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For illustration, I do not think that this Commission could find that conditions were detrimental to the public interest in that in relation to the adaptation of the security to the structure of the declarant, although they could not find that it was not reasonably adapted to that structure.

Chairman Frank: Certainly not.

Mr. Jackson: And I think that all that there is in Section 6 is a right to determine as a fact whether or not those things are reasonable and within that limit they have been left in the way of management discretion, and that whatever may be done by the Commission to simplify its determination of those standards, it may not take the form of imposing an arbitrary condition, that is a condition without which the declaration should be as it were invalid, even though it could not be found as a fact that it violated any of the six things there enumerated.

I don't know whether you wish me to take the time to discuss briefly the rule that we have proposed, or not.

Chairman Frank: Yes, if you care to.

Mr. Jackson: I will just cover that very briefly.

In the original report of the National Association of Security Dealers, they pointed out that while in their judgment the Commission had no right to declare an underwriting to be invalid because the underwriter was an affiliate, but only if in fact the transaction had resulted in an unreasonable fee, nevertheless they felt that in such a situation, that is in the

situation of an affiliate underwriter, it would be appropriate for the Commission to adopt a rule of practice that would be consistent with the rule applied by the courts in cases of transactions between corporations having interlocking boards of directors or common stockholders.

In that connection therefore it submitted a rule of practice which in their view formed an adequate basis of discussion for a workable rule to take the place of U12F2, which the Commission, and I believe the investment banking fraternity had found unsatisfactory. That was submitted, as you may recall and it provided that ~~when~~ an underwriter or finder is an affiliate of the issuer under clauses A, B or C, or after due notice and hearing has been found by the Commission to be an affiliate under clause D of Section 2(a)(11), the following rule shall apply. And then was established a burden of proof which was to be met by such an affiliate in the same way as any transaction between corporations of interlocking directors there was the burden of proving it to be fair.

Commissioner Healy: The difficulty with that was, of course, we were still faced with the problem of determining who were affiliates.

Mr. Jackson: That is right, sir, and I was going to say that that was admitted and Judge Healy very aptly pointed out to the Committee the difficulty that he now suggests and which we doubtless should have foreseen. Later we submitted a suggestion that

the rule be amended by having a further paragraph, that is where you had a possible affiliation of this Section 2(a)(11) -- that that would first have to be settled.

Commissioner Haley: After you settled it, you would have to wait 30 days under the terms of the statute before it could become effective, and in the meantime the security issue would be hung up here.

Mr. Jackson: Quite right.

Commissioner Healy: Which would not be very pleasing to the investment bankers.

Mr. Jackson: And perhaps not to the issuer.

Commissioner Healy: No, nor to the Commission.

Mr. Jackson: I assume that is also so. We therefore submitted a suggestion that in addition to the paragraph we had previously submitted, there should be added to the rule, this:

"(B) Where, although the underwriter or finder is not an affiliate of the declarant under Clauses (A), (B) and (C) and has not theretofore been found by the Commission (after due notice and hearing) to be an affiliate of the declarant under Clause (D) of Section 2(a)(11), the Commission, prior to the effective date of such declaration, issues an order directed to the declarant and to the underwriter or finder to show cause why the underwriter or finder should not be declared an affiliate of the declarant under Clause (D) of Section 2(a)(11), the declarant and underwriter or finder may in lieu of proceeding with the hearing to

determine whether the underwriter or finder is an affiliate of the declarant under Clause (D) of Section 2(a)(11), elect to assume the burden of proof prescribed by Paragraph (A) of these rules; provided, however, that such election shall not constitute an admission by the declarant, underwriter or finder that such underwriter or finder is an affiliate of the declarant for any purpose; and provided further that the hearing and determination of the declaration pursuant to such election shall not constitute a finding, determination, holding or decision by the Commission that such underwriter or finder is an affiliate of the declarant for any purpose."

It was our view that such a rule would adequately meet the situation and would be of more benefit to the Commission and to declarants and underwriters.

Obviously, under Clauses (A), (B) and (C), the determination of the affiliate relation is rather simple because it is a simple stock relationship; just as obviously as the determination of an affiliate relationship under Clause (D) is very difficult, as I think this Commission has pointed out in certain of its opinions, and it is likely to involve a long and costly proceeding before this Commission, and also because of the consequence it is likely to involve further protracted litigation in the event of an adverse decision.

Now, in our view of the statute, there is no prohibition against the affiliate being an underwriter. There is the

necessity that it should appear to this Commission that the result of that association shall not have been unreasonable fees. Consequently, in our fee, if an affiliate determination were established and assuming the whole deal don't blow up, as of course we know it would, all that would then have to be done by the declarant and the underwriter would be to establish and satisfy this Commission that the fees are reasonable. Therefore it seemed to us that where the Commission had reason to issue an order to show cause as to a possible affiliate relationship, it would adequately safeguard every requirement of the statute to have such a ruling whereby they could merely assume the burden of an affiliate for the purpose of establishing that that declaration should be permitted to become effective.

Commissioner Healy: Would they take the burden as to all of the standards of Section 7(d), or just merely with respect to the affiliate situation?

Mr. Jackson: I think they would take the burden of all of the standards of Section (d). As a matter of fact, I was thinking of the underwriting business and therefore did not mention anything else.

Commissioner Healy: Which way is your rule written?

Mr. Jackson: Only as to underwriting business, because that is all that was in the mind of the person who wrote the rule at the time, but that is the only reason.

Chairman Frank: There would be no objection to enlarging

it then?

Mr. Jackson: As far as I am concerned, there can be no objection to enlarging it. I think Judge Healy's suggestion applies to each one of the conditions.

Commissioner Healy: Do you know whether the rule as you have suggested it or as it is now suggested that it should be amended, is that acceptable to the NASD?

Mr. Jackson: I don't think I am authorized to make any statement, Judge Healy. I am simply going by the proposition that they submitted it as a suggestion to this Commission.

Chairman Frank: Presumably therefore they were in favor of it?

Mr. Jackson: And then when Judge Healy pointed out that there was a very serious omission, to cover this other situation they submitted an amendment, and I at least assumed that they were submitting something that was acceptable.

Commissioner Healy: Do you know whether the rule as suggested or as amended is acceptable to the I.B.A.?

Mr. Jackson: As to the I.B.A., I would not be in a position to state.

Mr. Stewart: I would say that the I.B.A. has never officially considered it. We would be glad, however, to take it into consideration before our Committee.

Mr. Ford: As I understand it, that rule as outlined by Mr. Jackson was submitted to the Board of Governors of the

Association and approved, and the Committee were authorized to continue their conversations with the Commission. It was re-submitted to the Executive Committee and reapproved by the Executive Committee, and the Committee was authorized to carry on their discussions with the Commission. The Chairman of that Committee unfortunately can not be present, but he has been waiting for some months for the reaction of the Commission since last May.

Commissioner Healy: I think it is fairly apparent what the staff's reaction to the rule is.

Mr. Ford: Their reaction is very apparent.

Commissioner Healy: I did not mean to indicate anything as to my own attitude on the rule; I just thought I would like to clear the air as to what proposal was before us.

Mr. Jackson: I was fearful that our second supplement in which we attempted to cure the defect which you pointed out might not have come to your attention, and I would be grateful if the Commissioners would look at it, as we were trying to be helpful and constructive and thought it was a practical thing.

I have only one more word to say, and that will take only about two minutes.

I earnestly and conscientiously feel that the Commission is without statutory authority to promulgate this rule in relation to transactions under 6 and 7. I entertain some doubt about Section 12(b), but I do not discuss it because it is not a matter

of primary concern, as I understand it, to the National Association of Security Dealers.

I respectfully submit that in any event there is grave doubt that such authority exists. I think it is also fair to say that if such a rule were promulgated, it would as a practical matter be almost impossible for persons who believe themselves to be vitally injured by it to invoke a judicial interpretation, and that for the reason suggested by Judge Healy a moment ago, and that is that when things can not go through this Commission, issuers are not going to wait.

Chairman Frank: Let me suggest a method by which it could be quickly tested if there were such a rule. The same problem arises as to many other matters. The Commission would be delighted in that case or in any other case to arrange for a test case and it could easily be done. An issuer not having an immediate dead line could bring in an issue and raise the question.

Mr. Jackson: Mr. Frank, I presume I am a little gun shy and you have helped to get me that way, with reference to the right to sue in cases, and I don't know how much difficulty there may be.

Chairman Frank: We differ on that subject apparently, and now our difference is just in the reverse. I would not think there would be any particular difficulty about it. The suggestion I wish to make is this -- Judge Healy suggests that perhaps I misstated what I had in mind. I did not mean suit by way of an

injunction; I meant what is referred to in the review section of the statute, in other words a case could be provoked which would raise a real case of controversy, in which an underwriter or an issuer could have a real interest which would be of such a character as to satisfy the provisions of the appeal or review section, namely a person aggrieved could take a case up and it could easily be arranged and the Commission -- I will say generally the Commission is always willing to arrange to have questions tested. I don't think I need to say this, as the counsel that appear before us know that we always are entirely willing and delighted to have questions tested in the courts in an appropriate manner if anybody has any doubts about our powers, and as to this particular matter I do not think it would be very difficult assuming that the Commission adopted such a rule, to have it directly tested in a case where there was no dead line.

Mr. Jackson: Mr. Chairman, I am not trying to set up laws, and the reason for my previous statement was merely to make this suggestion. I had conceived at least that there was great difficulty. Congress is in session. Amendment to certain of the Acts under your jurisdiction are under consideration, as I understand it, in cooperation with your staff. I respectfully submit that if it be true that Congress believes that the Commission should have authority of this nature, that it would be a simple matter to submit it to Congress and obtain

unquestioned authority.

Now, I think that the discussions before this Commission -- they have convinced me and perhaps they have not convinced everyone -- but they have shown that at least there is such grave doubt that it might well be, as I think is the fact, that Congress believes that such authority if exercised would do a great deal more damage than good, and I think that it would be appropriate to invoke a Congressional judgment if the conclusion should be reached.

I do not think that the difficulties by any means could be solved by the bidding rule even if contrary to my belief it is within your statutory authority. I am not one of those exporters of capital from Ohio to which the Chairman referred earlier; I am not, unfortunately; I wish I were. But I do know that because of my knowledge of various things, various investing houses and the like -- underwriting houses and the like -- there are cases where if I am offered a security which is sponsored by one of them, I would not buy it. I think there are other people in the same situation. I think that issuers who are required to sell to the highest bidder would be presented with a very grave problem with respect to such matters as that, and one which it seems to me would be neither practicable nor appropriate for this Commission to undertake to handle.

I do not know whether this is appropriate, but I also think the difficulties even in relation to 12(d) are illustrated by

this. I have had something to do with the attempt of Receivers to liquidate Continental Shares and to obtain some small fraction, 10 or 15 dollars of the capital -- not the dividends -- for the preferred stockholders out of the 35 million they put into that corporation. It has taken years to have done that, and it has been the universal judgment of everybody connected with it including people who represented the investors trying to get a little of their money back that any attempt to sell those securities at public auction or to dump them on the market would mean that the little remaining equity of the preferred stockholders of Continental Shares would be entirely wiped out, and it has been necessary to handle that in an entirely different way than by the usual processes of handling those transactions.

Commissioner Healy: I believe that earlier in your remarks, Mr. Jackson, you agreed that your suggestion about going to Congress would be wholly inappropriate if the Commission felt clear in its own mind that it had the authority to promulgate this rule?

Mr. Jackson: Of course, Judge Healy, I think that is right. I believe if this Commission believes beyond a shadow of a doubt that it had the authority and the duty to promulgate this rule, and naturally it would not go to Congress.

Commissioner Healy: Of course, there are almost no questions that could come up under this statute or any other that we administer, or that anybody else administers, as to which

good counsel may not reasonably differ?

Mr. Jackson: I recognize that, Judge Healy, but --

Commissioner Healy: (Interrupting) The proper place to get a construction on a statute when counsel differ is in the court, isn't it?

Mr. Jackson: The ultimate construction of this statute and every statute is for the courts.

Commissioner Healy: That is true of all Federal statutes, is it not, and indeed all State statutes?

Mr. Jackson: All statutes; I make no exception, but it is neither to be assumed or believed that this Commission would assume or exercise any authority which it did not conscientiously believe had been vested in it by Congress.

Commissioner Healy: I think we can all agree to that.

Mr. Jackson: I take the position and I act upon the assumption that while the ultimate decision rests with the courts, the initial decision is to be made by the administrative body with respect to the extent of its authority, and we all hope always that the nature of the decision may be such that no one may feel so seriously injured that they are compelled to go to court.

Chairman Frank: Mr. Jackson, let me for a moment follow up what Judge Healy said. Let us take another section of this statute which to a great many people is unpleasant. Let us take the so-called integration section, Section 11(b)(1). I have not

any doubt that there are counsel in this room who disagree with whatever the Commission decides to be the meaning of Section 11(b)(1), and they may turn out to be right. I assure you that I for one, and I know it is true for every one of my colleagues, will never render a decision construing that section contrary to their belief as to its correct meaning, but we are subject in whatever we decide to be the meaning, we are subject to interpretation by the courts. If your suggestion were to be followed, it would come to this -- let us divide it into two parts. If the Commission has not the power to enact such a rule, or, to take my other illustration, to issue a certain decision under Section 11(b)(1), then the Commission would not make such a rule or enter such an order. You can take that for granted. I think you do.

Mr. Jackson: Of course I do.

Chairman Frank: That is, if the Commission does not think it has the power. What the Commission thinks may be totally wrong, but if the Commission thinks it has the power, and if you think it does not have or any other group of lawyers thinks it does not, then don't you agree that what Judge Healy suggested, namely, that that is not an appropriate question to be submitted to Congress, in other words we are supposed to do what we think the statute calls upon us to do. If the statute, we think, authorizes it, and on the basis of the facts if they are such as we think the discharge of our duty requires us to do something

and we do it, then the review is in the courts.

On the other hand, if we think we have not the power to do something and we think it is highly desirable, then the proper method is to go to Congress. That is, if we think something ought to be done, Congress in effect in our statutes has invited us -- it has invited us to have legislative hearings for the purpose of making recommendations to Congress.

Now, either we have or we have not the power to make this rule. If we are convinced by your argument that we have not, or by anybody else's argument, we would not endeavor to exercise it.

Mr. Jackson: I trust the facts will prevent the Commission from exercising it, anyway.

Chairman Frank: Oh, if we decide it is undesirable, even if we have the power, then we won't.

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But make the assumption (a) we decide notwithstanding your argument that we have the power; and (b) notwithstanding the arguments that have been made by persons here in the last few days that it is desirable and in the public interest and for the protection of investors or consumers; then, as I understand you, you would not under those circumstances think that we could go to Congress?

Mr. Jackson: Of course, if this Commission believes it is crystal clear that it has an authority and duty, it is going to perform it and it is not going to ask Congress whether it should do it or not.

Chairman Frank: Otherwise it would defeat the very purpose that created such a situation.

Mr. Jackson: My contention is first that there is no authority, and that consequently if, as I personally think, it is very unwise and with which I hope the Commission will agree, - but if contrary to that, the Commission were to think that there should be a rule, then the proper thing is to appeal to the Congress. But it seems to me that there were some considerations here, Mr. Frank, as I said, that it is plainly without authority, and I think it is clear that there must be at least a very grave doubt about it. Certainly something is clear from this hearing - with little dealers coming here from all over the country, the great attendance here, that the proposed rule is regarded by them as one which will have wide-

spread consequences and widespread repercussions, so that the question of policy whether it ought to be adopted even by Congress presents some of the most difficult problems that could be posed before either a legislative or an administrative body. And since Congress is in session it would, as I see it, be a perfectly appropriate thing, if the Commission should reach a decision that it ought to have such authority, to submit it to Congress.

Chairman Frank: Oh, yes, but if we decide -- if we think we have the power -- let us make that assumption, just let us assume that we won't act unless we think it is in the public interest or the investors' interest, but if we decide both of those things, then you agree that it would not be appropriate to go to Congress?

Mr. Jackson: Well, if it is regarded as absolutely clear, I would think that was so, but I can see no haste in this matter. It is a matter which even after reading the report does not seem to me to indicate any imminent danger of any kind.

Chairman Frank: The Commission has not indicated by its conduct that it is acting in undue haste?

Mr. Jackson: Quite contrary, and that is the reason that I am saying that it is my judgment appropriate to resolve any doubts by submission to Congress.

Chairman Frank: If we decide that there are substantial

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doubts, of course we won't act.

Mr. Jackson: That is right. What I mean is this, - many people suggest that administrators proceed in pursuance of authority even though they are highly doubtful that it exists, or even that it probably does not exist, on the theory that "if we are wrong, the court will correct us".

Chairman Frank: That is not the attitude of this Commission.

Mr. Jackson: I am sure it is not, but I am urging that --

Chairman Frank: (Interrupting) There are three members of this Commission that are lawyers, and I think we have a very profound respect - perhaps laymen sometimes think too much respect - for legal authority, and I do not know of any instance in which the Commission has acted where it thought it was without authority.

Mr. Jackson: I have no doubt that is so, and I hope the Commission will not think that I am trying to instruct them or to make any suggestions of any criticisms in any way; quite the contrary.

Chairman Frank: Very good.

Mr. Stewart: May I have your permission to read this statement, Mr. Chairman? I think it has a direct bearing on the subject.

Chairman Frank: Yes.

Mr. Stewart: Mr. George L. Harrison, former Governor of

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the Federal Reserve Bank of New York and now president of the New York Life Insurance Company, speaking in New York today on this subject said:

"In view of all this, must we necessarily conclude that investment banking is threatened with extinction? To my mind that conclusion is not warranted, although, frankly, my primary concern is not so much with the success or failure of that business, as such, as it is with the protection of private enterprise, which I still believe is the essential basis of our American economy. But private enterprise depends upon private investment, and private investment presupposes that we must have some machinery for bringing together borrowers and investors, both big and little.

"This is all the more important now that the energies of the whole nation, industrial and financial, are being devoted to the successful prosecution of the program of defense. In the financing of that program, private capital must do its part if we wish to lighten the already heavy burden upon the Government. That program, quite properly, relies, in the first instance, upon established industrial concerns, and it would seem equally important, in the interest of National Defense itself, that those concerns should obtain the funds required to finance expansion of plant or equipment, either through the capital market or through their established banking channels, rather than through the Government.

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"This presupposes an active, fair and experienced machinery for negotiating issuing and selling securities. For that reason, if for no other, I seriously question the wisdom of undertaking any experiment, certainly at this time, such as the proposed plan for the compulsory competitive bidding of certain classes of public utility securities. Such an undertaking, especially if extended in scope, would, I believe, risk material curtailment of the existing machinery of the capital market without any assurance whatsoever that securities so issued would be better securities for investors. Personally, I would much prefer the continuation of negotiated sales, where the investor has an experienced representative to protect his interests in drawing the contract and where security as well as price will be an important influence. At the very least, a borrower should be free to choose to negotiate a sale, if he thinks it desirable in the circumstances of his own case."

Mr. Harrison also expressed doubt about the wisdom of the growing practice of private placement of securities and said that in his opinion this practice should be substantially restricted.

Thank you very much.

Chairman Frank: Since you have read those remarks, let me take this occasion to say what, with the concurrence of my colleagues, I have frequently said during the past year, and some of you, - Mr. Connely knows this because we had a confer-

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ence on the subject, and the NASD knows it because not only did we have a conference but I wrote a letter which was published on the subject, that so far as it is any of the business of the SEC, all of us are eager and desirous that as much as possible of the financing that is incident to the program be done through private channels. I do not see anything in the proposed rule, assuming that it should be adopted, that has anything to do with Government financing. Nobody is suggesting that the alternative to the present method of distributing utility securities should be the Government. That is not the issue.

The issue is, How should securities of registered public utility holding companies and their subsidiaries be marketed to private investors? Should it be through the mechanism of negotiation or should it be in certain instances through the mechanism of competitive bidding?

The Heavens have not fallen and the Union has not been ruined by the fact that the good old conservative States of New England for years have required competitive bidding on utility securities. I am not saying that we are going to adopt the rule, but it does seem to me that we ought to be reasonably moderate in our expression of opinion on a rather limited subject, and we need not go into calamity howling - I don't mean that Mr. Harrison is doing so - but your application of his remarks to the present situation seemed to me to be somewhat

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exaggerated.

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The Defense Program is not going to break down if we go to competitive bidding in utility securities, and private persons are going to be able to invest as heretofore, and the utility industry will continue to flourish and thrive, and the notion that, something that I referred to in the opening days of this hearing, - the notion that because competitive bidding for utility securities might be required, that that would extend to other securities is totally unwarranted, because this Commission has no such power and no intention to ask for any such power, nor does it know of any other agency, State or Federal, that could require it.

I think that what Mr. Harrison says about the desirability of maintaining the private mechanism for the distribution of securities is entirely correct. I think every member of this Commission thinks so and thinks it should be encouraged. The suggestions and intimations by certain persons that this Commission has any animus against the investment banking fraternity is totally unfounded. It has no animus, and I do not think any of its comments have ever so indicated.

Mr. Stewart: Thank you, Mr. Chairman. I don't think that I would wish in any way to interpret Mr. Harrison's statement. It came to me over the wire.

Chairman Frank: I did not attempt to interpret it, but its injection into this discussion, it seems to me, had some

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8 Mr. Stewart: His remarks were sent to me and I thank you for having received them.

Chairman Frank: Have you any other witnesses?

Mr. Stewart: Mr. Winslow is waiting.

Chairman Frank: Before Mr. Winslow comes on, I think the suggestion was made that Mr. Jackson was going to answer a question that was asked of the NASD in May, and I think he did. The question was two-fold. It was a question of law and it was a question of policy. The question was this - Has the Commission in your opinion the power under the Public Utility Holding Company Act to do anything about the apportionment of the spread as between the originating underwriter and the dealers? And, second, assuming that it has such power, do you think the Commission should exert it? The latter is not a question of law, Mr. Jackson.

Mr. Jackson: Mr. Chairman, as to the first question, I have given some thought to it, and my best judgment is that the Commission does not have the authority to apportion the spread. Briefly, my reasons are these:

Any apportionment of the spread would mean that on one hand some one who performed some of the particular segregated services in the link of financing would be paid more than they had agreed to take. Others would receive less. I would think that there would be no authority to compel anyone in the present

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state of the law to render such a service for less than he had agreed to perform it. There, of course, would be no objection on the part of some other dealer or whatever class the party might fall into receiving a large fee, but as I read the legislative history of the statute, Congress, rightly or wrongly, was not concerned with two low fees to anybody in connection with the underwriting of securities.

Chairman Frank: It was the other way around. I was wondering whether Congress was interested in see that the dealers got a larger fee than they received.

Mr. Jackson: That is what I have in mind, Mr. Chairman. And they concerned that excessive fees should not be paid in connection with the issuance of securities. So that I think there is no basis for legislative intent that this Commission should increase the fee of anybody beyond what he had agreed to take.

As I said, I think it would not be lawful to say that some syndicate manager must perform a service for less than he had agreed.

Chairman Frank: Yes, but if his particular portion of the fee were larger than we appropriately determined to be reasonable, we could condition our order upon his remitting that amount.

Mr. Jackson: You are now talking about a different question, as I understand it. I was taking the situation where

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the spread was reasonable and the Commission was considering apportioning the same among the dealers, the underwriters and syndicate managers.

Chairman Frank: You misunderstood me. I meant could we divide the subject up and say, so much is reasonable for this part of the service, and so much is reasonable for that part of the service?

Mr. Jackson: You do not mean to increase anybody's fee in the link at all?

Chairman Frank: No.

Mr. Jackson: As to the question of apportionment, I do not think that is within the authority of the Commission. I would not be prepared to express an opinion on the other question, Mr. Frank; I am sorry. I did understand that the first question of the apportionment of the total spread had been raised at a meeting with some member of the Commission, but I am not prepared to go any further than that.

Commissioner Healy: Isn't it conceivable that in passing on the reasonableness of the fee that some consideration be given on the subject of what the fee is for? That might involve you in a question of apportionment. A certain fee might be reasonable for an underwriter or unreasonable, and a certain other fee might be reasonable or unreasonable depending upon whether it went to a dealer or not. That is, what an originator or a principal underwriter might get might

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present one problem of reasonableness, and the question of what the dealer might get might present another question of reasonableness. Does that make any impression on you?

Mr. Jackson: I think I understand it. To my mind, two questions come now. Perhaps I am in error about it. The first one is, just taking the underwriting spread as a whole - can we juggle that around and say that so much less will go to somebody and so much more to the dealer?

And the other question is, even though you did not say so much more was going to the dealer, could you pass separately upon fees?

Chairman Frank: To put it more specifically, we might say that a spread of X points was not unreasonable for the entire service, but that if more than one quarter of X was going to the underwriter, then he was being paid an unreasonable sum.

Mr. Jackson: That is what I understood your question to be, Mr. Chairman, and that, to my mind, is a question of whether Congress in this statute was concerned with the reasonableness of the entire spread, as you have said, or intended to authorize the Commission to pass upon separate fees.

Chairman Frank: We do not seem to make ourselves understood. It may be that the dealer would be entitled to a certain amount but that in the particular case they are not getting it, and that the underwriter is allocating to himself some of that

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amount, so that we may reach the conclusion that while a spread of X points as the whole might be reasonable, on the particular facts in the particular case since as you say the dealer had agreed to take less than he was entitled to, we would have no power to increase his compensation, but we might say that it was unreasonable to give a portion of that total to the underwriter.

Do you agree to that?

Mr. Jackson: I am sorry that I expressed myself so illy. That is precisely the question I understood you to ask second, and which I said I had not understood to be raised and I am not prepared to express any opinion. The other one I did understand to have been raised before and I expressed my views.

STATEMENT OF PEARSON WINSLOW,

Vice president of Bonbright & Company, Inc., New York City, New York.

Mr. Winslow: Mr. Chairman and gentlemen: My name is Pearson Winslow. I am vice president of Bonbright & Company, Incorporated. I shall endeavor to be brief.

The question as to whether there is an undue concentration in the management and underwriting of securities issues and the question as to whether there is domination of issuers by investment bankers are very vital questions, and I think that the Commission is doing well to probe carefully and deeply and to determine whether these conditions in fact exist.

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That there should be a certain amount of geographical concentration such as Mr. Dean referred to, I think is quite natural. I think it would be surprising if a substantial portion of the capital in the investment banking business had not located itself in New York where are also located a substantial proportion of the headquarters, or at least the financial headquarters, of the issuers of the country, and where also is located a substantial portion of the capital of the country which is available for investment.

As to undue concentration and lack of competition, I do not believe that they exist to anything like the degree implied in the report of the staff.

As to domination of issuers, I do not think it exists at all.

I have given my reasons for that conclusion at considerable length in a letter addressed to you on January 22nd, and I do not want to take your time to repeat them here. I should like, however, to read one or two brief quotations from that letter, because I think they cover points that have not been particularly stressed before.

Referring to the report: "Starting at page 9, there is a discussion of concentration in investment banking from which we believe unwarranted conclusions have been drawn. If it considered important that 57 percent of all registered managed offerings were made during the 5-year period ended June, 1939,

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14 under the management of six houses, is it not significant also that 43 percent were managed by other houses? It appears from what follows immediately that if we include 91 percent of the registered managed issuers, we find a total of 38 leading firms. The memorandum refers to only 38 firms, but we see no justice in the implication that there ought normally to be any materially great number of firms managing security issues. Certainly the comparison with the number of members of the Investment Bankers Association whose qualifications for membership require the capital of only \$25,000 is misleading. It is well known that the great majority of these members do not pretend to have the capital necessary to undertake the underwriting function, or the personnel or the experience necessary to undertake the management function.

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"We believe that the figures mentioned in the Commission's statistical release No. 439 which was referred to in the report but not quoted gave a much truer picture of the situation as it actually exists today. And according to this release, there were 159 registered managed issues in the calendar year 1939. These issues were managed by 102 different firms, and 374 firms had underwriting participations in these issues. Similar statistics for the calendar year 1940 are not yet available to us, but it is our belief that the tendency which has prevailed in recent years for more and more firms having underwriting positions continued during 1940."

One further quotation:

"On page 11 is the statement that under existing conditions 'a new firm would have practically no chance of successfully entering the investment banking business. It would have no opportunity to manage or participate in any issues other than those of firms newly entering the investment market.'

"Success in the investment banking business does not necessarily involve the management or the offering of new security issues, and it simply is not true that new firms which have capital and whose members have experience have been unable in recent years to compete successfully with houses of long standing. In the recent financing of the Appalachian Electric Power Company which was managed by ourselves, there

were 19 underwriters who have been organized within the past 10 years, and at least 10 of those who have become active as underwriters and distributors of new issues only in the past few years."

There has been much discussion but not very much as to the practicability of competitive bidding on equity securities. There is no experience to guide us in our opinions as to whether it is practicable or not. Personally, I am more inclined to agree with the views of Mr. George Woods than I am with those of Mr. Eaton, but I would like to read to the Commission an extract from "The 1939 Report of the Special Committee on Public Utility Financing to the National Association of Railroads and Utility Commissioners", as follows:

"If the competitive bidding requirement can not be limited to better grade securities, but must be extended to all grades of securities issued by all types of public utilities, there is no reason to expect the degree of success experienced in the case of the standardized equipment trust obligations or in the case of the high grade bond issues by certain New England utilities."

Commissioner Healy: What year was that?

Mr. Winslow: 1939.

Commissioner Healy: Do you remember who the chairman of that committee was?

Mr. Winslow: I do not. I haven't a copy of it with me.

It is a short memorandum of about 8 or 9 pages, I think.

No one who has had experience in underwriting and management of utility issues in the past few years could possibly be unmindful of the high standards which have been set by this Commission under the Utility Holding Company Act, nor of the standards set by the Trust Indenture Act. We can not be unmindful that the protection thereby afforded to investors, and I might add in some instances the help which they have been to underwriters in negotiating with the issuing companies.

I do not feel, however, that the responsible underwriter can blindly rely, in setting up an advising company, entirely on the standards as set by this Commission under either of those two comments. No one is infallible, and we must exercise our own judgments. On two occasions in the past year, we have been unable to induce the issuing companies with whom we were negotiating to include as strong protective features in one direction as otherwise we would have been able to persuade them, because they refused to go beyond the statutory requirements of the Trust Indenture Act.

Fortunately, the hypothetical situation that Mr. Chamberlain mentioned a couple of days ago of there being one investment banker only in this country, who would thereby dominate all industry, does not exist nor does anything like a remote approach to it exist, and I think that such a condition only could exist if that one investment banker was the United

States Government. The United States Government is already, as Mr. Eaton has pointed out, a substantial investment banker, and I do not think it is entirely clear that they have taken that position because of the failure of the investment banking industry. There may be other motives on the part of some.

If, for example, people agree with the thesis of Mr. Adolph Berle that the wealth creation should be a function of government and that consequently over a period of years the Government will gradually come to own most of the productive plants of the United States, that we would have such a condition, and whatever rules are passed affecting the bankers' mechanism of the country would be of no moment, but I am sure that we are all agreed that we expect to continue in a condition of private enterprise, and if that is the case the investment banking mechanism of this country will be as important in the future as it has been in the past, and as Mr. Eaton pointed out, it will have a very real job to do in raising capital, new capital for industry.

I think that if any rule of this nature or any nature should be imposed, it might impair the effectiveness of that mechanism.

We may not be able to establish to the satisfaction of this Commission that such results will flow from the promulgation of the proposed rule, but on the other hand I submit that it is equally difficult for anyone to prove

that some impairment will not result, and to me the situation seems of such vital importance that I would urge that this Commission do not pass this rule or any rule unless it is very sure in its own mind that there will be no result from that which will in any way impair the effectiveness of the investment banking mechanism, which should be, and I think will continue to be a vital part of our national economy.

Chairman Frank: Thank you.

Mr. Stewart: Mr. Dean would like to carry on for a moment.

Chairman Frank: How many more witnesses have you?

Mr. Stewart: Mr. Gallagher and Mr. Connely will follow Mr. Dean.

| STATEMENT OF ARTHUR H. DEAN ✓

Counsel for the Securities Act Committee of the
Investment Bankers Association

Mr. Dean: Mr. Chairman, you asked me yesterday to supply for the record the total amount of railroad financing since the passage of the Securities Act of 1933, offered publicly. |

As far as we can ascertain, according to figures reported by the Commercial and Financial Chronicle, from June 16 to December 31, 1934, \$138,676,000; 1935, \$196,733,000; 1936, \$796,058,900; 1937, \$360,649,000; 1938, \$72,371,000; six months ended June 30, 1939, \$67,273,000; total for the period June

16, 1934 to and including June 30, 1939, \$1,631,580,900.

As far as we can ascertain, we may have missed some, because as you know, all of these are not reported, but the aggregate of all securities, railroad and terminal securities privately placed during the same period, is \$39,926,000.

Mr. Rodgers: Does your first figure include equipment trust financing?

Mr. Dean: The total railroad financing reported, according to my understanding, does not include equipment trusts.

Mr. Fournier: Do those figures include securities issued in connection with reorganizations?

Mr. Stewart: If I may answer, I would say no, I think not.

Mr. Dean: I presume except where there was a public offering in connection with the reorganization.

Mr. Stewart: That, of course, would be included, yes.

Mr. Weiner: Perhaps to supply a figure for the record while we are getting figures, - on the point made with regard to the maturities, we compiled a rough calculation to the effect that of the securities of public utility subsidiaries, the sinking funds would provide on the bonds a maximum retirement of a trifle over 10 percent. Those are the figures as to which the Chairman spoke, and which Mr. Ford stated that there were sinking fund requirements. That percentage is a maximum.

Mr. Dean: Mr. Chairman, if it is the position of the Commission that the Public Utility Act of 1935 lays a mandate on the Commission to adopt a competitive bidding rule, then I respectfully disagree with that interpretation of the 1935 Act, and I may say that I can not find that mandate in the Act or in the legislative history of the Act.

Chairman Frank: If by a "mandate" that we are obliged to do it regardless of whether we think it is wise or not, of course not.

Mr. Dean: By "a mandate", I mean if there was any Congressional intent expressed in the Act that you should adopt any rule with respect to competitive bidding.

Commissioner Healy: How about Congressional authority to do it?

Mr. Dean: If you are addressing yourself to the question of whether or not you have the authority to do it without going back to the Congress, then I must say that as an advocate of the administrative law, of the power of administrative bodies, while I think you would be very unwise to exercise it without canvassing the whole situation with Congress, I believe that unless your exercise of it in a particular situation was arbitrary and capricious, that you have the authority.

What I mean by that, Judge Healy, is that I believe that the Supreme Court said in the Electric Bond and Share case that they were going to apply the various provisions of the

Act to the particular situations as they arose. They in effect said to the industry at that time, "Don't cry until you are hurt".

If somebody were to come in with a negotiated price where the price offered under Section 7 was so clearly reasonable, and all of the terms and provisions of the particular transaction were so clearly in the public interest and in the interests of investors, I am not sure that a court would say there that you would be justified in finding that that was not reasonable and that you had to throw the thing into competitive bidding.

On the other hand, if the question were to go up in a particular situation where somebody was contending that as a matter of evidence before your Commission that you should not in a particular instance have the right to demand proof of competitive bidding, I am not sure that the courts would say that you, being the authority agency charged with carrying out the policy of this Act, would not have the authority to demand evidence of competitive bidding if you thought that you reasonably required that evidence in order to carry out your statutory duty. Does that answer your question?

Commissioner Healy: I think it does. I interpret your statement to mean that if we found in good faith that it was an aid to us in applying the standards of 7(d) to require competitive bidding, that we would be at liberty to do so. Do I misconstrue your remarks?

Mr. Dean: Yes, sir.

Commissioner Healy: Do I misconstrue them?

Mr. Dean: No sir, you correctly construed them.

Commissioner Eicher: Do you think the rule as prepared contains sufficient rubber so that if we appropriately exercised our authority we would be on solid ground?

Mr. Dean: I think if you adopt the rule in its present form or anything like its present form you will regret it, and I think you will find that it will greatly hamper the Commission in carrying out your statutory duties in connection with the sale of portfolio securities under Section 12.

Commissioner Eicher: I call your attention to Exception 5 in the draft of the rule. I would like very much to have your opinion on that.

Mr. Dean: I think it is going to be a very difficult thing to apply, especially in the sale of equity securities which sometimes involves three or four months of preparations. I am enough of a Yankee to believe that you can get along under almost any set of conditions if you make up your mind that those are the conditions that you have to face and the best thing to do is to

get along with them. I broke my leg once, and I just did not know how I was ever going to get along getting around, going up and down the subway stairs, but I did because there was nothing else that I could do. Of course, I fell down those stairs three or four times trying to do it, and I used to come to Washington three or four times a week too, but I managed to do what I had to do under the conditions confronting me.

Chairman Frank: Are you suggesting that this rule be the equivalent of kicking you downstairs?

Mr. Dean: I might, Mr. Chairman, but I believe that the industry could live under it. I think that you would find especially in the same of medium grade or equity securities that a great many issuers would very greatly regret to see the credit of their company placed on the auction block, and then if you found that the bidding was very low, much lower than the board of directors had contemplated, that the board of directors might find that the credit of that company had been greatly injured if they were exempted from competitive bidding. If competitive bidding were universally the rule and you had to come down here and have a hearing in order to prove to people that the credit of that company would be injured if its securities were sold on the basis of competitive bidding, I think the very fact that you had to have a hearing in order to get relief from the universal competitive bidding rule might in a particular instance do great harm to that particular company. |

Chairman Frank: I have a recollection of a case, I think in which the New Hampshire Commission under a rubber clause of that sort relieved the company of the competitive bidding requirement --

Mr. Dean: (Interrupting) Yes, and the Federal Power Commission last week --

Chairman Frank: (Interrupting) I don't think that has done great injury to the company, has it?

Mr. Dean: I do not believe, Mr. Chairman, that the competitive bidding rule has been applied in the case of equity securities.

Chairman Frank: You are restricting your attention now to equity securities?

Mr. Dean: I personally think it would be a great mistake to adopt the rule with respect to your highest grade securities as well as your medium grade securities, but I think it would do the least amount of injury to your highest grade securities.

Commissioner Healy: When you speak of equity securities, are you speaking of new original issues, or are you speaking of those that are covered by 12(d) where the issues have been outstanding for some time and are now held in the portfolios of holding companies?

Mr. Dean: I was addressing my remark primarily to what you might call debentures, convertible debentures, preferred stocks, and common stocks. I should think my remarks would have direct

application upon the sale by holding companies of the stocks of their subsidiary companies in order to carry out the integration plan.

Commissioner Healy: Of course in those instances, there is no negotiation possible as to the terms of the security.

Mr. Dean: Well, you might in order to be able to sell the securities, the bankers might go to the holding corporation and say, "If you want us to sell the securities of subsidiary No. 1 with its present plan of capitalization at the best price, all we think we can get you is X dollars. If on the other hand you would be willing to put a certain number of dollars into the common stock or reclassify the preferred stock or reclassify the common stock or make various other changes in your charter, then we believe we might be able to get you X plus Y dollars, there may be three or four months of intensive discussion gone into by particular investment bankers and the holding corporation or the operating company in order to bring that about.

Commissioner Haley: Undoubtedly there are other situations where that could not possibly be true. For example, let us take the holding companies of the North American and the Standard Gas & Electric and the Pacific Gas & Electric, or the North American holdings in the Detroit Edison. Do you conceive of any such situation as you have described arising in connection with those securities?

Mr. Dean: I do not believe that the North American Company

would realize the maximum price of the Detroit Edison securities or if the other securities were put on the auction block. I believe that what they would want to do would be to call in investment bankers in whom they had confidence. Somebody said to me the other day in connection with one of these administrative bodies that one of the things he found so difficult when he first went on there was the fact that you had to learn to work with your fellow commissioners. I think that is on a par with the basis of this whole antagonism of people to competitive bidding. It takes them a long time to get them to know other people's minds and to know how to work with them. If you have confidence in other people's judgment as you have after having worked with them over a long period of years, that is another thing. One person may say, "If you put \$16,000,000 of securities on the auction block, we think we can get you so many dollars". That would be all right if they knew him. But if they did not, of course they would not have the confidence that it could be done. But if on the other hand you are working with a fellow like Jim Forrestal whose experience goes back to before 1917 where there was a situation where they sold bonds and there was a declaration of war and nevertheless the transaction was carried out in a very creditable manner, if you have been through a great many trying experiences, and especially in the early period of the 20's when the utilities went through a very difficult time in raising capital, you begin to have great

confidence in a person's judgment. If he tells you the best thing to do is to sell it in blocks or that he can get this or that price for you if you will allow him to work on this thing for a period of three or four months, and that he thinks that he can get you a very good price that is based upon years of experience, you will let him go ahead on that basis.

I think if it were to be known tomorrow that the North American Company had to put up the Detroit Edison securities on the auction block, that they would get a very low price for them.

Commissioner Healy: It would not necessary follow that they would have to sell them all at once, would it?

Mr. Dean: No sir, but I think several years ago there were several large blocks of stock of Woolworth overhanging the market, and on an earning basis Woolworth stock was selling 12 or 14 points below other comparable chain store stocks. When those several blocks of stock were finally marketed, the Woolworth stock went up and sold back on the comparable levels with the other chain store stocks, but while it was known that the executors of those estates within a certain period of time had to sell those blocks of stock in order to meet the instalments on the inheritance taxes, all the investment advisers were advising people not to get into Woolworth because they knew that those blocks of stock were coming into the market.

Mr. Weiner: Is it your thought that that presently is affecting the market for Pacific Gas & Electric or Detroit Edison?

Mr. Dean: I really don't know. I am not an expert on public utility securities. One of the things I have learned over a great many years is not to express an opinion on that subject for my banking investment clients.

If you were to adopt this competitive bidding rule, I think you ought to give careful consideration to the integration of the adoption of this rule to the Securities Act of 1933. You no doubt will tell me that you have already adopted Rule 880, and that the conservative New England public utility companies have gotten along all right.

Commissioner Healy: We will go a step beyond that. We will tell you that some of the investment banking firms that you have represented and have filed registrations for under the Securities Act and marketed the securities.

Mr. Dean: Yes, I admit that. I will say, as the old fellow said, "I plead guilty and I don't want to hear anything more about it".

(Laughter.)

Commissioner Healy: I did not have any suspicion of guilt in connection with it; I thought it was very much to your credit.

Mr. Dean: I would like to call your attention to these facts, however, Judge Healy: that several of these issues were done prior to the passage of the Trust Indenture Act of 1939. The Boston Edison, of course, was just about that time. I would point out to you, however, that under Section 3(a) of the Trust

Indenture Act, there are several provisions providing that if there are certain relationships between the trustee and the underwriters, then the trustee is disqualified. I should think that your normal ordinary situation would be for your issuer with its counsel and based upon past experience -- I don't know whether that will continue in the future or not -- but they probably will call upon some underwriting house and their counsel will work for them and would get the indenture in shape -- they would get the registration statement complete with the exception of the price, the proposed spread, and the names of the underwriters and their holdings, issuers and their holdings, and the relationship of the officers and trustees and directors, to the issue.

Now, supposing it so happened that the underwriter bidding the highest price after he sent out his questionnaire to the trustees discovered that he stood in one of the forbidden relationships to the trustee?

It would seem to me that you would either have to throw out that underwriter's bid, which would be very unfair to him, or you would have to ask the trustee to resign. Other people might then complain that the securities that were awarded to the underwriter with the highest bid were not the securities on which they had made their bid.

We have had two situations recently -- they were both industrials. One was the Jones & Laughlin indenture where the Union Trust Company had to resign and it went to the Bankers

Trust Company. We had a situation the other day where the Shell Union Oil, where J.P. Morgan resigned and it went to the Central Hanover.

It seems to me, and I am merely expressing my opinion on the basis of having worked on several of these registration statements where there has been competitive bidding, that the underwriter and their counsel are definitely handicapped in the investigation which they make under competitive bidding. I am not saying that necessarily in the high grade security issues especially where they have been registered three or four times before or where the Public Utility Commission has been over them with a fine tooth comb that there may be anything serious about it, but let me point to you some of the difficulties.

Some of these New England public utility companies have decided to go in for competitive bidding, and a large number of underwriters and bankers swarm up there to their offices. Generally speaking, financing is an interlude in the life of an operating public utility company, and most of them dislike it intensely because of having all kinds of folks from Wall Street come in and take their minute books, take their correspondence, sit in their offices and smoke their good cigars, drop ashes on the floor and in general be expected to be invited out to lunch. They do not come home to dinner and their wives do not like that, and they are around there for a period of two or three weeks. That is bad enough, when you have got one fellow and one set of

investment bankers. But when you have got eight or 10 sets of lawyers there or maybe 10 or 20 investment bankers all of them asking for the minute book of the same day, or all asking for copies of the indenture including the refunding issue of 1906 of which there is only one typewritten copy, and all of them asking to be taken into the president's office and sitting down and saying, "Now, Joe, tell me if there is anything in the family skeleton", they don't like it. If I were the president of an issuer and I wanted to withhold any real information, I would have one of these public meetings, because it is the easiest thing in the world to withhold information in one of these public meetings.

Chairman Frank: You are not referring to this meeting?

Mr. Dean: I think more would be accomplished at a private conference.

Chairman Frank: This public conference was held at the suggestion of your clients.

Mr. Dean: I quite understand.

Chairman Frank: I agree with you. I think we learn more in a private discussion than we do in this kind of a meeting.

Mr. Dean: If you are sitting down with a vice-president of a public utility company and pursuing a conversation over a period of several weeks, and you think that he is trying to hide something from you or trying to keep something back -- and practically all corporations of any size or age have some family

skeleton of which they are not too proud, a sort of a Sister Emmy who is an epileptic hidden away in the attic upstairs -- but you do not get that sort of a thing in a town meeting. Maybe you think that is important and maybe you think it is not. But I personally think you don't make as good an investigation on these competitive bidding issues just for the very reason of having the number of people working on them and because of the fact that you can not get on that intimate relationship with the officers and the issuers that you can with private negotiation.

I submit that for whatever it is worth.

It may be that if you had universal compulsory competitive bidding, that you would have these so-called professional agencies set up, but I wonder if that would not be substituting another problem for the problem of your underwriter? I should think that if that were done, that over a period of time, you would have five or six of these professional agencies, and the first thing you know you would have a charge of a monopoly in these professional agencies. Then the Commission would have the problem of deciding what is the worth of the services of this so-called professional adviser?

Personally I can not see that competitive bidding solves the problem of the Commission except upon this question of the affiliation with the affiliate, which seems to me to be the guts of this whole question. I honestly do not think that the price or the spread will be solved by this question of competitive

bidding at all. It seems to us if we were to address ourselves to the question of how the Commission can solve this problem of who, what and which is affiliated under 2(a)(11)(b) and try to suggest to you some more specific rule for the rule that you have now, that perhaps we might be able to make a contribution to the Commission in trying to help the Commission find out whether or not the issuer really was affiliated with its investment bankers, and isn't that the real question that is bothering the Commission?

Chairman Frank: Have you such a rule up your sleeve?

Mr. Dean: I have not such a rule to offer today. I will tell you why.

Naturally, representing an association you can not suggest a rule without submitting it to a large number of your organization who would be interested. Obviously, those who headed public utility of securities would want to see whether or not the rule would be satisfactory to them and also see whether or not it would meet some of the fundamental issues that have arisen under Section 11(a)(2) and under your present rule U12F2. I may be wrong, but it seems to me that the real question which is troubling the Commission is whether or not the issuer has been free to pick the leading underwriter regardless of the price of the spread. The staff's report says that as far as what data there is, there has been a slight overpricing on the basis of securities that have been offered on the competitive bidding method, and I gather that you think that is rather inconclusive

one way or the other.

Chairman Frank: Perhaps you have in mind when you refer to affiliates, something more than that limited question. What does bother us a great deal more than price and spreads is whether the issuer is getting the best advice possible in the circumstances as to the character of the securities, as between bonds and stock. That is what bothers us a great deal more than, in the present market, the question of price and spreads.

Mr. Dean: Of course, generally speaking in working on these issues, investment bankers submit all sorts of plans including immediate plans and long range plans and alternative plans just as Mr. Woods said this morning, some of which involve mortgage bond financing, debenture financing, convertibles, and so on. It is said in the report that some of the bankers are much more interested in selling bonds than in selling stock. In my experience I do not think that makes any difference; I think the banker is just as much interested in selling preferred and common stocks as they are in selling bonds. As a matter of fact, there is a higher spread on some stocks than there would be on some bonds.

Mr. Weiner: That would not be true if that banker did not handle the other classes of securities?

Mr. Dean: If he did not handle the ^{other} classes of securities, then generally speaking they say that frankly and urge the issuer to call in somebody else. After all, in most of these

companies that you are dealing with, you are not dealing with people who are inexperienced. You are dealing with somebody like Delafield of the Columbia Gas and other executives who know a great deal about the market. These are all people that have studied these markets for years; they are not children and they have got men on their boards like Kemp on the Southern California who is the president of a life insurance company out there and the president of a bank, and various other people that have been in business for a long time and invested for large estates and thoroughly cognizant of capital structure, and they know pretty well whether these investment banking houses are giving them honest judgment or not.

I personally can not quite see that if investment bankers were to sell to their proposed issuers the services of their Buying Departments and that the same investment bankers were then permitted to bid upon the issue how you would get any more disinterested advice than you get now.

Chairman Frank: It would make this difference; conceivably the banker who gave the advice would not be sure in that instance that he was going to be the successful bidder as he would in the other.

Mr. Dean: Yes, but on the other hand there may be greater chance of collusion, just as there is in the case of competitive bidding. Fifteen or sixteen years ago, I remember coming down to Washington for some of my clients because various people at

that time had gotten the Bureau of Standards to specify a certain kind of spigot pipe, and when these municipalities all over the country let their contracts on competitive bidding, they would say, "The standards as specified by the United States Navy", and that meant that everybody except this one particular manufacturer's pipe was excluded.

I remember another time --

Chairman Frank: That would be a little difficult today in these circumstances.

Mr. Dean: He might set the thing up in such a way that there were certain sleepers in some of the securities that were not readily apparent on the advertised bid that he would be far greater cognizant of the possibilities than some of the others.

Chairman Frank: I think the astuteness of the investment banker will enable him to discover those sleepers, don't you?

Mr. Dean: I can not quite see, if that would be your sole reason for going into competitive bidding, then I think that would be a step backwards, because in my experience, the work of the Buying Departments of these investment bankers shows that it is very thorough, very conscientious and very well done. Practically every one of them are submitting plans to issuers all the time with respect to their recapitalization.

There is some curious miasma about the mind of the investment banker that he is going around calling upon the public utilities all the time, and yet he won't say that he aggressively competes

for the business. I think what he means by that is this, that if they went out and used the tactics of the strong arm methods and aggressively went out and got the business, once they got the business they would be in position whatsoever to negotiate protective covenants, that they are in no position whatsoever to try to set up a sound piece of business, that if you have gone out and said to somebody else who is satisfied with the leading underwriter that you can take that business away from them and do a better job for you, then in order to do a better job for the issuer, they have to do a worse job for the investor. That is what I think they mean when they say that they do not go out and aggressively compete for business, but I think that every single one of them would jump at the chance of being offered a new piece of business, and every single one of them -- I was out working on the Southern California in 1935 when it was free choice for everybody, and if there was not an investment banker that did not go to Bauer's office, it was because he did not want it. I think practically everybody in the United States was calling Bauer on the telephone or sending him telegrams or using every conceivable kind of influence to get that particular piece of business. And I think that is true in every situation in which investment bankers think they have a ghost of a chance.

Mr. Weiner suggested this morning that some investment bankers thought that other investment bankers should not go out and try to get business. I don't see why anybody should not go

out and try to get all of the business it can. I don't see why Mr. Eaton should not go out and get all of the business that he can, and as far as I know he does. It seems to me it is perfectly all right. This idea that anybody has got a sacred hold on any piece of business and anybody else is doing something wrong when somebody else tries to take it away from them, I think is the bunk. I don't think you improve the situation if you go out with competitive bidding.

On this question of priceⁱⁿ/competitive bidding, very often the board of directors of the issuer says to the investment banker, "Are you going to sell all of this issue to the large insurance companies, because if you are, we want to get somebody else to do this piece of business. How many underwriters are you going to have in this business with you; how many selling distributors; how much are you going to allot to people in our own territory?" The officers of the issuers study the proposals of the investment bankers as to how many dealers they are going to have and how much distribution they are going to have around the country, very carefully. That dealer distribution, naturally, costs money. If you have competitive bidding and if insurance companies are going to bid at the same time, then naturally if anybody is going to bid, he has got to cut -- the investment banker to bid successfully with the insurance companies would have to cut to the bare bones.

Mr. Weiner: Would you mind an interruption at this point?

Mr. Dean: Just let me finish this statement, and then I will be glad to answer you.

Suppose you have a \$50,000,000 issue and your rule is adopted that you can bid for a part of it. If your insurance company were to bid 101 for \$25,000,000, and your investment banker is going to bid 101 for \$25,000,000, then obviously you are going to get rid of that participation as fast as he can and he is going to get his distribution cost down to the bare bone minimum. And if the insurance companies are only willing to bid 101, then it is obvious that the insurance companies are not going to be in the market for any part of the other \$25,000,000 at 101½ or 102, and therefore whoever goes into that thing has got to go out and sell it and sell it fast and sell it just as quickly as they know how.

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Now, I will be glad to get your question.

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Mr. Weiner: I was going to ask you about the local distribution, what cases have come to your attention, because the only one we have particular seen was the Consumers Power case where, contrary to the general expectation that the issuer has insisted, or that the underwriter because of his own motivation has not given the local territory as much as it can absorb, it was as the result, as I recollect it, of a letter from the Chairman of the Commission stating that the Commission was interested in local distribution but had no power to direct it, - that an additional million dollars of bonds was allocated to the local dealers?

Mr. Dean: I remember ever since I was in the utility financing business, back in 1923, the first case I had was the case of the Milwaukee Electric, and at that time the board of directors was very keen --- I think that, if my memory serves me right, it was an affiliate of the First National Bank of Wisconsin and other large Wisconsin^o dealers, - that they be given large participations in order that they get proper distribution in that territory.

I remember in the Cleveland Electric Illuminating issue that they were very anxious to get local distribution.

I remember in the Southern California Edison issue that the board of directors went over the distribution of the issue and the names of the underwriters and dealers in a very careful manner, in order to be sure that there was proper distri-

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bution in and around the State of California.

Mr. Weiner: There might have been other reasons?

Mr. Dean: You mean the fact that they might be anxious to see that friends of theirs were taken care of?

Mr. Weiner: Yes, friends of theirs, or people who are influential in making sentiment regarding the company in the community.

Mr. Dean: Yes, although in that particular situation, as I think the testimony before the TNEC shows, in one of the issues a large block of bonds had to be repurchased by a secondary syndicate, and redistributed in the East.

But generally speaking, most issuers are very keen to achieve very wide distribution of their securities.

Now if you offer the dealer too small an amount he won't work, I mean he just won't go around and wear out his shoe leather pounding the pavements, calling upon his customers, if the amount that is allotted to him is too small. He will try to sell something else.

The suggestion was made here that the Commission might try to allocate the amount that was to go to the underwriters and the amount that was to go to the dealers. I am not addressing myself to the Commission's statutory authority to do that. I simply would like to say this, that you of course have got to pay capital enough to interest capital, and you have got to pay the dealer enough to interest the dealer.

WLC

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Now the spread between the dealer is naturally a combination of bonds times spread. When you get into a particular city like here in Washington, as Cliff Folger will tell you, if you have too many people being allotted bonds, he won't be able to take care of his own particular bonds, and if you have too many people calling up each customer for one bond, you can ruin your market in that security in a particular city; whereas, if you confine yourself to a particular number of dealers where, by some magic, such as a successful syndicate manager, you would have a successful issue in that city.

It would seem to me that you would have to go into the question of many underwriters you were going to have, how many bonds each underwriter was going to have; how many dealers you were going to have; how many bonds each dealer was going to have; whether there were enough dealers in your syndicate -- in other words, the Commission would be taking over the functions of a successful syndicate manager, which, Heaven help me, I have never been able to understand.

Mr. Weiner: I don't think that was the Chairman's suggestion. I thought he suggested that the issuer might prescribe the conditions of his bid.

Mr. Dean: As a practical matter that bothers me very much from this standpoint.

Supposing you have a \$50,000,000 issue and adopt a rule permitting an insurance company to bid for it and an investment

WLC

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banker to bid for it; and suppose each bids 101 for \$25,000,000 apiece. The insurance company says, "We are going to keep our bonds, we are not going to reoffer them". The investment banker then says, "We don't quite understand how, - if the insurance company has bought their bonds and they are the property of the insurance company and the Commission has no further strings on what the insurance company does with them, - why the bonds that we have bought aren't our property, and why the Commission should be putting strings on what we can do with our property because we bought it and paid the issuer 101 just the same as the insurance company has paid 101; and since it is our property, we don't think that those are fees paid by the issuer."

Mr. Weiner: I didn't understand that. As I recollect what I believe you are referring to, when the point about local distribution in the territory where the company operated was made, the Chairman suggested consideration of the feasibility of an issuer who desired that kind of distribution specifying in the first instance in soliciting bids a requirement that arrangements be made for local distribution of some character.

Mr. Dean: This happened in one instance that I know of, where the president was very insistent that the investment banker include a certain number of dealers. He also insisted on a very high price. When the bonds were offered to the dealers, there was an almost universal dealer declination, so that the

WLC

underwriter was left with those securities.

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The president still insisted that the underwriter would have to use every effort to try to sell those securities to the dealers. The underwriter said, "I can not and will not use pressure upon these dealers, the only thing for me to do is, they are now my bonds, and I am going to sell them in whatever way I please."

It seems to me that you can't expect people, as a practical matter, to take their money and take it out of their pockets and put it in the issuer's pockets, so that their money is then the issuer's money, and then they own the bonds, and then for the underwriter to be told "Now these are your bonds and whatever loss is on them is yours, and whatever profit is yours, and I, the issuer, am going to tell you how to sell these bonds."

I think, as a practical matter, that is a very difficult thing to do.

Well, I have already taken up a great deal of the Commission's time. I can only say that I sincerely hope that the Commission will not adopt this rule, proposed rule; but if you do adopt it, I also sincerely hope that you will not adopt it without giving Congress -which I believe at the time of the passage of the Securities Act of 1933 expected underwriters to make very careful investigations of security issues, and which I do not believe had compulsory competitive bidding in mind

WLC when they adopted the 1933 Act or the 1935 Act- an opportunity
6 to review these various statutes with you in order to see
whether competitive bidding fits into the theory of the
various statutes under the Commission's jurisdiction.

Commissioner Healy: Competitive bidding was practiced
in various sections of the country when all of those statutes
were passed?

Mr. Dean: It had not come up at that time here in the
District of Columbia.

Commissioner Healy: That is true. But it had been
enforced however in Massachusetts since 1919, if I remember
correctly.

Mr. Dean: That is true, and I don't want to make any
statement on that subject because I am not a student of it,
but it is my understanding -perhaps Mr. Ford can help me out- that
the Edison Electric Illuminating issue of 1934 was one of the
first pieces of long-time financing ---

Mr. Ford: (Interposing) I believe it was the first.
The Boston Edison Company financed itself on a short-term
up until 1934 by the issuance of one, two or three year
notes, which, under the Massachusetts statute as it then
stood, was permitted without competitive bidding.

Commissioner Healy: My information is that the Massachusetts
statute was passed in 1919, and that the traditional method of
financing utilities in Massachusetts is by short-term loans which

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are subsequently refunded after the money has been invested in capital additions.

Mr. Ford: That is quite true.

Commissioner Healy: Isn't it true that competitive bidding had been in force in Massachusetts by statute for at least 14 years before the Security Act of 1933 was passed?

Mr. Ford: I am not sure of the exact date when the Act was passed.

Commissioner Healy: I am not sure either, but I think that is about right.

Chairman Frank: And that obviously was also true with the Trust Indenture Act.

Mr. Dean: Yes, Mr. Chairman, it was, although I don't know of course what went through the minds of the Congress, but I don't recall any discussion either with the Commission or before the committees of Congress about the relation of competitive bidding to the Trust Indenture Act.

Chairman Frank: The fact as, wasn't it ---

Mr. Dean: (Interposing) It never occurred to me about what would happen if you were to let --

Chairman Frank: (Interposing) I don't see much difficulty about it. You can provide names of trust companies in the alternative.

Commissioner Healy: Besides, don't you think that a bidder would be somewhat negligent if he didn't discover

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that he was disqualified, or that the trustee was disqualified, until after he had made his bid? Isn't it reasonable to expect that an investor would investigate that subject in advance?

Chairman Frank: Or that the issuer would investigate it if he wanted to have a particular bid from a particular investment banker.

Mr. Dean: He might not know.

Chairman Frank: He would inquire, then.

Mr. Dean: Suppose he had never heard of this particular underwriter who came along and put in a bid?

Chairman Frank: The underwriter would know, and if it became a matter of importance, the issuer could specify one of several trustees.

Mr. Dean: But the various trust companies might not wish to give out the securities in their portfolios, the securities they held as trustee in their various capacities, to people unless they knew the person was a successful bidder.

Mr. Weiner: Which disqualification under the Trust Indenture Act are you speaking of?

Mr. Dean: The various ones set forth under Section 310, about various security holders.

Mr. Weiner: That is as interrelated with the proposed underwriters?

Mr. Dean: Yes, sir.

LC

Mr. Weiner: A fairly rare case today, isn't it?

Chairman Frank: We will reflect on that, Mr. Dean.

Is there anything further?

A Voice: May I ask Mr. Dean whether his figures on total railroad financing included certificates of bankruptcy trustees and receivers in equity?

Mr. Dean: These figures were telegraphed me today by Franklin McClintock. We asked Mr. McClintock to give us all publicly offered securities of railroads other than equipments and include in it the total private placements of which he had any record. Now we excluded equipment trusts.

aj-1.
cyl 3

I would like to file a copy of the brief of the Investment Bankers Association of America, as part of the record.

Chairman Frank: Is that the brief that we heretofore received?

Mr. Dean: Yes, sir.

Chairman Frank: Then the reporter need not copy that in the record.

(A copy of the brief referred to is filed with the transcript.)

Mr. Weiner: I should assume that all the replies received ought to be regarded as a part of the document.

Chairman Frank: Yes.

Mr. Stewart: If that is the case, will copies of the other replies be available to us as well?

Mr. Weiner: I think they should be, yes.

Chairman Frank: I should think so.

Mr. Stewart: We would be grateful if they were.

Chairman Frank: You have another witness?

Mr. Stewart: Mr. Gallagher.

STATEMENT OF FRANCIS P. GALLAGHER

Manager of the Municipal Bond Department of
Kidder, Peabody & Co.

Mr. Gallagher: My name is Francis P. Gallagher, Manager, Municipal Bond Department of Kidder, Peabody & Co.

Mr. Chairman, I have a very excellent speech on this

entire subject, but in the interests of adjournment, I am going to file it.

(The prepared paper of Mr. Gallagher is as follows:)

Factors that Influence Price on New Issues:

Negotiated Issues:

1. Satisfaction to issuer.
2. Approval by S.E.C.
3. Acceptance by investor.

Competitive Issues:

1. Satisfaction to issuer.
2. Approval by S.E.C.
3. Acceptance by investor.
4. Certainty of award.
5. Advertising accruing to purchaser.
6. Establishment of character as house of high grade issues.
7. Prestige of syndicate manager.
8. Availability of large block of acceptable issue.
9. Recovery of expenses incurred in examination.
10. Estimate of what second bid will be.
11. Actual knowledge of existing market for succeeding issues.

On both negotiated and competitive issues, factors 1 to 3 affect the public interest. On competitive issues, factors 4 to 11 do not concern the public interest, but nevertheless

influence price.

- - -

Mr. Gallagher: I would just like to summarize one little paragraph here that I thought would draw a picture of the existing circumstances, and what can happen in the future. Nobody knows, under the rule, what can happen or what would happen, but I just want to recite here what can happen, and I was thinking of how our great Lincoln said something about "All of the people all of the time" and "some of the people some of the time", and I just wrote this down:

Under existing methods of negotiated issues publicly offered, the following results are evident at the present time: Some of the investors get some of the bonds all of the time. Some of the investors get some of the bonds some of the time. None of the investors get all of the bonds any of the time.

On competitive bids it is possible for some of the investors to get all of the bonds all of the time.

Competition in a broad sense implies an equal chance for two or more persons to attain a given end. In competition for new issues of public utility issues there would not be an equal start for bond houses against insurance companies because, under the 1933 Act, an insurance company would not be an underwriter and subject to the impediments attaching to an underwriter. Consequently, there is not fair competition.

In the interests of adjournment, I will stop with those few remarks.

STATEMENT OF EMMETT F. CONNELLY

President, Investment Bankers Association of America

Mr. Connely: I think it would be a very welcome note if I would say, "The defense rests".

But I would just like to touch on one thing, as President of my own company, the First of Michigan, which has not been covered, a point on the concentration of underwriting, and I won't read this whole statement, but I will leave it here with the reporter as part of the record.

(The statement referred to is as follows:)

aj-1

I would like to make a few remarks, not as President of the Investment Bankers Association but rather as President of my own company, the First of Michigan Corporation of Detroit.

As I have listened to the testimony given to date, it seems to me that there has not been brought out certain information that might be of value regarding "concentration of underwriting power". In the testimony yesterday there were occasional references to things that happened in the investment banking business prior to the passage of the Securities Act of 1933. Also, certain testimony developed in the report of the Public Utilities Division uses evidence given at the T.N.E.C. hearings that deals with investment banking practices of the 20's and even earlier dates.

It seems to me that there is little to be gained by delving into past history except where such history may be used constructively to compare what was going on then as against what is happening now. I do think one should compare concentration as it existed prior to the passage of the 1933 Act with the so-called concentration of today; and I think I know a little something about this subject. When bank affiliates were permitted, prior to 1933, I was president of the First Detroit Company. This company had \$6,000,000 of capital of its own and resource to a great deal more capital if needed from the First National Bank and the Detroit Trust Company,

the two largest institutions of their kind in Detroit.

In 1933, with a group of my own associates, I formed the First of Michigan Corporation with a rather limited capital. In the old days the First Detroit Company, with all the capital and all the prestige that we had, were underwriters in comparatively few large situations. About the best we could do was to be in a banking group or a sub-underwriter's group, but equally often, I believe the records would show that we were but selling group members. There was definitely more concentration then than there is now.

With the breaking up of bank affiliates many officers and officials of those companies went into business for themselves. For example, the First Boston Corporation was formed by the affiliates of the First National Bank of Boston and the Chase National Bank of New York. Many people that have been in business for a long time completely rebuilt their business as far as underwriting activities were concerned. We did. Since 1933 we have been able to have satisfactory underwriting positions in a great many more deals than we ever had in the old days. We have, as a result, a more diversified list to offer our customers than we had formerly. As a result of this trend Michigan has come to be a pretty good public utility market. Prior to 1933 Michigan was known in the trade as a very poor public utility market, except for issues of the Detroit Edison Company. Even the issues of

Consumers Power and other big utilities were sold little in Michigan prior to 1933. Now the Michigan investors are able, through larger underwriting groups, to get Consumers Power bonds whenever they are offered. We also have more opportunity to get into more industrial financing than we used to have.

Therefore, if you compared what the situation was in the 20's as against what the situation is today, I am sure that it is conclusive proof that there is constantly being given more consideration to broadening distribution rather than concentrating the purchasing power of a few houses in New York.

Experience in my company is not at all unique today. In any sizeable deal there are anywhere from 40 to 100 underwriters; this contrasted with perhaps 3 to 5 underwriters formerly.

I firmly believe that if the competitive bidding rule is put into effect there will be a tendency to contract these underwriter groups because the mechanics of handling the deal will be complicated plus the fact that there will be a natural desire to take bigger positions on the part of those that are heading the accounts because they will feel there will be that way a narrowing spread and they have to get their gross. Therefore, there are two risks coming out of this - less underwriters and probably few selling groups, and we would return to the concentration of the 20's.

I would like to also add a little more testimony to what Mr. Walter Sacks said yesterday about the competition of the market. There is no question about this existing in our business, just as it does in others. While we don't buy our clothes on competitive bidding, competition in the market keeps prices in line. We certainly don't buy our groceries on competitive bidding, but again, comparable prices are quite an influence. No grocer can very well go along charging too much for his merchandise and get away with it.

It is not up to me to discuss the legal aspects of this situation, but I confess that from a layman's reading of all the material that I have seen, I have had to come to the conclusion that the Congress, when it passed the 1935 Act, was talking about competitive conditions and not competitive bidding; that it was talking about conditions as they existed between interrelated public utility companies and not as they existed between a utility company and what has been semantically termed an emotional affiliate in the underwriting business.

It is because of this feeling that I think that this matter should be cleared up by Congress and that is why I urge that any action on this rule be deferred until it can have the attention of the appropriate committees in the House and the Senate.

Mr. Connely: The point is that I think we have completely ignored what happened prior to the Securities Act of 1933. I was President of a bank affiliated at the time in Detroit, and we had \$6,000,000 of capital of our own, and all the extra resources we needed from the First National Bank and the Detroit Trust Company, and yet we were very rarely an underwriter.

Now since 1933, as President of a very much smaller company, we have been a very frequent underwriter and have been in many, many issues, and had a great deal more diversified list to offer to our customers.

I would like to point out that in that particular case, if a firm such as the First Detroit in the old days couldn't make very much headway against concentration of buying power, that the competitive bidding might turn that situation back where little fellows like I am today, would never get an underwriting.

I think that is worthy of thought, because in the old days there used to be three or four houses underwriting practically everything.

There is one more thing I would like to submit for the record. Mr. Weiner stated this morning - if I remember correctly - that he hadn't had a reply from an operating company on this subject.

John McKeon, of Hartford, sent me a copy of a letter that

Mr. Ferguson, President of The Hartford Electric Light Company,
sent to the Commission, so I assume you have that copy. It is
dated November 14, 1940.

WLC

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On January 27, 1941, Mr. Ferguson wrote Mr. McKeon, and he gave me permission to use this, which I shall also file, in which he says that there are two things in the public utility business that he considers do not lend themselves to competitive bidding.

(The letter of January 27, 1941, referred to, is as follows:)

THE HARTFORD ELECTRIC LIGHT COMPANY

Hartford, Connecticut

January 27, 1941

Mr. John J. McKeon

Charles W. Scranton Company

209 Church Street

New Haven, Connecticut

Dear Mr. McKeon:

In answer to your inquiry as to my feeling in regard to the value of competitive bidding to utility companies would state that I have previously made a suggestion to the Commission which I feel would enable them to find out what is not known now, namely, whether or not such procedure would be of advantage to the companies.

In our business the two prime essentials are -

- 1 - a sure supply of fuel;
- 2 - a sure supply of money.

I am positive as to (1) - that we could not consider

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competitive bidding since a sure source of supply is of far more importance than the saving of a few cents per ton even if such saving should result (which is by no means certain over such a period of years as covers both a buyer's and a seller's market).

I am inclined to the same opinion as to (2) - certainly until it can be demonstrated in some way that competitive bidding is a real advantage to the public. To require it with present information looks like attempting to rectify specific abuses by a course analogous to getting rid of rats by burning down the house.

Yours very truly,

S. FERGUSON

SF:8

President

Copy to: Mr. Emmett F. Connely, President

Investment Bankers Association

I think in fairness to Mr. Ferguson that I should state he qualifies his objections. I want to make that perfectly clear. He has offered a rather unique idea that the Commission might insist on a bid on 10 percent of the issue, and then throw the rest open to negotiation.

(The letter of November 14, 1940, from Mr. S. Ferguson is as follows:)

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THE HARTFORD ELECTRIC LIGHT COMPANY

Hartford, Connecticut

November 14, 1940

Jerome N. Frank, Chairman
Securities and Exchange Commission
Washington, D. C.

Dear Mr. Frank:

I note in the press that the Commission has heretofore invited suggestions as to methods that would assure that the public is not burdened by excessive underwriting fees in connection with utility financing.

I would suggest that in place of requiring competitive bidding on an entire issue that there be required the sale of five or ten per cent of each issue on such a basis.

Such a bid would naturally be somewhat higher than the underwriters of the major part of the issue could afford to make on account of the difference in amount of work and responsibility but the fact that a comparison of fees would be a matter of record would --

- (a) Accomplish an automatic check on collusive offers.
- (b) Furnish your Committee with data which would show whether or not an extension of the method was desirable in the public interest.

I might say that those underwriters with whom this proposal has been discussed dislike the suggestion as liable to put them

WLC

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unduly on the spot.

Yours very truly,

S. FERGUSON

SF:S

President

Now we are most appreciative, Mr. Chairman, for the time that you have given us here. I think this has been a very worthwhile, although pretty tedious, three days.

Chairman Frank: It has been very interesting to us.

Mr. Connely: And we have been extremely grateful to you for that.

I am going to file this statement, and there is just one part which I would like to read.

(Whereupon, Mr. Connely read a portion of his prepared statement, the full text of which is as follows:)

On behalf of those who have represented the Investment Bankers Association of America at these series of conferences I want to express my appreciation to the S.E.C. for the manner in which they have conducted these hearings. The Commissioners have evidenced a high type of fair minded interest which reassures my belief that they have an open mind on the subject and will decide the question solely on the basis of the reports, letters, briefs and memoranda submitted to them by all interested parties together with the testimony taken at the present meetings.

the present meetings.

Considering the proposal which was put forward by the P.U.D. staff one has to ask who has demanded the imposition of competitive bidding? Does the public ask for this? Does the investor ask for this? Do the public utility companies ask for this? Do the great majority of investment bankers ask for this?

The testimony submitted in the last three days definitely refutes the premise that any of these demands exist.

Witness after witness has appeared here to testify against this proposed rule. Investors representing banks, insurance companies, college and hospital funds, etc., have voiced their concern and disapproval and have indicated that the proposal if adopted, would injure the public interest. Small dealers, medium sized and large underwriters have been equally equivocal in advising against the adoption of the rule. Only two interests outside of the P.U.D. staff itself, favored the adoption of the proposed rule namely Halsey Stuart & Co. and Otis & Co. (the latter supplemented by Mr. Chamberlain, a former utility executive who acknowledged that he at one time headed a company which was dominated by Mr. Eaton of Otis & Co., and who, by his own testimony is unfamiliar with financing practices since the Securities Act of 1933.)

I believe that in the court of public opinion the case for compulsory competitive bidding under the weight of opposing evi-

dence must collapse.

Without any desire to prolong this closing statement I must point out that the adoption of the proposed rule would further complicate and impede the free flow of capital at a time when the nation is crying for industrial expansion for national defense without delay.

The adoption of the proposed rule would largely offset, as applied to public utilities issues, the amendment to the 1933 Act sponsored last year by the Commission and the industry to make possible the acceleration of the effectiveness of registration statements.

It would further burden the Commission with the task of being judge and jury on many questions that might more properly be decided by corporate management and finally it would undoubtedly make necessary certain amendments to the 1933 Act to insulate underwriters from liabilities of section 11 and 12 as far as mis-statements of issuers and experts are concerned.

Because of all of this I respectfully ask the Commission to defer final action on this proposed rule until the broad question of public policy involved here can be considered by the Congress along with the proposals which we hope will be put forward for amendments in the 1933 and 1934 Acts, and to ask Congress to clarify the 1935 Act with such supplemental legislation as may be needed with respect to this problem.

Chairman Frank: As to your last point, there is no need to traverse the same area that we did with Mr. Jackson, but I think you understand the attitude of the Commission which can be briefly stated thus:

As to whether the 1933 Act needs amendment in order to make this rule workable, we will consider that, although, as we have already indicated, experience with the New England competitive bidding issues would seem to show that it isn't necessary.

Putting that to one side, if the Commission decides that it has no power to make such a rule, that is the end of it. Then there is no need to go to Congress to determine it because we won't exercise it.

If, on the other hand, the Commission believes that it has the power and considers it desirable, it doesn't understand -and Judge Healy put it very well- why it should go to Congress on this kind of a question any more than it should on any other contemplated action under the statute which someone objects to or some lawyer objects to. We might as well say that every time we are going to take action under Section 11, because there is objection to it, we should go to Congress. It is only in the event that we thought such action was highly desirable and we thought that we didn't have the power, that the suggestion of going to Congress would seem to us appropriate.

I am enlarge on that to this extent, to say that if an

administrative agency believes it has the power to act, and that it was desirable to do so, if it went to Congress for approval in each instance it would defeat the very purpose for which Congress created the administrative agency, because the idea of creating administrative agencies was that Congress is so burdened already that it delegates to the administrative agencies certain functions.

Mr. Connely: I completely agree with you.

Chairman Frank: We have received requests to be heard on this subject from persons in California and Texas, and there may be others, and for that reason, although I think everybody is agreed that we have spent an immense amount of time in these hearings, we have decided to have a further hearing on the subject, or a public discussion on the subject, on February 5th at 10 o'clock, and would limit that period to those persons who have not heretofore been heard, although that doesn't mean that we won't be pleased to have any of you present as spectators, but we wouldn't like to traverse the same area again.

We assume you are all satisfied that you have had ample opportunity to present your views. Is that correct, Mr. Dean?

Mr. Dean: Yes. Will there be an opportunity of correcting the record that has been taken of the proceedings?

Chairman Frank: Certainly.

Mr. Ford: Before we break up, I should like to express the

appreciation of the National Association of Security Dealers for the patience which the Commission has shown in permitting such a full hearing.

I believe all of the gentlemen who have appeared here are members of houses who are also members of that Association.

We wish to thank you most sincerely and heartily.

Mr. Dean: I would like also to express my very sincere appreciation, Mr. Chairman, and to say - as I heard it stated here by someone - that if they had any desire to be a Commissioner, this hearing has cured them of that desire.

Chairman Frank: I am sorry to hear that. (Laughter.)

Mr. Stewart: I would like to add, Mr. Chairman, that I am very grateful to you for your consideration, and your patient and courteous treatment, and I do particularly wish to record my thanks.

Mr. Weiner: Would it be appropriate to suggest that -- there were several specific amendments to the rule, if it were adopted, that were of interest to a number of persons, and that perhaps it might be well to be prepared to have that discussed at the February 5th meeting. I am thinking particularly of the exemption for commercial banks. I know, from what I have been told, that the investment bankers and the commercial bankers are both interested in having that discussed.

Chairman Frank: We will put that on the agenda for February 5th.

We will now stand adjourned until February 5th.

(Whereupon, at 6:30 p.m., an adjournment was taken until 10 o'clock, a.m., Wednesday, February 5, 1941.)

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(The following is the letter in full, excerpts from which were read by Mr. Ford, as indicated on page 368 of the transcript in these proceedings dated January 28, 1941:)

aj-1

JOHNSON, CLAPP, IVES & KNIGHT

50 State Street

Fred'k Manley Ives
Henry F. Knight
Hervey W. King
Wilford L. Spencer
William R. Cook
Henry C. Perkins
Frank B. Frederick

Boston

January 3, 1941

Charles O. Pengra, Esq.,
30 State Street,
Boston, Mass.

Dear Charlie:

I have not seen the report of the Securities and Exchange Commission on competitive bidding but only the release of December 19, 1940 which summarizes the report. This release is numbered 2441 under the Holding Company Act of 1935. I had supposed and still suppose that the proposed rules respecting competitive bidding applied only under the Holding Company Act and not under the Securities Act of 1933. I do not know enough about the operation of the Holding Company Act to express an opinion on the workings of such a rule under that Act.

Competitive bidding for Massachusetts public utilities is, of course, here to stay under our local law, and I assume a duplicate requirement under a Federal law would be no more burdensome. So far as I know, the only reason for legislation requiring competitive bidding is that it prevents the opportunity for collusion between an issuer and underwriters; and

that, of course, was the argument advanced by the proponents of the Massachusetts statute. The opportunity for collusion is, I suppose, greater in the cases of holding companies than in the cases of companies without affiliates.

From the point of view of the Edison Company the objection to competitive bidding is the delay which might result between the date of acceptance of a bid and the delivery of the securities, in order to enable counsel for the successful bidder to give an opinion upon the legality of the issue and respecting underwriters' liabilities. In our two bond issues that feature has been my principal worry. Strange counsel might, I presume, investigate the corporate records and satisfy themselves that the issue was lawful or unlawful in a reasonably short time, but I do not see how they could possibly form an opinion with respect to underwriters' liabilities for false or misleading statements or omissions in registration statements and prospectuses in a period of a week or ten days.

Fortunately, my worries have not materialized in our two bond issues because of the willingness of the underwriters to supply you with the rather intimate knowledge of our affairs which you have gained from your representation of underwriters of our securities long before 1933 and in cases where competitive bidding was not required. But if Ropes, Gray or Palmer, Dodge, or some other equally eminent firm, who knew nothing about our business and who could be relied

upon, to do a thorough job, had been employed by a successful bidder, I cannot believe that they could have given an acceptable opinion in ten days.

If the Securities and Exchange Commission themselves approved issues so that the underwriters might rely upon that approval, the case might be different, but, of course, under the Securities Act there is and can be no approval by the Commission, and the underwriters are liable for false and misleading statements and omissions in registration statements and prospectuses almost to the same extent as directors. Perhaps, under the Holding Company Act the underwriters' liability is not so comprehensive. I have not investigated and do not know.

I have been unable to find any memorandum of conversations during the registration of the 1935 bond issue with Commission officials respecting the necessity of an effective date under the Securities Act prior to inviting proposals under the Massachusetts statute. There has never been any doubt in my mind that we had to have an effective date for this purpose; and according to my recollection my discussions at that time with Bane and John Burns were predicated on the proposition that an effective statement was necessary as a matter of course. Schedule A, paragraph (16) of the Securities Act requires that a registration statement state, "the price at which it is proposed that the securities shall be

offered to the public or the method by which such price is computed....." It seems to me that we satisfied this requirement when we stated in some form of words that the price would be not less than par or such higher price as might be offered and was acceptable to the company. Perhaps if no minimum price had been stated Schedule A is not satisfied; and I am sure I don't know whether the Commission will permit a statement to become effective if no minimum price is stated.

Yours very truly,

/s/ Fred'k Manley Ives.

FRED'K MANLEY IVES."

