Douglas so contributed, the elimination of market manipulation, the increasing of responsibilities of trustees under corporate indentures, the regulation of the reorganization process, are all calculated to improve the security of the investor. The providing for these developments, however, should not be taken as final. Experience, calm counsel and conference may well indicate changes making regulation accord better with the vitality of the economic process.

One subject which demands thought is certainly the cost of com-

[18] Id. 243.
[19] Id. 32-33, note.

pliance with the present issue requirements. This, notwithstanding Justice Douglas' opinion to the contrary, remains a source of complaint, especially by small enterprises, which he so desires to see helped.

Voting trusts of corporate stock are marked for elimination by Justice Douglas "as little more than a device for corporate kidnapping." In certain situations, however, such trusts actually afford a means for insuring a continuity of personnel and policies over a period for the benefit of investors, and while Justice Douglas suggests that there are other ways of attaining this end, he does not set them forth. And if, as he recognizes, this end is beneficial, the simple and established means of the voting trusts is not to be eliminated.

Competitive bidding by underwriters for proposed security issues is strongly favored by Justice Douglas. He sees little but sham in the idea of sponsorship by a particular house of issue and only harm in the help of experts of such house in shaping the issue. He concentrates on the dangers of favoritism and of undue influence.

Danger in compulsory competitive bidding is, however, recognized by Justice Douglas, who says:

> "As against its many obvious advantages may be put the disadvantage that lively competitive bidding for stylish and readily salable securities may induce overissuance. One phase of this is well illustrated by the large number of investment-company issues that came out in 1928-29. Their popularity made it possible for brokers and bankers to make themselves sponsors, incorporate an investment company, and go on producing stylish and popular merchandise until the crash came." [20]

Justice Douglas might have gone much farther, and have instanced the many issues in the twenties of foreign securities brought about by the eager competition for readily salable and popular merchandise.

It will always be true that by shopping around many houses of issue, whether by competitive bidding or otherwise, a corporation can find a house ready to put out the issue at the highest price and carrying the greatest risk and the least safeguards. Such a course indeed involves the very thing to which in other connections Justice Douglas so objects—"business becomes pieces of paper, a mere conglomeration of stocks, bonds, notes, debentures." [21]

One may have large reservations also about the value of the full-

[20] Id. 38.

[21] Id. 9, quoted supra, note 5.

time paid director, giving his whole attention to the company's affairs. Better directors are most desirable, and payment of directors in these days of complication is most fitting. Yet a full-time paid director is little more than an extra officer, with a roving commission, not calculated to add to the efficiency of the regular officers. Managements are not likely to be efficient under Ogpu methods.

The way to efficiency and serviceability in the economic process through constant government intervention is perhaps less clear than Justice Douglas believes. Indeed, what he himself says about the difficulty of managing a single large business—a problem which in many cases has in fact been satisfactorily solved—applies with still greater force to the government in running all businesses. With the substitution of big government for big business, consider again the words of Justice Douglas on the difficulties of managing large enterprises.

> ". . . bigness taxes the ability to manage intelligently. The energies and abilities of man are limited. No single man or group of men can intelligently conceive, promulgate, supervise, and execute from day to day intimate business details necessary for the intelligent operation of big business."[22]

Justice Douglas is fully conscious of the difficulty of successfully administering the acts providing for detailed regulation of the complexities of industry and finance, stating:

> ". . . the character and rate of our progress depend upon the quality of men in the public service. It demands a development along the lines envisioned by President Roosevelt of a new American career service, reorganized along sound business lines and creating the profession of administrative government."[23]

Yet that profession, so needed if government intervention is to be successful, has by no means been forthcoming.

In its seven years of existence, the Securities and Exchange Commission has had four chairmen and is about to have a fifth. There have been numerous other changes in its membership. These changes may be wholly understandable, as in the case of the elevation of Chairman Douglas to the highest Court, but they operate against that development of experience and knowledge which make for the best administration.

The necessarily very numerous staff of the commission has always

[22] Id. 14-15, quoted supra, note 8.
[23] Id. 247.

been the scene of constant turnover, and in important posts. Members of the staff are necessarily human, vitally interested in their own careers, and actual administration of these far-reaching statutes hardly presents that picture of complete disinterestedness which Justice Douglas has so firmly in mind.

There is grave danger that constant intervention—"daily intervention"—of the government in business, coming on top of the complex and changing regulations, will rob the economic process of essential vitality. The cost of that to investors and to the public would be very great indeed. No operation can be considered successful if the patient dies.

At the very time when the government of the United States is in the way of being made national instead of federal, it is rather strange also that national business enterprises should be frowned upon and checked, and perhaps prevented from making their full potential contribution to economic well-being.

The vision of actually directing the flow of capital into the channels in which some body of government officials think it will be most helpful, if fully achieved, would seem likely to result almost in some form of state capitalism, very difficult to distinguish from totalitarianism.

This writer put down Justice Douglas' book with the feeling that the author has performed a great service in stressing a highly social point of view in the approach to financial and business problems, and in exposing evils in past practices and expounding the remedies which have been found. He had also the feeling that Justice Douglas has minimized values that remain in permitting the individual citizen and business man to proceed with reasonable assurance under law laid down in advance, and has overstressed the actual fruits of constant government intervention by means of techniques and procedures so far developed. Government, like business, still needs humility and patience, and the avoidance of set attitudes. Business owes to Justice Douglas a debt of gratitude for the contribution which he has made to the development of the social attitude and purpose by which alone business, if allowed to live, can do its full part.