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AFTERNOON SESSION

(The conference was resumed at 3 o'clock p.m.)

Chairman Frank: Let us proceed, gentlemen.

Mr. Kellogg!

STATEMENT OF CHARLES W. KELLOGG

President, Edison Electric Institute, New York City

Mr. Kellogg: Mr. Chairman: My name is Charles W. Kellogg. I am President of the Edison Electric Institute, New York City.

I asked you, Mr. Chairman, to be allowed to make a statement here today because I observed in the press the impression that the utilities, as such, were not particularly interested in the proceedings with respect to the nature of this hearing, which I understand is largely on the matter of competitive bidding in securities sales.

Chairman Frank: In sales of securities of public utilities.

Mr. Kellogg: I stand corrected, yes.

Just to qualify very briefly, I have been engaged in the public utility business since 1903. During most of that time - I resigned from active business about a year and a half ago - I have been connected with operating utility companies, but during the last 14 years I was President, and later Chairman of the Board of the Engineers Public Service Company, a registered holding company.

In order to save your time and to clarify the record, Mr. Chairman, I have prepared a very brief statement that I should like to read.

I believe there is misapprehension as to what is the most effective competition in the public offering of securities. The proposal of the S.E.C. purports to rest it solely on price and spread. I maintain that these two factors take care of themselves, if the utility focuses on the true essentials of:

(a)- A price that will make an issue move fairly readily into the market;

(b)- A price that will raise the capital at the lowest feasible cost to the utility;

(c)- A distribution that will cause the issue to be as widely held as possible by the largest possible proportion of permanent investors.

Now, under (a) - If a security is priced too high, it hurts everybody - the investor, by producing a deficient return on his money; the investment banker, by leaving him stuck with relatively unsaleable securities; the utility, by hurting its credit from having its securities go begging on the market. Yet the whole tendency of competitive bidding, if on the basis of price alone, will necessarily be to over-price securities.

Chairman Frank: Has that been the case in the New England securities that have been sold by competitive bidding?

Mr. Kellogg: I would think that was the inevitable tendency.

Chairman Frank: It seems somewhat unreliable to rely solely on conjectures as to inevitability when some evidence of some relevance is available, and to pursue your idea -- we have done it several times in the course of these hearings, we did it this morning -- let's follow your idea through.

If the result of competitive bidding is to over-price an issue, that means that somebody is going to get hurt. Now the small dealers have said that they didn't want to sell at prices that were too high to their customers, because they would have unsatisfied customers.

One would assume, then, that they would refuse to dispose of them at too high a price. One would suppose that the underwriters who agreed to take at too high a price, as the result of the bid, would find themselves incapable of disposing of those securities at too high a price, or that if they did, they would have dissatisfied customers, and it would come back on them.

And as one of the witnesses said this morning, he assumed - and I think he is right - that if it happened it wouldn't happen very many times before it was stopped.

If a banking group took at too high a price, and as a result the securities were sticky, they would either have to hold them until the price advanced, or they would have to sell them below what they bought them at, and that wouldn't happen very often.

One has to assume that people are going to look out for their own self-interests, and if - and that is implied in everything that has been said by you and everybody else - the investment banking business must depend on the good will of its customers, unless they make one deal and then go out, then it seems very unlikely that many times there would be bids at too high a price, because as I say, one of three things would happen: Either the bankers that bid at a price that was too high would take a loss, or they would hold the securities in the hope of an advancing market, or they would injure the purchasers, and their injury to the purchasers would mean that they had lost or would lose good will, and they wouldn't be able to do that very often.

So, making your assumption that other things would tend to force over-pricing, it seems to me that all the factors that have been mentioned in these several days of discussion indicate that there are other factors that would lead not to excessive pricing, and when you say it must inevitably - if we are going to argue in this a priori fashion, just on the basis of conjectures of the operating forces, then I can point to things that I have just pointed to, as well as you.

But has it been true that there has been over-pricing of municipals; has it been true that there has been over-pricing of equipment trusts; has it been true that there has been substantial over-pricing of utility securities sold through competitive bidding in the New England States, where it is required?

Now I don't see much evidence of that. So that, if you take it a priori, or on the basis of experience, it seems to me your argument is verbally coherent, but it seems to me it neglects known facts of experience, and on the basis of reasoning, the factors would tend to lead to the other conclusion.

Now, take your suggestion of wide distribution. I was saying this morning, and I didn't receive any satisfactory explanation, that if you have a negotiated sale and you are the head of a utility company, and you want wide distribution, you can have it, you can arrange for it, and one of the reasons, you say, that you are against competitive bidding is that you might not get adequate distribution.

You would get a higher price, according to your reasoning, but you wouldn't get as good distribution. In other words, to get the higher price you have to sacrifice the distribution, which is another way of saying that you pay something for getting the distribution which you think is desirable.

Why can't you do the same thing under competitive bidding; why can't you, if you are the head of a utility company, put in your offering, in the specification of terms on which you will accept bids, that you want distribution of a certain kind? That will cost you more, that is, if the testimony here has been correct, because the underwriters will charge you more for insuring that distribution.

But you say that one of the conditions is just what you would exact in a private negotiation, that you want a certain kind of distribution.

The argument has been made here again and again that if
the leading underwriters, the originating underwriters, wanted
to get the last nickel out of the dealer, and didn't care about
distribution, they could make more money by narrowing the dis-
2 tribution. But they do get the wider distribution, which
costs something. Why can't you specify that they shall give
you the same kind of distribution that they would give you
if it were a privately negotiated deal? What is there in-
herent in the very fact of competitive bidding that precludes
the insertion of such a condition?

Mr. Kellogg: As to that, Mr. Chairman, my answer would be that I was listing what seemed to me to be the really important factors.

Chairman Frank: So was I.

Mr. Kellogg: More important than price alone, as I will try to show.

Chairman Frank: And I agree - as I say at times parrot-like - that I think in this kind of market that we are dealing with today, the attainment of the highest price is not the most important aspect of competitive bidding, and as far as I am concerned, what is far more important is that we should see that the utility executives get the best advice available as to whether the securities should be bonds, or stocks, or the proportion of bonds and stocks, whether they should be preferred stocks or common stocks.

Mr. Kellogg: I agree with that, there is no question about that.

Shall I proceed?

Chairman Frank: Yes, if you will.

Mr. Kellogg: (Continuing):

Criterion (b) - So far as the matter of pricing a security too low is concerned, this is distinctly the responsibility of the utility management. In this day and generation, when the criteria for security values are so widely known and so well understood by the investing public, buttressed by such independent services as Poor and Moody, and with the constant necessity that exists in the utility business for raising new capital - so that management is constantly in practice on the subject - it is simply inconceivable that any issue will be sold at too low a price, regardless of competitive bidding.

(c) - The importance of widespread and high quality distribution shows up almost at once in the secondary market, after the original offering of an issue. Bad distribution can cause loss of credit standing to a utility just as surely as intrinsic weakness in the security itself.

The kind of competition which maintains these three essentials of the most truly effective capital raising has, according to my experience, always been present in the investment banking field. Let us stop to consider why one investment house is more successful than another. Is it not the same thing that makes one law firm more successful than another, or one doctor more successful than another - that is, the reputation for skill, judgment and integrity, of which, in this case, the raisers of capital wish to avail themselves? In this fundamental respect the investment banking business is as competitive as any business could well be.

Moreover, its reputation is always at stake in every underwriting or offering a house undertakes. The cash capital of investment houses is not large compared to their turnover. Their greatest asset is their reputation, and this can be maintained only by the soundest judgment and the most scrupulous and unceasing care in every issue they undertake. By this method, which has been the practice for decades, the public, both investor and consumer, has the benefit and has had the benefit of the most effective, because the most enlightened, sort of competition.

This reputation to which I have referred is not only with the investor, but with the issuing company. The investment banker is really a disinterested expert, standing between the investor on the one hand and the borrower on the other. He has in the past advised the utility as to its best interests, as a raiser of money on a basis which, under competitive bidding, he would be powerless to do, on account of not knowing beforehand if he was to get the business.

It is easy to jump to the conclusion that because some investment house has handled the issues of securities of a given utility company for many years, that it is the result of some inside influence. Such an assumption, however, ignores two points:

1. How well has the job of capital raising been done by the house in question?
2. How long would the investment house continue to hold the business if the quality of its advice and services fell off?

Eternal vigilance is the only way to continue to hold such business.

The question may well be posed: Why shouldn't securities be sold by the highest bidder; doesn't the consumer of electric service win by this in the end? My answer would be: Not at the price that would have to be paid for this change. Since the yield basis on which securities sell always in the end comes back to what the investing public is willing to pay for them, the inevitable effect of competitive bidding would be to cause investment bankers to cut down costs by reducing the true value of their services. Sound judgment and the building up of a reputation would be thrown away in the mad scramble to get the business at any price and let the public take the consequences.

I have heard the same kind of criticism leveled at the utilities themselves, - that there was no competition in the business, it was a monopoly. Competition in price and territory there is not, of course, for the very simple and sound reason that in that business, with its enormous ratio of capital to earnings, competition of the ordinary kind could only mean a sinful waste of capital that in the end would make service poorer and more expensive for the consumer thereof. But of really effective competition, the kind that makes for better and cheaper service to the public, there is a plenty - competition with the gas man, the ice man and others to do the job for the people - competition among the members of a large organization whereby the best men are stimulated to try to succeed to the most responsible jobs. This competition is constructive where the other is destructive and wasteful.

The same difference, in my opinion, exists here - competitive bidding based on price in the investment field would atrophy and finally destroy the really worth while results which have been obtained in the past from competition based on service and well-earned reputation.

Commissioner Healy: I have two or three points that I would like to take up with you, Mr. Kellogg.

Can you give me some idea as to the membership of the Edison Electric Institute?

Mr. Kellogg: As to numbers, do you mean?

Commissioner Healy: What percentage of the industry are members of the Edison Electric Institute?

Mr. Kellogg: About two-thirds in size.

Commissioner Healy: Can you name some of the large systems that are not members?

Mr. Kellogg: Well, the largest one that is not a member is the Commonwealth Edison of Chicago.

Commissioner Healy: Is the New England Power Association?

Mr. Kellogg: I think not, now, no.

Commissioner Healy: Do you think of any other large systems that are not members?

Mr. Kellogg: The Southern California Edison Company is not a member.

Commissioner Healy: Is the Associated Gas & Electric?

Mr. Kellogg: No, not itself, but some of its former subsidiaries are members.

Commissioner Healy: Well, some of its subsidiaries are still not members?

Mr. Kellogg: That is right.

Commissioner Healy: Is the Cities Service Company a member?

Mr. Kellogg: No, not as a company.

Commissioner Healy: Are you speaking here on the authority of your membership, based on a canvass of their sentiment, or are you speaking merely as an individual giving your own point of view?

Mr. Kellogg: I am speaking as an individual. I am very glad you brought that out, Judge Healy, because this is not a question on which the Institute has ever taken any position at all. The reason I gave my standing with the Institute in introducing myself was simply because that is my business address.

Commissioner Healy: Then you are not here with authority to speak for the membership, or even the Board of Governors, of the Edison Electric Institute?

Mr. Kellogg: I am not, no.

Commissioner Healy: Have you any interest in Stone, Webster & Blodgett?

Mr. Kellogg: No.

Commissioner Healy: Or in any other investment banking house?

Mr. Kellogg: No.

Commissioner Healy: Did you come as a result of any suggestion from the I.B.A.?

Mr. Kellogg: No, I did not. I came, as I stated, on account of seeing in the papers that there seemed to be a lack of interest in this subject on the part of the utilities, and as I was very much interested in it myself, I asked to be allowed to appear.

Commissioner Healy: That is, you had noted the lack of interest on the part of the utilities in this problem?

Mr. Kellogg: Only from the papers.

Commissioner Healy: Now, you have made a point in your paper about the service that the investment banker can perform in setting up the issue, and so on. Perhaps you intended to include, if you did not, the terms of the indenture, and so on, is that right?

Mr. Kellogg: That is correct.

Commissioner Healy: And on another occasion - I can't recall just when it was, but it was not so long ago - you made a statement which I have quoted two or three times, which made quite an impression on me, that in these capital set-ups, the common stock was the basis and the foundation of the whole structure. I don't remember exactly just what your expression was, but it was some such statement as I have just stated. Is that right?

Mr. Kellogg: That is, in general, correct, yes.

Commissioner Healy: Well, now, let's argue from that premise regarding common stock, and your other idea as to the service that can be performed by investment bankers, putting in with that, the statement of the Chairman that his interest and the interest of the other Commissioners was not so much in price and spread, as it might be in the capital set-up.

What would you think of a suggestion of this kind: Suppose that an operating company stated its needs; it had to raise so much money for such-and-such a purpose. Suppose, instead of merely taking bids on first mortgage bonds, they invited the responsible underwriters, or a group of responsible underwriters, to submit their suggestions as to what was the best way to raise that money, leaving the thing open far enough so that an investment banker could come in if he saw fit and say, "I think you ought to raise all of this money by common stock" or "I think you ought to raise so much of it by bonds, and so much by preferred, and so much by common", or perhaps in other proportions.

Now if the investment banker can do the kind of service that you have talked about, wouldn't that be an appropriate way to have that kind of genius and talent exercised?

Mr. Kellogg: It certainly would, yes.

Commissioner Healy: Would you see any big objection to that kind of competition? Of course, the investment banker, in submitting his suggestions, might include his views about prices on the assumption that it was done in various ways, and he might indicate which way he would advise the company to do it.

3

Mr. Kellogg: If I understood your question, Judge, there was no competition involved in that. You asked me whether I thought that would be the sort of advice which a well-posted investment banker would give to a client.

Commissioner Healy: Yes, there would be competition in it in this respect, that you might ask for those suggestions from several investment bankers.

Mr. Kellogg: Yes.

Commissioner Healy: Now that would be competition, not as to price but as to brains, would it not?

Mr. Kellogg: Yes.

Commissioner Healy: You say they have got that kind of brains, and here is a chance for them to use them. Would you see any great objection to that kind of competitive set-up?

Mr. Kellogg: Not so far as the competition is concerned. I don't know as I quite get your point.

Do you mean that a prospective issue would go to various investment bankers and their judgment would be asked as to what the best form of security was to issue?

Commissioner Healy: At the same moment they might ask, say, five different investment banking houses to submit their suggestions as to how the needed sum of money should best be raised.

Mr. Kellogg: Yes, I can consider that happening, I think five might be a rather large number, but it might be done.

Commissioner Healy: Can you see any great objection to that?

Mr. Kellogg: No.

Commissioner Healy: All right. Now on this matter of the kind of service, the kind of judgment, the kind of intelligence that investment bankers can exercise in getting up these indentures, these indenture issues - do you care to make any comment on this fact, that in 1938, I believe it was, on the basis of studies made by this Commission, and their own investigation, Congress concluded that the writing of indentures had been so poorly done that the contents of indentures ought to be regulated by a Federal Statute, and the Barkley Act resulted.

Do you think that would have happened if the investment bankers had performed the kind of service toward protecting the investor that I think your paper was intended to convey or describe?

Mr. Kellogg: I don't know as I know the circumstances you refer to, Judge --

Commissioner Healy: (Interposing) Well, you know the Barkley Act was passed by Congress, don't you?

Mr. Kellogg: I don't know about that Act. I do know that indentures have gotten so complicated that that is a great bugbear with the public and investors.

Chairman Frank: The Barkley Act was aimed at the great defects disclosed in the indentures, and the fact that indentures contained provisions exculpating corporate trustees from any liability unless they committed murder or mayhem, and that was the purpose of that statute to which the Judge has referred. It is popularly known now as the Trust Indenture Act.

The Judge's point is that if there had been the scrupulous care to protect the investors in these negotiated deals on the part of the investment bankers, there never would have been the necessity for such a statute.

Mr. Kellogg: My experience, Mr. Chairman, is that they have been very scrupulous in trying to protect the investor.

Chairman Frank: I would be interested to send you the testimony before the Committees of Congress, and our reports on the subject, which show that almost without exception the indentures contained exculpatory clauses that relieved trustees from liability with, in some cases, very unfortunate consequences for investors. I don't mean that in the utility field particularly, but since those same exculpatory clauses were in the indentures, the same consequences might have occurred, and it is just good luck they didn't.

Commissioner Healy: I don't know how closely you followed the issues of securities that have gone through this Commission in recent months.

Mr. Kellogg: I haven't followed them at all.

Commissioner Healy: Are you familiar with what happened in the Appalachian case, the Appalachian Electric Power?

Mr. Kellogg: I am not.

Commissioner Healy: Well, has it come to your attention that in a great many of these issues that are being put through this Commission, in the final analysis the deal isn't set up by the underwriters, but is, to a considerable extent, the result of negotiations between this staff and the issuer?

Mr. Kellogg: Yes, I realize that.

Commissioner Healy: For example, you know how it happened in the case of the Appalachian Electric Power Company, that many millions of dollars of debt claimed by the American Gas & Electric Company was translated into common stock?

Mr. Kellogg: I haven't followed the recent issues, I have been busy down here with the Defense Commission.

Commissioner Healy: Do you know the history of the El Paso case, and do you know what happened to the original issue as it was presented to this Commission, and how it compared with the final issue that was approved and put out, with our consent?

Mr. Kellogg: My recollection is that there was more equity required to be contributed. I have forgotten the exact figures. I was familiar with it at the time.

Commissioner Healy: Did the investment bankers work that out?

Mr. Kellogg: No, the investment bankers were, I take it, engaged in trying to raise the money by refunding, on as cheap a basis as they could.

Commissioner Healy: That is, the task of raising that money in the way best suited to the issuer, to the applicable statutory standards, and to the interests of the investors, wasn't done by the investment banker, was it?

Mr. Kellogg: Oh, yes, his advice was taken, not followed blindly, but my recollection of the El Paso case was that the total bonded debt was reduced to some extent.

Commissioner Healy: The bondability of depreciation additions was controlled by the indenture, was it not? That was put in at the behest of the Commission, was it not, or at least the ratio was reduced?

Mr. Kellogg: I dare say, I am not sure.

4 Commissioner Healy: Can you point to any instance where any clauses were put into indentures in the case of a first mortgage debt, that were designed to preserve a favorable ratio of debt to net property through the device of restricting additions built from depreciation money?

Mr. Kellogg: I don't know as I can specify that one, Judge, but I know of a great many provisions that have been in indentures in the past to preserve the ratio of debt to total property.

Commissioner Healy: Well, I think it may be open to question as to whether the provisions had that effect.

Let me ask you this one: Suppose you start with an issue where the ratio of debt to net property is 50 percent. Do you think that a provision in an indenture, permitting additions built from depreciation money to be bonded up to the point of 70 percent of the cost, will preserve the 50 percent ratio?

Mr. Kellogg: No, but the reason that is done is this --

Commissioner Healy: (Interposing) Just a minute, it would destroy it, would it not?

Mr. Kellogg: May I just finish my answer?

Commissioner Healy: Yes.

Mr. Kellogg: Of course it would destroy it if it were used to the limit, but those figures, as I have always understood, have been put in there so that a company would be able, when the bond market was particularly favorable, to get the maximum amount they possibly could reasonably borrow on their property. They would still be up against the same criteria for soundness of capital structure in selling their various securities in the future, as they had been in the past. They would probably strive to maintain that 50 percent ratio you mentioned, and possibly to improve it. But I do think, in all justice, it should be said that that relatively high ratio, the 70 percent, is put in there as a matter of flexibility in case the bonds should be sold at a time when it was particularly advantageous to sell bonds, that is, when bond money was most easily obtained.

Commissioner Healy: Well, without trying to get into too many specific instances, perhaps you will agree that if, in the case that I posed a moment ago, if you started with the 50 percent ratio, and the company were permitted to bond depreciation additions to the extent of 70 percent of cost, the favorable ratio with which you began would be destroyed?

Mr. Kellogg: If they utilized that, yes, but not unless they did.

Commissioner Healy: I would like to ask your judgment on this point:

Many of these issues have to go through a State Commission and then many of them have to come here, and if it is an exemption case under 6(b) of our Act, we have the power to impose conditions. Then many of the provisions of the indenture are controlled by the Barkley Act.

Do you think that as a result of the Holding Company Act and the Barkley Act, and the kind of scrutiny that the issue gets, the kind of scrutiny that the indenture provisions get, that there is a distinct tendency toward standardization of indenture provisions?

Mr. Kellogg: I should think, so far as the indenture provisions were concerned, yes.

Commissioner Healy: Will you agree that the area in which the investment banker can exercise the kind of ability that you have described, with respect to the indenture provisions, is being constantly narrowed as a result of those statutes?

Mr. Kellogg: As to that particular point it might be, yes.

Commissioner Healy: Now you spoke in the early part of your statement to the effect that it was inevitable that competitive bidding would lead to prices which would be too high. How do you arrive at a judgment as to whether a price is too high or not?

Mr. Kellogg: Merely from the results of the offering. If the price were too high, the issue would go badly, and would come back on the underwriters' and dealers' hands. They would probably have to sell it out at a loss.

Commissioner Healy: Well, assuming that they didn't sell it out at a loss, but succeeded in selling it, would you give any weight to the market behavior of the particular security over a period of a few weeks, say, after the issue was sold?

Mr. Kellogg: Yes, quite considerable weight. I think the secondary market would indicate, unless there had been some basic change in the whole market, would indicate whether the price had been right when it came out.

Commissioner Healy: Now, assuming that during the distribution period before the dissolution of the syndicate, the price has been stabilized, and assuming also that the market in general has remained about static, do you think that the market behavior of the security during the stabilizing period gives you any adequate basis on which to form a judgment as to whether the price was too high, too low, or just right?

Mr. Kellogg: I am not sure that I know exactly what you mean. You say "before the syndicate was dissolved"?

Commissioner Healy: During the period that the syndicate is in existence; and assuming that the syndicate stabilizes the price during the period of distribution.

Mr. Kellogg: In that event, the price would not, of course, prove anything in itself, but the price after it is over, would.

Commissioner Healy: After the syndicate is dissolved and the law of supply and demand begins to operate without artificial restrictions, you feel that you can then form a true judgment as to whether the issue was priced too high, or too low, or about right?

Mr. Kellogg: Necessarily, yes.

Commissioner Pike: In this matter of bonding depreciation reserve, instead of using a 70 percent bond clause in the indenture, if you started out with a property bonded at 50 percent, and had a 50 percent limitation only, and still bonded your construction made out of depreciation funds at 50 percent, you would still be adding an undue amount of debt to your property?

Mr. Kellogg: Possibly so, but I want to repeat, Mr. Commissioner, that in all my past experience the size of that ratio between cost of extensions and the amount that can be bonded has always been way beyond what the companies have used, and has been fixed at a price so that they wouldn't be cramped in a particularly favorable bond market situation.

Chairman Frank: Well, a particularly favorable bond market might be particularly favorable to the issuer, but if it helped towards or led to a dilution of the outstanding securities, and a reduction of the margin over the bonds outstanding, it is something that ought not to be allowed, don't you think?

Mr. Kellogg: It is something you would want to correct in later years in order to get back to where you would consider the thing ideal.

Commissioner Pike: Of course, in the history of the electric industry up to, say, 1930 or 1931, we have been dealing with an industry that grew at a rate of 5 percent per annum compounded, or not much under, sometimes nearer 10; so that it doubled itself every 12 or 14 years, and frequently more often, and this whole question of depreciation has been relatively unimportant, because from half to two-thirds of your property in service was new.

Mr. Kellogg: Yes.

Commissioner Pike: It may very well be that we are not in that area any more. I mean, that is the typical history of new businesses that get popularity, that they come up with a big push, and the electric business has been pushed, that somewhere along the line they level off and grow with the population. Now the electrical business is still growing faster than the population, but the prognosis would be that somewhere it would act like all the others, and either level off and go with the population, or some other new invention like Uranium 235, or some directional waves, or the like, may take a part of the business or all of the business.

And if it just levels off so that depreciation alone results - I am leaving out obsolescence at the moment - the method of handling depreciation becomes very, very important in setting up the final earnings, and also in saying what should be the limit of debt on the property, much more so than when the thing is growing.

Here we have all been following - I say "we" - most of the operating utilities have been following the retirement reserve method, roughly taking out of earnings enough to retire the property, to write off the property that came out of service, which roughly is, say, 20 years old. It is property that came out of service in a company that was a half to a third the size of what it is today. Where, if you go at a method looking forward to the time when the present property goes out of service, you would have to double or treble your provision, either including or not including interest, let's leave that out for the moment.

And when you get to a static level in earnings, your actual physical retirements are going to build up to what you would necessarily have to set aside, with the retirement reserve and the straight line depreciation methods tending to come together.

If we look forward to that happening in the next 20 years, it looks pretty reasonable to expect that we should be more and more insistent upon adequate depreciation now, and much more insistent that money taken from depreciation and put in the property, which is the practical way to handle it, should not be bonded at all.

This is getting away from the original question, but it gets back to it, and that is one thing, to the best of my knowledge, we have never seen in any indenture, or at least in very few indentures, and I must say that the investment bankers have been right shocked at having been asked to put it in. They have put it in, although not too graciously.

Mr. Kellogg: Well, when you say "put it in", that affects the ratio of total property that can be bonded or affects the ratio of the new investment that can be bonded?

Commissioner Pike: The new investment made out of the depreciation moneys saved within the system itself at the expense of the consumer, and to make sure that the people who have put senior money in there won't have a lot of other bonds along with them to be paid off, too, but they themselves have furnished the money out of which the property was built, and out of which this depreciation was earned, where the new construction was made.

Now give yourself a 20-year property, operating under static conditions, a 50 percent bond ratio to stock, and allowing 50 percent bondability of new construction. The only new construction you need is - you save enough out of your depreciation to do your new construction. At the end of 20 years your old property - let's say the impossible, but assume the circumstance - all goes out of service at once. Your property now is the property built in the last 20 years out of depreciation money. You have bonded 50 percent of it. Your old bonds haven't been paid off, and you have bonded 50 percent of this new construction. So you have a 75 percent ratio on your present property.

Mr. Kellogg: In the meantime your bonds would very likely have been cut down by a sinking fund.

Commissioner Pike: I hope so. We have a good many issues come in without sinking funds, and still trying to allow bondability of all additions, no matter from what funds the construction was done.

Mr. Kellogg: I will say this, in commenting on what you have said, that of course if it is conceivable that the industry ever reached a period of absolutely no growth whatever, then the retirement reserve depreciation method and the straight line depreciation method would be the same thing in figures, that is perfectly true.

Commissioner Pike: They tend to come together over a period of years?

Mr. Kellogg: Yes. Of course, on the other hand, if you had zero growth, you wouldn't be raising any more capital money and your bond issue, through the sinking fund, would be very substantially reduced at the end of 20 years.

Commissioner Pike: Again presuming the ideal --

Mr. Kellogg: (Interposing) What I mean is: the effect of that sinking fund over 20 years would probably be to cut the bonded debt down to, say, 60 percent of what it was, and you would have the same properties you had before, and the same earnings, and it would be a very much better buy. 6

Commissioner Pike: I agree thoroughly.

A great many issuers don't want to put those provisions in, and a great many underwriters bring the issues down to us after all the negotiations, and they are still not in, and they are not too happy when we ask that they be put in.

Commissioner Healy: I think that there is one comment I would like to make about a question that I asked you, Mr. Kellogg. I asked you if you had any interest in Stone, Webster & Blodgett, or any other investment banking house. I want to say that I didn't think you did have.

Mr. Kellogg: I have not, Judge, not one cent.

Commissioner Healy: I wanted to ask the question to get the facts in the record.

This is a little off the subject, I don't know how much it has to do with this subject we are discussing, but since you are here before us, and since you have said many things today and in the past that have been of great interest to us, I would like very much to get your ideas, if you are willing to give them, as to what you think the ideal capital structure should be of an operating electric light company, the ratio of securities to total capitalization?

Mr. Kellogg: As I have said many times in the past, I think that the 50-25-25 ratio is a good, sound ratio, 50 percent bonds, 25 percent preferred stock, and 25 percent common stock.

Commissioner Healy: Which goes without saying that 40 would be better, or does it?

Mr. Kellogg: It depends on what you are trying to accomplish, Judge. If you wanted to play frightfully safe and could raise money easily, of course the best thing would be nothing but common stock, that would be a perfect company, it couldn't go broke; but it would not necessarily raise all the money at the cheapest rate. That is why bonds, on the whole, have been sold, because a well-secured debt can raise that much of the money cheaper, and, in the composite, is supposed to raise money cheaper than in any other way.

Commissioner Healy: Of course, it also affords leverage for the common stockholders?

Mr. Kellogg: Well, Judge, I don't think it has been done for that reason. I won't say it never has, but I don't see that as the basis for setting up capitalization of the company.

Commissioner Healy: You have got a good many companies where the common stock ratio is even smaller than you have indicated. But this is true, is it not, that if you assume a 7 or 6 percent return on total capitalization, or total property, that the stockholders not only get the allowed rate of return on their own investment, but they are also the beneficiaries, are they not, of the difference between the effective rate of interest on the bonds and the fair rate of return; that is, if you have got 4 percent bonds and a 7 percent rate of return, there is 3 percent that goes to somebody else, - in other words, that is leverage, is it not?

Mr. Kellogg: That is leverage.

Commissioner Healy: And it does exist.

Mr. Kellogg: It does exist, definitely. Of course, it works two ways, Judge. The mere fact that that would be the case if you got 7 percent on your whole investment doesn't mean that you necessarily would get the 7 percent. In other words, common stocks, as a whole, are not doing so terribly well these days in some ways, so that the leverage does work two ways.

Commissioner Healy: Well, my observation is that the common stocks that represent actual investments in companies are doing quite well; and common stocks that represent write-ups and are based on mere bookkeeping entries, are not doing so well.

We know of many cases where the common stock is owned by a holding company and the operating company cost the holding company nothing, and in some cases less than nothing. It isn't surprising that people aren't getting as good a return as they used to, in these days of intensive regulation, on a common stock that cost them nothing, isn't that so?

Mr. Kellogg: That is inevitable.

Commissioner Healy: When you find that situation, doesn't it appeal to you as sort of poetic justice that that should happen?

Mr. Kellogg: Well, I shouldn't think of it so much along the lines of poetic justice, as it being the inevitable result of an unsound capital structure.

Commissioner Pike: You can take a good rifle and hit from here the power plant of a company that has a common stock which cost its owners nothing, and yet is earning well over 100 percent a year on its stated value. It has no asset value whatever.

Chairman Frank: Thank you very much, Mr. Kellogg.

Mr. Webster!

STATEMENT OF ROBERT C. WEBSTER

Nashville, Tennessee.

Mr. Webster: Mr. Chairman and Gentlemen of the Commission:

I am from the country. My firm operates at Nashville, Tennessee, has no branch offices, and our function is to serve the investment demands of Nashville and the immediate vicinity.

At the outset I would like to state that our clientele is not unaware of the additional safeguards which have been afforded them by the Securities Exchange Act and this Commission, and the fact that I appear on this occasion does not mean that we are opposed to the purposes of the Securities Exchange Act or this Commission.

But without going into any academic discussion or technical discussion, both of which grounds have been thoroughly covered during the process of this hearing, I want to address myself to one subject, and that is the welfare of the small institutional and individual investor back in the country districts, and the small dealer.

My firm and its predecessors have been in continuous operation for a period of 50 years. The only reason that I can account for the fact that we are still in business is that we have conceived that our function is two-fold, and I don't know which 7 function should be stated first; that is, to offer as comprehensive and thorough an investment service as possible to the people of our community; and to make money for ourselves.

One is so dependent upon the other for existence that I don't know which should come first.

Under the old order, not necessarily old order but until the past few years when we all began to feel the pressure, our policy on the matter of distributing syndicate issues was briefly this, that every issue offered by certain principal underwriters which met the investment requirements of the people of our community, we took the entire amount of bonds offered to us. We didn't worry a bit if they didn't go out the first day or the second day. We had a point or more protection in the bonds, we had enough profit in them to justify carrying them, and enough profit to pay a salesman, to justify a salesman going out in the sticks and peddling the bonds, if necessary one and two at a time.

Our individual sales on syndicate issues have run as high as 30 on a given issue, and our participations are small.

My problem is entirely different from that of Mr. Starkweather, who stated this morning that these syndicate issues were a principal source of revenue or profit to his business. To us they are not. I think that I would be glad to submit our books for examination on syndicate issues for the past four or five years, and I would be very thankful if we found that we came out in the black.

But it is absolutely necessary, in order to render the kind of investment service that our people require, that we give them the opportunity of getting the top name utility and other corporate issues.

We believe, and our clientele believe, that if this rule is put into effect, we will be deprived of that opportunity.

Now you gentlemen are well aware that under the N.A.S.D. rules, and the terms of the selling agreement, if we take 50 or 75 bonds, due in 40 years, at a yield of 2.61 percent, with a half point in them, until the termination of that selling agreement we can sell them only at one price, regardless of the demand and regardless of what our customers may think they are worth. Our hands are tied.

Commissioner Healy: Do you think they ought to be tied, Mr. Webster?

Mr. Webster: Judge, I would much prefer that they not be tied as tight as they are. I think that an eighth is very little compensation for selling a bond, and when my selling agreement only permits me to re-allow an eighth, it makes it a little difficult to move the bonds if another dealer has the order.

Commissioner Healy: Have you noticed some distributors finding themselves in that predicament, who have dealt with the men in the G.I. market?

Mr. Webster: In times past, yes, but not recently.

Commissioner Healy: Is that because the N.A.S.D. has somewhat cramped the style of the G.I. market recently?

Mr. Webster: That would be my guess, sir, I think it has had a decided effect on it.

But that is a problem to us when we have such a small margin in the bonds, and the constant threat of changing money policies emanating perhaps from this center, or the constant threat of war developments that might break a market 5 points, and if you make a half point on 50 bonds, if that is your possibility, and one of these market cracks comes along, and you take a 5 point loss, it takes a good many syndicate issues to make that back.

Commissioner Healy: But when you see that coming, this agreement leaves you rather helpless?

Mr. Webster: When we see that coming, we can put them on ice and hope, that is all we can do, sir.

Commissioner Healy: Just sit there and take it?

Mr. Webster: Yes, sir.

Now we have felt the effect of two recent developments in the investment business, and I don't intend to discuss this academically. I think we might argue the rest of the year on whether or not compulsory competitive bidding would over-price issues. I am firmly convinced that it would.

Chairman Frank: One way of finding out would be to find out?

Mr. Webster: To find out, sir, and we have found out, Mr. Chairman, and I want to cite just a few instances.

First, I would mention the Southern Bell Telephone 3's that came out in 1939 --

Chairman Frank: (Interposing) Were those sold competitively?

Mr. Webster: No, sir; but the threat of competitive bidding was there.

Chairman Frank: That is an interesting question. Let's develop that.

Supposing we don't make a rule - we haven't had a rule on competitive bidding, but we have had competition of a certain kind in one issue, for instance, pretty well known, the San Antonio, not due to any requirement of this Commission, but due to the fact that at the last minute the banking house sought to take the issue and offered, knowing the price that had been agreed upon, to top that price, and the utility executive felt obliged to, notwithstanding all the previous negotiations, consider it. So the original parties with whom he negotiated topped the original price. It was distributed at a half a point.

Now that was in no manner any consequence of anything done by this Commission or any competitive bidding rule. It would seem to me that that kind of a situation can develop again and again and again in the absence of any competitive bidding rule; whereas, if you had competitive bidding of the kind that this proposed rule would contemplate, each person would make his bid without knowing what the other person had bid, and the advantages obtained by the adversary bidder in the instance to which I refer, would be non-existent. In other words, every fellow has put his cards up at the same time. So that the apprehensions you have about such a deal as the Illinois deal or the San Antonio deal, are not going to be relieved by the non-promulgation of a competitive bidding rule.

On the contrary, I think the competitive bidding rule would do a good deal to stop that kind of situation.

Mr. Webster: Perhaps you are right, Mr. Chairman, but my observation on that point would be that that is still an academic discussion. My actual experience is that we did not feel the effect of the threat of competitive bidding until the attitude of this Commission became known.

Chairman Frank: Oh, this happened long before we had any attitude - we haven't had any attitude. Let's get the facts here. We sent out in February, I think it was, of 1940, a request for comments on our Rule U-12-F-2 because certain persons in the investment banking industry were critical. It is true that two members of our Commission, but not the majority, had indicated an opinion that they thought competitive bidding was desirable. And all we did - three of us did not so indicate - we sent out a request for comments, and we got a lot of them, and most of them were numerically from the same persons that have been appearing here the last few days. The Commission did not indicate its attitude, and has not yet.

The staff prepared a report which went out December 18, I believe, of last year, which was the staff's view, and as to which the Commission said it had not reached a conclusion.

But even assuming that anybody believed that that represented the Commission's then view, that was December 18, 1940, and the Telephone issue to which you refer was --

Mr. Webster: (Interposing) July, 1939.

Chairman Frank: Long before this Commission had even remotely indicated any interest in competitive bidding.

Mr. Webster: I was under the impression, sir, that discussion of the subject had been invited by at least individual members of the Commission.

Chairman Frank: Not at that time.

Mr. Webster: But in any event, we did not feel, prior to two and a half years ago, approximately, in the inland points, in our job of distributing securities we felt no effect of either the actual competitive bidding or threat of competitive bidding.

Now in the case of Southern Bell, the preliminary price discussions and ideas were 105, at which price we had a substantial local interest. The Southern Bell serves our territory. When the several State Public Utility Commissions were approached by one underwriter on the subject of competitive bidding, and they communicated with the Securities and Exchange Commission --

Chairman Frank: (Interposing) And the Commission said it had nothing whatsoever to do with it, which it hadn't, because they were telephone issues, and even if we had been sympathetic to the idea, it was none of our business, because we have nothing to do with telephone issues except to see that the registration honestly sets forth the facts, and that is what this Commission said in statements which were published at the time, it had nothing to do with the matter.

Mr. Webster: Well, in any event, the bonds, instead of coming at 105, came at 107-1/2, at which price we sold 5 bonds, and sold the remainder of our very nice allotment at a price of around 105.

Chairman Frank: Which exactly illustrates my point that in the absence of any rule on our part, you are going to be subject to that situation.

There are two gentlemen in this room that believe in going after business, and the rest of the banking community don't like it, but they are going and nothing this Commission can do can stop them, even if it wanted to. I don't know why it should want to, because it is none of our business. But if they want to go and actively compete for issues, they ask us to make a rule. If there were a rule made, then the competition would be that everybody at one moment would have his bids opened. But, there not being any such rule, if banking house A makes an offer, and the deal is about to go through, and the terms are published, and Mr. Stuart or Mr. Otis can come in and offer a better price, then the utility executive who cavalierly turns that down may find himself in difficulty with his security holders.

Now we can't do anything to stop it, but you have got the threat of competition in its worst form in the absence of a rule, and as I say, that sort of thing started long before we manifested any interest in it, and with respect to a type of security as to which we had nothing to say, the Telephone issue.

I don't know how you are going to stop it; we can't. And if that is an evil, I think you might mitigate the evil by a competitive bidding rule, but you won't augment it.

Mr. Webster: We may have a very false impression, Mr. Chairman, but back home we are all of the belief that the urge of competitive bidding has been more or less fostered by this Commission.

Chairman Frank: Well, if you will take your dates you will see that it can't be so, that that Telephone issue to which you refer came out before this Commission had expressed any views, even remotely, on the subject, at a time when we had no rule and there was no discussion on it.

Our rule U-12-F-2 provides that where we find a banker to
be an affiliate, so that his participation would be limited to
5 percent, that he may avoid that limitation by either having
9 competitive bidding or showing it to be impractical. But that
clause has been a dead letter, and that is the only remote
reference to competitive bidding up to 1940, as far as this
Commission is concerned.

No, I don't think we stimulated the interest of Messrs. Stuart and Otis in the problem of competitive bidding. They can speak for themselves on that. They may think they stimulated us, I don't know that they did; I don't think we put any ideas in their heads, I don't think we needed to.

Mr. Webster: And if I am in error, I want to correct myself on that.

But to proceed with my actual experience, and I intended to stick to cases instead of an academic discussion, a recent case of the Boston Edison is of interest. I want to show you the mechanics from my standpoint, my problem as a small dealer.

There was one local order in our market for those bonds. We were given our proportion of that order. When the price was known, as soon as we got the telegram from the First Boston Corporation, we immediately entered the subscription, which was all we could do, for the bonds. We were not offered any firm bonds. This was an insurance account. The bonds were offered publicly at this price for subscription. We had to confirm our bonds to the insurance company. We got confirmation from the syndicate manager the following day --

Commissioner Pike: (Interposing) For all the bonds you wanted?

Mr. Webster: Yes.

Now if the issue had been hot, and I had been left out, I would have been short and would have had to cover two points loss, perhaps. Now that is one evil and one serious injustice to the small dealer back home. We don't maintain a trading position in those issues that would enable me to recover that loss. When I am short, and have to cover two points loss, that is the end of that story on that issue.

That is contrasted with the method which is usually in vogue, of offering us a given number of firm bonds for acceptance up to a given hour during the day. So I think that places an undue penalty on us.

Chairman Frank: What do you say to the suggestion made several times in the course of these discussions, that an issuer who wanted to see that kind of distribution that you refer to, could impose the condition in his offer for competitive bidding, that there be such syndicate arrangement made, so that the small dealer would have an opportunity to deal in what you consider the traditional manner?

Mr. Webster: I would put that in somewhat the same category as the statement of principle of the Congressman from Illinois this morning, - it is a beautiful idea, but it won't work.

Chairman Frank: Why won't it work? I understand you say it won't work, and I heard that said many times, but I just couldn't follow the reasoning. It is said to us that the issuer finds it desirable to have that kind of distribution, and that it costs him something to get that kind of distribution, because - so it is said - competitive bidding of a kind that would eliminate that kind of distribution would enable him to get more for his bonds, or, to put it differently, you get a higher price in competitive bidding, so it has been said, because that type of distribution drops out and the spread is narrower.

Now if the issuer wants that type of distribution, if he thinks it is desirable, why can't he put that in his offer? If he doesn't want it, if he doesn't think it is desirable - and it has been said again and again that he does - but if he does not, then I would think that was his own business. But if he doesn't think it is desirable, if he doesn't think there is going to be over-pricing, if he doesn't think these consequences are going to ensue, he ought to be allowed to use his judgment. But if he does, he can get anything he wants. Why can't he do that in competitive bidding just the same as in private negotiations?

Someone answered that the syndicate manager has to sit there watching, minute by minute, and he can't make such firm arrangements. Well, if he can't, then he can't in a private negotiation. He can make just as good arrangements in a competitive bidding deal as in a privately negotiated deal. As Judge Healy suggested, the best you can get in any kind of setup like that is the "best effort" clause.

Someone said here this morning that on a privately negotiated deal you couldn't absolutely agree you were going to have a certain distribution, but you could have an understanding that you would endeavor to do so. I don't see why you can't put that in a competitive bidding offer.

Mr. Webster: Well, my understanding of the chain of liabilities under the competitive bidding system would make that very difficult to be workable. As I understand it, if compulsory competitive bidding is put into effect, we, either as underwriters, the underwriting group would either have to be relieved of certain liabilities which they now have under the Securities Exchange Act, or would have to spend a tremendous amount of money prior to the date of sale of those bonds in the investigation of the issue.

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Chairman Frank: Now see if I understand you. You are now talking of the liabilities of those who are underwriters?

Mr. Webster: Yes.

Chairman Frank: Well, it is astonishing to me, and I think to all of us here, that that question has been raised, because we just do not understand how the very persons on whose behalf that argument has been made had dared to take those allegedly tremendous burdens and liabilities in connection with competitively sold utility securities of New England companies. It is a very funny thing that we never heard of those liabilities, and that it was practical to sell those things, and that Mr. Arthur Dean was counsel for the company that did it and he never came down here and said, "You have got to change the Securities Act in order to do it". Arthur Dean, when we talk about competitive bidding, suddenly discovers, by Heaven, he made a mistake. He said the other day, rather humorously, we ought not to bring that subject up any more. We just cannot avoid it. It is just too significant that we never heard of these terrible things about the millions and millions of New England bonds sold. The Securities Act suddenly takes on the form, vis a vis, competitive bidding, when it never has been up to now.

Mr. Webster: Mr. Chairman, I have never been the originator of a public utility issue. Our firm, in recent years, has originated one corporation issue of a small size, $2,500,000, in which we were joint managers, and it took us a period of about three months and a good many thousand dollars to become fully aware of what our liabilities and responsibilities were. During the process of preparing the statement and filing the statement, the incubation period, during that period we became fully aware of our responsibilities.

I did not intend to get into that field. If you will pardon me, I will confine myself to my field. I wonder if you have ever been on the receiving end of these 35-percent cases?

Chairman Frank: Mr. Pike has.

Mr. Webster: Here is our problem. We get an issue of 30 or 40 year maturity, between $2.50 and $2.70 yearly, with a half point yield in it. We find our average cost of salesmen's compensation --- We in the country do not have the large institutional accounts that Mr. Starkweather has, therefore our syndicate business is not as profitable. We find our sales commission averages 35 percent on such issues. If we take and successfully sell, without any write-off and without wholesaleing, 50 bonds, with a half point yield in it, after paying our costs, our firm has made $37.50 on the 50 bonds. If we have three quarters in it, we made $212.50. That is a very small profit for a $50,000 commitment, with war threats changing money policy and everything of that kind, without giving us an additional threat of competitive bidding. As I say, I do not want to discuss that academically. I am firmly convinced, my clients are firmly convinced that competitive bidding of necessity will produce higher prices. They see it operate on our small municipal issues.

Our house makes as much money primarily out of municipal bonds, and on corporate bonds, not on syndicate bonds. As I say, that is a service we must render in order to keep the position we hold in our community. We say on a small municipal issue, such as 50 to 100 bonds, in our immediate vicinity, with these dealers bidding to recover their position, we make 3/8ths or 1/2, and the same thing will prevail in the corporate field.

I am thoroughly in accord with Mr. Starkweather, as far as he went, on one point. I think there will be one principal benefactor of this rule and perhaps half a dozen of the principal underwriters who might benefit from this rule. I think this rule would serve to greatly concentrate the underwriting in a few hands, rather than in approximately 125 to 150 houses, who occasionally participate in it.

Chairman Frank: May I ask a question? This is not said in any cynicism. Human nature, with a dollar sign in front of it, acts uniformly. I mean men ordinarily in business do not disclose amazing generosity in giving away their funds. If you were going to be the beneficiary, financially, of a rule to be promulgated by the Commission, you would not come down and object to it, would you?

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4

Mr. Webster: If I were the beneficiary, I would not. I said "benefactor". I meant beneficiary.

Chairman Frank: You would not object, would you?

Mr. Webster: No, I would be here supporting it.

Chairman Frank: Is it not surprising, although you and Mr. Starkweather say the underwriting firms would be beneficiaries, that they come down here objecting to it?

Mr. Webster: I say those are the possibilities. Perhaps a half dozen additional ones would benefit. I can see one house that would very definitely benefit, and I can think of another half dozen, by reason of their position in the underwriting field, that the underwriting would be more and more concentrated among those houses.

Chairman Frank: If there is going to be more concentration than there is now, then those persons who are in that group known as the concentrated group are all going to be beneficiaries, and yet most of them are objecting. People do not usually object to something that they think will benefit them. Therefore, they must disagree with you.

Mr. Webster: Perhaps they do. But, on the other hand, they may feel they can do a better job under the conditions under which they have operated, because, as I understand it, the issuer wants a steady market in his issues. He prefers not to have them concentrated in a few hands. If we can place the bonds in a dozen different hands in and around Nashville, Tennessee,

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5

it will help, rather than have them all concentrated in New York.

Now I see another group that might materially benefit, where there is a possibility of their benefiting, and that is your top five or top ten insurance companies who might bid directly to the issuer and bid a higher price than the underwriters might bid. Either of those would deprive us of the opportunity of offering our clients an opportunity to buy those top grade names. That is what I am primarily interested in. I am not interested in Mr. Stuart's problem, or Mr. Stanley's problem, I am interested in Mr. Webster's problem back home.

Chairman Frank: Quite right.

Mr. Webster: And what I can do for my client. I am speaking on behalf of, and I think I offer the sentiment of 95 percent of the approximately 1500 small dealers in the 48 States who at one time or other do participate in these offerings. We think that our clients will be done a gross injustice if this rule goes into effect, and I make the plea in their behalf, gentlemen.

Chairman Frank: And the same injustice that Mr. Stuart and Mr. Otis will continue in their activities. We cannot stop them. How are we going to stop them? If they are going to bid these issues up and get them, how are we going to stop them? There were two cases pointed out in which this Commis-

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sion had no rule whatsoever. They just went ahead and bid.

Mr. Webster: Mr. Chairman, it is a strange thing that we did not feel any of that influence until the last year or so. We did not feel it before this Commission came into existence.

Chairman Frank: A lot of things happened in the last two years.

Mr. Webster: Yes. That is all I have.

Chairman Frank: Mr. Ford made the statement this morning to me privately that something I had said this morning was not quite correct. I wish he would correct that for me.

Mr. Ford: I meant to keep off the air today, Mr. Chairman. We had a great deal of discussion. As I said the other day, you were very patient. You did make the statement, in the heat of discussion, that it was impossible that there could not be profits made by the underwriters. That is not strictly accurate. As I recall, the New York Times showed our figures were incorrect. Roughly a million and a half. We showed a net profit of $28,000, I think, the last year, before portfolio losses, which amounted to $100,000 or more. The Halsey Corporation published a statement at the end of January. You can tell very readily from the state of those figures what has been the result of our operations for a year.

As long as I am on my feet I would like to just make this remark. The Boston Edison Company has been bandied about this floor pretty freely for the last four days, I think. I do not think they would object in any way, but you yourself raised the point several times that there is a perfect example of competitive bidding, and people like myself and others object to it, representing other underwriting houses. I think I said the other day, and I want to repeat it today, to set the record straight, the reason the First Boston bid on the business was because we have been bankers, as you all know, for the Edison Company for a great many years. Looking at it from the open point of view of my corporation, that was not a competitive deal in the full sense of the word. We were called in by that company in 1935. We set up the debentures, we set up the deal for them. Now that is the way we were called in. We set up the deal for them.

There was mention made this morning of an indenture that had not been fully correctly drawn. Everybody knows it was the Boston Edison indenture.

Chairman Frank: I do not think we had the Boston Edison in mind at all. We were thinking of private negotiated deals.

Mr. Ford: How is that?

Chairman Frank: I say we were thinking of privately negotiated deals in which there were, what we considered, sub-standard indentures.

Mr. Ford: It may be; I do not know. This one was brought out. The reason my associate bid on that deal was because we knew about it, we knew it was set out.

Chairman Frank: You made the same point the other day, and since you are repeating it, I will repeat what someone said by way of comment on it. Leaving out the First Boston, there have been a considerable number of competitive bidding deals on which most of the first-rate investment banking houses have bid, and they have been advised by eminent counsel, and apparently neither they nor their counsel saw any difficulties under the Securities Act, and we never heard of any until there was a proposal that we should issue such a rule. Maybe, in the case of your house, your familiarity with that deal may explain that deal, but it does not as to the others.

Mr. Ford: I think we have got a realistic problem, Mr. Chairman. That is what I am trying to be specific on. I think in this discussion one isolated instance of competitive bidding has been used as a generality.

Chairman Frank: No, you have used the one instance, Mr. Ford. Have you got a copy of our report? A good instances of competitive bidding are there in the New England associations.

Mr. Ford: Six or eight, I do not recall.

Chairman Frank: About 17. There are 17 issues running up to a considerable sum of money, in which eminent counsel advised their executives that there were no difficulties under the Securities Act. I doubt whether the same counsel want to stand up here publicly confessing that they erred and that their clients are liable under the Securities Act?

Mr. Dean: I take it that what we are here for is to air all of the pros and cons of competitive bidding.

Chairman Frank: I think we have done so pretty well. It is getting to be more pros than anything else.

Mr. Dean: I believe I said the other day I believed you could get along under every set of conditions. When I was in college I worked for an old fellow. The students would come in and look all around the store. If you did sell them you made something, but if you did not sell them you could not eat. When they went out of the door without buying anything Ike Alexander would say to me, "Why did not they buy it?". I said, "They looked around." He said, "Ring that up on the cash register and buy yourself a Christmas present with it". (Laughter)

Well, now, on an issue of the public utility companies in Massachusetts or New Hampshire, or any of the other New England States, where you have competitive bidding, and say to a house like the First Boston Corporation, the Lehman Brothers, or Otis & Company, or anybody else, that "We are going to get out an issue of securities. We want you to work with us on it," and you naturally are going to do it. If your underwriters, or their counsel, are going to sit around and say, "It is far more difficult to do this thing under competitive bidding," you naturally are going to do the work, because you are going to do the very best you can under all possible circumstances. You are going to keep your mouth shut about the difficulties, because nobody is interested in hearing anybody beef at any time.

Chairman Frank: We are interested in hearing it.

Mr. Dean: I do feel, - and it is only a matter of opinion, - that on a negotiated issue you can do a better job of sitting down over a period of months or weeks, working with the executives in private conferences over a definite period of time, in drafting the registration statement, in ironing out the problems and in drafting the indentures. I do believe that you can do a better job that way than you can where you have got a large number of people, a large number of counsel, all trying to work on the same problem at the same time.

I do not want to stand here to be heard to say that, to the best of our ability, the underwriters did not do a very competent job in investigating these issues that they bid on competitively, that we did not do our very best to draw the registration statement and that the indentures were the best possible we could prepare. I can only say this, that we negotiated, in a private negotiation, for the issues, and we said, "As financial vice president, we urge you to put in a clause with respect to bonding of property."

I would like to say on that point, in answer to Judge Healy, that in all probability one of the reasons why those provisions are not made is because there is such stiff competition between investment bankers for the issuer; that you could do a better job in sitting down in private conference with the financial vice president, or the counsel, than you can with 30 people sitting in the room, because you can say to every one of them, "Why should I pay any attention to what your arguments are with respect to these covenants, because we are going to put this up for competitive bidding? We are going to draw these indentures."

I do not believe any of the underwriters, or any of the counsel, that have worked on these competitive bidding issues, want this record to show that they had done a bad job. I think the record should show that they have done the very best job that they could possibly do under the circumstances. I think that they can, speaking personally, I would offer it purely as a personal opinion, that you can do a better job on negotiated issues. I think, especially since the Trust Indenture Act of 1939 has come along, that that has added to the complications of trying to work out a public utility issue. That also comes under the Trust Indenture Act, on the basis of competitive bidding. I do not mean to say you cannot do it, because you can do anything if you make up your mind to do it.

Mr. Stanley: May I ask Mr. Dean whether he can do a better job with the margin of difference in returns greater in junior securities and second-grade securities than in high-grade securities?

Mr. Dean: Yes, Mr. Stanley, I would think that would be very clear. I remember when the Commission issued their opinion on the preferred stock in the North American Company, that was a very interesting and significant opinion. I think everybody who was working on preferred stock issues of public utilities studied the opinion of Chairman Frank in the North American Company.

Chairman Frank: Apparently studied it more than my colleagues did.

Mr. Dean: They studied it with a great deal of interest. Shortly following the North American case I was counsel on a negotiated issue for the New York State Electric & Gas. I drafted the preferred stock provisions which, to the best of my ability, I followed what the Chairman said in the North American case. We came down here and submitted it to the Public Utilities Staff, and as I recall it was passed with favorable comment. A great many other people in the utility business criticized the exact terms of the New York State Electric & Gas case to the executives, without allowing me to get away with it. All of the ideas on this thing came to the head of the buying department of the First Boston Corporation, and the entire provisions of the preferred stock were worked out in collaboration with Mr. Woods, vice president of the First Boston Corporation and vice president of the New York State Electric & Gas. If we were working on that issue on the basis of competitive bidding I believe the counsel for New York

State Electric & Gas would have drafted those provisions and have bid on those provisions, and the Commission could very properly say, "Well, we would not have allowed the New York State Electric & Gas to have gotten away with anything. We ourselves would have set up the terms and provisions of that preferred stock issue, and therefore you would have had just as great protective provisions in that preferred stock issue as the First Boston Corporation set up." That may be true; I do not know. It does seem to me that the issuer is being deprived, in competitive bidding, of the best judgment of the buying department of the underwriters.

Chairman Frank: Does anybody else care to be heard?

Mr. Dean: Mr. Chairman ---

Chairman Frank: (Interposing) May I ask, before you start, is there anybody else who cares to be heard?

Mr. Walker: May I be heard for a moment?

Chairman Frank: Yes. Anybody else?

Mr. Rodgers: Yes, I would like to be heard.

STATEMENT OF ARTHUR H. DEAN (Continued)

Mr. Dean: Mr. Chairman, when I was testifying the other day, I think in response to a question, I referred to the fact that it was easier to do business with people that you knew. Some members of the Investment Bankers Association called my attention to the fact that it seemed to them that I was making a statement that when I mentioned that one specific person, that

WLC

14

I thought he was better able to do financing for that particular issuer than anybody else was. I would like to disclaim any such statement. I have worked with the investment bankers all over the United States, and I am quite sure that there is no monopoly on brains of the people in any one firm or any one city, and I am quite sure the investment bankers in all parts of the country are just competent as they are in other parts of the country, as, for example, in Chicago, Dallas, or San Francisco.

Chairman Frank: Somebody was unduly sensitive. I do not think anybody up here noticed it.

Mr. Dean: I did not mean to give that impression. I am very sorry that I did.

Commissioner Pike: There just is not any such thing as bad whiskey. (Laughter)

Mr. Dean: In giving the figures on railroad financing, private railroad financing, the other day, - and I might say that seems to be a very difficult subject on which to get complete and exact information, - I gave a total figure of $39,926,000. I think the total figure on the issues that I cited should have been $51,925,000 as against $1,346,000,000 total railroad financing, excluding equipments.

Mr. Churchill Rodgers has also called my attention to an issue of Chicago Heights amounting to $562,000, the Union Terminal of Dallas in the amount of $1,750,000, the Atlanta

Terminal in the amount of $1,600,000, which brings the total of private financing to $55,837,000 as against $1,346,700,000 total. There may be other private issues which still we have not stumbled onto, although we have tried. We have checked with a great many people and we have examined a great many portfolios of life insurance companies and insurance companies.

In response to Judge Healy's question about the standardization of indentures, as to why investment bankers did not put in a great many of these restrictions in covenants, I would like to say that when I was working with the First National Bank in Ithaca, New York, in 1916, public utility bonds, as I recall it, were selling down in the low 70's and 60's at that time, and the savings bank and trust company there and the First National Bank would not recommend public utility bonds, they thought they were highly speculative, and the type of issues the people should buy were interurban traction and rails. The public utility business at that time was regarded as a highly speculative business.

When I first came downtown the staff of the Milwaukee Electric Railway & Light Company had been working for some time with the Bureau of Mines on pulverized fuel. They had been carrying on experiments for the period of quite some time. There was a tremendous dispute in the public utility business as to whether a plant that was going to burn pulverized fuel was going

WLC

16

to be efficient or not. Some of the best engineers in the country gave it as their opinion that that plan would not succeed. The staff of the Milwaukee Electric Railway & Light Company and the Bureau of Mines, on the other hand, felt that they could bring the relative efficiency of a steam plant up from, I think it was roughly 16 or 17 percent, up to possibly 25 percent. They talked with a great many investment bankers, and a great many investment bankers said they would not finance the securities of that company if they went ahead and designed that plant on the basis of pulverized fuel. Other investment bankers with whom they negotiated for some time had engineering firms in whom they had confidence to make a long study, and finally the bankers said, "All right. If you go ahead we will do our best to sell these securities," and they finally went ahead and built the plant, with great dispute, and finally sold the securities. As I recall it, the Wisconsin Railroad Commission had a good many investment bankers come out there and testify as to the price, because the bonds were seven or eight percent bonds selling down in the low 80's. There was tremendous discussion in the utility circles at that time as to whether that was a good or bad issue, but eventually their judgment was proved.

In the City of Milwaukee there was an announcement that the New York Edison Company was not going to use pulverized fuel. I remember Mr. Wade said to me, "I will make you a bet of a

nickel that during the construction of the plant they will
WLC 17 change," and they did. I merely cite that to show that at
that time those bonds had been put up for competitive bidding.
If the company had merely given this long engineering report
dvc I doubt very much whether that particular advance could have
been carried through.

When you are discussing with operating public utility companies, as the Commission well knows, these restrictive covenants, if you are going to cushion your amount of bondable issues to, say, 50 percent, that means for every 50 cents you are going to bond you have got to find 50 cents either of preferred or of common stock financing, or plow it back into your property. I think the Consolidated Edison shares were sold the other day over the counter and the yield was somewhere around 7 or 8 percent. If you had complete common stock financing, if you took the Consolidated Edison Company as a representative company and you had no bond or preferred stock financing, and you also had not the benefit of the deductions now given you by the tax laws, with reference to the actual cost of money to public utility companies, the ability of those companies to reduce rates would be seriously affected.

It seems to me a great many of these questions are social questions. In the early 20's, when the people were faced with a public utility industry that was growing exceedingly rapidly, I remember many discussions as to whether it was proper to bond the depreciation money. The argument was constantly made that if the business was static, that might not be proper, but in a dynamic, growing industry, where the plant account was constantly on the increase, where there was a tremendous demand for electrical energy, where you were constantly replacing the property so that probably at the end of 20 or 25 years the entire plant would be replaced, that that was a sound thing to do. Whether it was or not is probably arguable, but you have to bear in mind that the company was faced with the question of how many dollars they could get for bond financing, and how many dollars they could get for common or preferred stock financing. You recall at that time a great many people criticized it because of its social implication. Public utility companies had great difficulty in making public offers of preferred stock. They were using the old public ownership plan argument. They were getting their salesmen, their own employees to try to get people to buy preferred stock and the common stock of the company, and those securities were very unpopular.

Commissioner Pike: It was mostly preferred, was it not?

Mr. Dean: Some operating companies, I believe, Mr. Pike, sold common stock. I think the holding corporations, the subsidiaries of holding corporations generally held preferred stock. It was all a question of an over-all plan of what you could do under all of the circumstances.

Commissioner Pike: It was a question, in other words, of

WLC expediency, of what you could get at that time.

19 Mr. Dean: Yes. Many utility executives and many bankers would say, "If we would be able to draw an ideal indenture here, this was what would be ideal". was

But, on the other hand, with the utility business being a growing business and the public not yet having accepted the public utility business --- I think the best proof of that is that the bill in the New York State legislature failed for three years, 1924, 1925 and 1926, to make possible the buying of public utility issues by savings banks or trust funds. That was because a great many people felt the securities were so speculative that it was not proper for trustees to invest in them.

Commissioner Pike: Is not this a sound time, where there is a choice as to what sort of security can be issued, for us, as a Commission, to bring what pressure we can, either to keep capitalization sound or to push it in a sound direction by getting more and more of a common stock cushion, so the next time you cannot sell any of the bonds there will be a little leeway there so the boys can sell bonds? Is not this the time that we ought to be very careful and very chary about allowing bond issues and get close to the upper edge of the proper proportions?

Mr. Dean: Well, I would say, Mr. Pike, that the work that the Commission has been doing is recognized by most people in the

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20

business as very helpful and very constructive, while there may well be differences of opinion as to whether or not the covenants that you put into a particular indenture are proper in all of the circumstances, in view of the particular program that a utility is facing. I find it a very difficult thing. When you start out as a young lawyer drafting an indenture you can think of about three hundred ways that the issuer can defeat the security back of those bonds, and then you sit down and you find while that is probably true, it also makes the actual daily operation of the property almost an impossibility, and you finally have a compromise between the best judgment of the investment banker and the best judgment of the utility executive, and only time will tell whether or not they were too liberal or whether they were too severe. I do not say this disrespectfully at all, but I think that some of these covenants of the Commission you may find are too severe.

I would like to say in connection with this standardization of indentures, while I think that the work of the Commission under the Public Utility Act and the work under the Trust Indenture Act is very good, I think you may also find in the next ten or fifteen years that in your effort at standardization you have also impeded progress, just as we find our children are far more healthy because they have orange juice and go to bed at 7 o'clock, but they also cannot stand the ravages of disease nearly as well as other children on the street.

WLC Commissioner Pike: I would not know about that.

21 Mr. Dean: When you get into this question of how the covenants are going to work, one of the provisions that I would personally like very much to see put into trust indentures but you cannot put in because of the Trust Indenture Act is the provision that is in all English indentures, which permits a majority of the bondholders to change certain provisions in the indenture, or if you call a meeting and publish it and you cannot get the majority of those present, then the majority of those present at a reconvened meeting can make the changes. It also raises a question of the negotiability of the bonds. I think you are going to find a great many provisions which able and intelligent utility executives and the Commission themselves might like to put in the indentures, that if you put them in the indentures you are going to be impeded because of the restrictive provisions of the Trust Indenture Act.

Commissioner Pike: We can all go up on the Hill together.

Mr. Dean: With the existing provisions you cannot amend the indenture.

Chairman Frank: You implied that that was in the future.

Mr. Dean: Yes. On your question, Mr. Chairman, as to whether your issuer could not ask bids on the basis of a specific price, it seems to me that that falls within the same category of a tie-in clause in the contract. The very fact that you have had to have legislation such as the Miller Tydings Act and the

Prosser-Feld Act in New York seems to me a good commentary on the fact that manufacturers are absolutely unable to enforce the resale provisions of their product. Once a man has bought a product, generally speaking it is his. It is generally impossible to try to follow that into his possession and try to force him to sell it in a manner which the original seller thinks is proper.

Just one thing in conclusion. I have noticed several times in the course of the hearings that the Commission itself, and I believe also the staff in their report, said that the question whether or not the advice the issuer received in connection with its offer of capital set-up, as to whether or not it could issue bonds, debentures, notes, or preferred or common stock, was in many respects more important than pricing or the spread, and that the Commission, as long as this Commission sat, that the Commission would see that the indentures, and so forth, were set up upon a proper basis.

If there is not any real problem, as far as the pricing and spread is concerned, if the Commission is satisfied that they themselves can protect the issuer and protect the investor with respect to the proper set-up, then your problem narrows down, does it not, to the question of the maintenance of competitive conditions? May I merely make that suggestion, because I think that statement has been made at various times in the record, and that is my conclusion that I can draw from your report. So

WLC 23 if you can be satisfied that there was maintenance of competitive conditions, then I should think the problem which the Commission has to administer under the Act might be solved.

Commissioner Pike: Bring us up a solution.

Mr. Dean: We are working on that very actively.

I do not care to make any detailed comment on what Mr. Love said this morning, other than to say that we fully recognize that to a certain extent long-term terms made by commercial banks to public utilities are competitive with securities that would be publicly offered in the market. We also very definitely recognize that in many respects bank loans are not competitive. They are, in fact, supplementary. In a great many instances it would not be possible to carry out the public offering of securities were it not for the possibility of the commercial banks to make loans in the interim periods. The many investor plans which they submit to public utilities recommend to the management that the bank loans with serial maturities have a definite part in the program that they play.

I think we would simply reiterate our theme song, that we think competitive bidding is bad in long-term financing, and then we also think it is bad in short-term financing. We regret, even though probably the commercial banks are competitive to a certain extent with investment bankers, we regret very much to see any regulation drafted which would hamper either investment bankers or the management or the issuers in setting up

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24 financial plans which they regard as the soundest possible financial plans under all the circumstances.

Commissioner Pike: Do you also take the opposite stand, that one who might consider competitive bidding was good for a long term it would also necessarily carry it through a financial emergency, in a short-term security?

Mr. Dean: I think it is very difficult to answer. I think it is a very pertinent question, but it also is a very difficult question to answer.

Commissioner Pike: I know it is. That is why I asked you.

Mr. Dean: We would say if you have to have competitive bidding for long-term financing, it is our honest opinion it is going to be terribly difficult to set up proper financial structures for public utility companies, and logically I suppose it should follow we would recommend competitive bidding for short-term financing, too. I do not think we would, however. Maybe individual members of the Association would disagree with that viewpoint. I think, after discussing it at considerable length with a good many members of the Association and the public utility executives, it would be very difficult to set up any kind of a plan where you would not be able, in connection with your whole financial set-up, where you would not be able to go to your executive officers or bank and say, "Will you or will you not do this? Because of the basis of it, will you or will you not change your whole financial structure?" Conversely, I know there is definite disagreement, that it does not make any difference who the investment bankers are. Nevertheless, I think you would find that loan officers of commercial banks would give you one answer on whether or not they would give you a short-term loan. If so-and-so said, yes, in principle they were committed to long-term financing, and they might give you another answer if somebody else were going to do the long-term financing.

Now let me say it is terribly difficult to project this forward into a realm of trying to do business in a set of circumstances where none of us have ever found ourselves.

Commissioner Healy: Have you made it sufficiently definite as to what your reaction is to Mr. Eicher's suggestion that if a competitive bidding rule is enacted insurance companies who want to take private placements should be exempted from it?

Mr. Dean: We have been discussing that at great length, Judge Healy. Mr. Connely can correct me if I am wrong. I do not think we are prepared to take a position on that as yet.

Mr. Connely: I think Mr. Eicher made a pretty good case for us, but I think what Mr. Dean said is right, that we would rather discuss that a little further among ourselves.

Commissioner Healy: All right.

Mr. Dean: Thank you very much.

Commissioner Healy: Is there anyone else who is ready to

WLC speak tonight?

26 Mr. Walker?

STATEMENT OF BURNETT WALKER,

representing Smith Barney & Company.

Mr. Walker: Mr. Dean covered one of the points that I would like to remark on, I might amplify it slightly, and that is in connection with capital structure. The Chairman's remarks and then yours, Judge Healy, made me think you devoted considerable thought to the best way in your program here to get an approved capital structure. I got the impression from some comments from the staff in the past that they have felt that some of us in the issuing houses have used bonds because that was easier for us and more lucrative. I think as to the first, that is correct, it is easier. I would like to correct the second though, it is not more lucrative.

My house, for example, issues a substantial amount of common stock, and the disparity between profit on high-grade bonds and common stocks is very substantial.

When you are talking in generalities, I happen to have a memorandum which the head of our statistical department prepared for me last night on some bond yields. I might say I do not have any intention of using it in this connection, but I think it is pertinent. He remarked on the disparity in yields, or rather cost of money, putting it in terms of the utilities' position, he remarked that in the last three or four weeks there

WLC blocks of utility common stocks issued in the New York market,
27 not issued to be sold in the New York market.

Commissioner Pike: Secondary distribution?

Mr. Walker: Secondary distribution. Those three were the Consolidated Edison, the Pacific Gas & Electric, and North American. Two of those are operating companies. It happens that we handled two of the three. Those three issues show yields of from 7 to 9 percent.

Commissioner Pike: Did he give you the price and earning ratio on those two?

Mr. Walker: That is on the current yield. As a matter of fact, those would run up --- The Pacific Gas & Electric I happen to know is around 10 times earnings, and an average of utility companies would be around 12 times earnings. This was on the current yield of the dividends.

Now if you will contrast that with the yields on these securities: Cleveland Electric Illuminating, the market yesterday showed a yield of 2.64 percent. Southern Bell Telephone, 2.71. Southern California Edison, 2.81. Dayton Power, 2.69. Even the Indianapolis, which is not a company that ranks with the very top because it has its problems and is evolving, - even that is on a 2.94 basis. You contrast that with the 7 or 9 percent on current yield and 12 times earnings on an average of first-class companies of common stock. When you add to that the advantage in having a debt, where you can

WLC

28

deduct the interest in calculating your income tax for the cor_poration, it has made a barrier that has been almost impossible to hurdle.

Commissioner Pike: The pressure is pretty strong. There is no question about that.

Mr. Walker: If you will ask me the question you asked Mr. Kellogg as to the ideal capital structure I should answer it a little differently, but it would be, in substance, the same. As far as I am concerned, I should like to see about a 40 or 50 percent debt on these companies, in order to get some cheap money and high rates for common, but you would have to have some help on that from the Commission too, to keep impressing on the utilities and everyone else that we must reduce the over-all cost of money. Anything that the Commission can do to aid in that connection of balancing the corporate structure I should say anyone in my profession would be delighted to see.

Commissioner Healy: You might read what we put out yesterday in the case of El Paso.

Mr. Walker: I did. I have not read it except in the newspaper accounts, but I have seen it.

Commissioner Healy: That is tending directly in the direction that you have just approved of, is it not?

Mr. Walker: Yes. Now there is one other thing that I should ask to be permitted to remark on. I was not able to be here in the hearings last week, but in those hearings I understood that the Northern States of Wisconsin was referred to from time to time.

Commissioner Healy: It was Minnesota, was it not?

Mr. Walker: No, it was the Northern States of Wisconsin.

Commissioner Healy: The Northern States of Wisconsin?

Mr. Walker: Yes. I think that is a rather interesting case and illustrates the point of view at least that I have. I do not undertake to speak for all of my associates, because the subject did not happen to come up for consideration. I think it illustrates our attitude towards competition in our business. As far as I am concerned, I haven't any objection to any form of competition in this business which permits two main over-all objectives. One is that we shall be able to preserve the facility for the corporation and the Commission, and whoever is going to do the banking, to sit down like three civilized human beings and work out a program. We all have our points of view, we all have our experiences, and I think they should all thrown into the pot, and I think any system which makes it impossible to do that is a material sacrifice in our financial structure.

The second thing is this: Our house is quite concerned over the possible inauguration of any system which weakens the general investment banking structure of the country. We have written a letter to you, Mr. Chairman, with copies to your

WLC Commission, saying that it is our view that this country has 30 before it a colossal job in connection with financing. We think it would be a very serious thing for this country if any steps were taken which seriously damage the investment banking machinery. We think rather that it would be pertinent for this Commission to make the corrections that you think should be made in our industry, or tell us what they are, but do not do something which destroys a substantial part of that machinery, as we believe would be the case if the competitive rule were put into effect.

I thank you.

Commissioner Healy: Does anybody else wish to be heard?

Mr. Rodgers: May I take a minute?

Commissioner Healy: Yes, Mr. Rodgers.

STATEMENT OF CHURCHILL RODGERS,

Assistant General Counsel,

Metropolitan Life Insurance Company.

Mr. Rodgers: I wish to comment very briefly on two points. First, the figures given by Mr. Dean in regard to railroad financing. I submit that those figures indicate simply that railroad issues have not been an appropriate investment for life insurance companies and other long-term investors recently. Our total purchases of railroad bonds during this period, the last six years, has amounted to a little over $50,000,000. Of that amount a little over $20,000,000 is represented by private purchases of railroad securities. So you see the percentage is about 40 percent, which is not much belong the percentage on, say, utilities or any other type of security.

The other point that I wish to comment on is Mr. Love's statement this morning. Mr. Love gave a very able description of a type of financing which does not lend itself to competitive bidding. Without now attempting to discuss our request for the broader exemption, I wish to point out that in this respect insurance companies and other financial institutions should be treated on the same basis as commercial banks. Under the laws of the State of New York, under which we are organized, we too are authorized to engage in that type of financing. I think it is important that the borrowers be able to turn to us in the same way that they are able to turn to commercial banks, in order to get this type of financing.

Therefore, I would suggest that if that type of exemption is put in for commercial banks, that possibly "financial institutions" or "lending institutions" be substituted for the words "commercial banks".

Mr. Fournier: Do you have any difficulty in getting a ten-year note in connection with the broder program of an operating company? Do you have the same difficulties which Mr. Love mentioned this morning?

Mr. Rodgers: Yes, I think Mr. Love made a very good statement of just about the problems that would arise, like financing, even more so in long-term financing, where you need to sit down with the borrower and work out the terms of the loan. Now you take a case such as the financing of emergency plant facility contracts, the Government there pays the corporation back in 60 equal monthly installments, and the corporation needs to borrow the money privately and pledge that contract. Therefore, you need a 5-year note, you need a 3-year loan or you need a 5-year loan. You need to provide for the details of pledging that contract with the Government, and there are many terms which have to be worked out. It is not the type of a loan which can be readily distributed. It is not a matter for public financing, it is a matter for direct financing. It is necessarily a matter of two people getting together and working it out. I do not think it lends itself to competitive bidding.

Mr. Dean: Mr. Chairman, I do not want at all to enter into any debate with Mr. Rodgers, but if the Metropolitan bought $20,000,000 in railroad securities and private placements at a total of $50,000,000, if that figure is correct,--I say it is probably subject to adjustment-- then it is obvious that other people buying securities privately was the remaining securities in the total of $1,346,000,000. So the ratio of the other life insurance companies privately bought securities to the total bought can hardly be as high as the 40 percent figure

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33 that Mr. Rodgers mentioned for the Metropolitan.

Chairman Frank: I suggest that you and Mr. Rodgers endeavor to stipulate the factsand get together on them.

If there is nobody else that cares to be heard we will adjourn until 10:45 tomorrow morning, as we have at least one witness who desires to be heard who has not been able to be here today.

(Whereupon, at the hour of 5:15 p.m., an adjournment was taken until 10:45 o'clock, a.m., of the following day,

END Thursday, February 6, 1941.)

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