OFFICIAL REPORT OF PROCEEDINGS

BEFORE THE

SECURITIES AND EXCHANGE COMMISSION

DOCKET No.....

In the matter of...THE PROBLEM OF MAINTAINING ARM'S-LENGTH BARGAINING AND COMPETITIVE CONDITIONS in THE SALE AND DISTRIBUTION OF SECURITIES of REGISTERED PUBLIC UTILITY HOLDING COMPANIES AND THEIR SUBSIDIARIES

Place ..Washington, D. C.....

Date...January 28, 1941.....

Pages....207 to 484.....

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BEFORE THE

SECURITIES AND EXCHANGE COMMISSION

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Public Conference concerning

THE PROBLEM OF MAINTAINING ARM'S-LENGTH BARGAINING AND COMPETITIVE CONDITIONS in THE SALE AND DISTRIBUTION OF SECURITIES of REGISTERED PUBLIC UTILITY HOLDING COMPANIES AND THEIR SUBSIDIARIES

- X

Hearing Room 1102,
Securities and Exchange Commission Bldg.,
Washington, D. C.,
Tuesday, January 28, 1941.

Met, pursuant to adjournment, at 10:30 o'clock a.m.

PARTICIPANTS:

COMMISSION:

JEROME N. FRANK, Chairman, (presiding)
SUMNER T. PIKE, Commissioner
ROBERT E. HEALY, Commissioner
EDWARD E. EICHER, Commissioner

STAFF OF COMMISSION:

JOSEPH L. WEINER, Director, Public Utilities Division.
ROBERT H. O'BRIEN, Associate Director, Public Utilities Division.
GEORGE OTIS SPENCER, Assistant Director, Public Utilities Division.
LAWRENCE S. LESSER, Special Counsel.
LESLIE T. FOURNIER, Supervisory Utilities Analyst.
ROGER FOSTER, Special Counsel.

OTHER APPEARANCES:

Name	Representing
Nevil Ford	Ex. Comm., National Association of Securities Dealers', Inc.
Emmett F. Connely	Pres., Investment Bankers Association of America
Robert McLean Stewart	Ch., Securities Acts Committee, I. B. A.
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W. R. Daley	Otis & Co.
Cyrus S. Eaton	Otis & Co.
S. K. Cunningham	Pres., S. K. Cunningham & Co., Pittsburgh
F. W. Ecker	V.P., Metropolitan Life Ins. Co.
William Chamberlain	Former Vice President and Gen. Counsel of the United Light & Power Co. and subsidiaries; later Pres. of same.
G. W. Drayton	Insurance Co. of North America, Philadelphia
Roland Behrens	St. Louis Union Trust Co.
Chapin S. Newhard	Newhard, Cook & Co., St. Louis
Harold Stanley	Morgan Stanley & Co.
Herman B. Joseph	Joseph Co. Inc., Cleveland
Albert E. Van Court	William R. Staats & Co., Los Angeles
Joseph M. Scribner	Singer, Deane & Scribner, Pittsburgh
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OTHER APPEARANCES (continued):

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Lowry Sweney	Lowry Sweney, Inc., Columbus, Ohio
Judson S. James, Jr.	James, Stayart & Davis, Inc., Dallas, Texas
Pearson Winslow	Bonbright & Co. Inc., New York
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Charles S. Engle	Engle, Adams & Co., Denver, Colo.
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Fred N. Oliver	Gen. Counsel, Nat. Assoc. Mutual Savings Banks
Cloud Wampler	Stern, Wampler & Co. Inc., Chicago
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John C. Legg, Jr.	Mackubin, Legg & Co., Baltimore
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J. C. Folger	Folger Nolan & Co., Washington, D.C.
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OTHER APPEARANCES (continued):

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PROCEEDINGS

Chairman Frank: We will resume the conference.

Apparently our appeal was not so great as to maintain the same number that we had yesterday. I think we had about 200 here yesterday. Apparently we were not sufficiently interesting to hold our audience.

Do I understand, Mr. Stewart, that there are some gentlemen, small dealers from out of town, that wish to be heard this morning?

Mr. Stewart: Yes, Mr. Chairman, there are two or three others, and there are two, I think, who would like to continue the same general type of testimony as Mr. Drayton and others spoke on yesterday.

Chairman Frank: I would like to suggest in so far as possible that we avoid repetition of the things that were said, and if a witness is in concurrence with what was said, that he so indicate and confine his remarks to anything novel, because I think we have got the point of view, and if it is merely a statement of concurrence, that can be noted of record. I do not want to be rigorous about that, but we do have a lot of other work to do, and we would like to get finished.

Mr. Stewart: I will ask Mr. Kuhn to present a statement.

STATEMENT OF C. JOHN KUHN
Vice President, Firemens Insurance Co.,
Newark, N. J.

Mr. Kuhn: I have a prepared statement here, sir. May I

read that?

Chairman Frank: Does it cover much the same ground that was covered yesterday?

Mr. Kuhn: There is some repetition, I do not doubt, of what was said.

Chairman Frank: I wonder if you could not indicate where you concur, and if you have anything new to state, state it, and to the extent that it overlaps, file your memorandum and it can be made a part of the record.

Mr. Kuhn: I will try, then, as I go through this, to eliminate what was said yesterday. I have not read the testimony, but I have a general idea of what may have been said.

I am convinced that the imposition of any regulations requiring the use of competitive bidding in the sale of public utility securities would be an unwise, impracticable and undesirable measure and would not be in the public interest.

I have read and studied, in so far as the short time allowed has enabled me to do so, the recent report of the Public Utilities Division of the Commission advocating competitive bidding for certain public utility securities, and the reply thereto of the Investment Bankers Association of America, dated January 18, 1941. In my opinion, the former, although a brilliant, theoretical exposition of the case, is unconvincing, whereas the I.B.A. answer to that report is a

clear, adequate and comprehensive argument in opposition, which, in the light of my experience, I believe to be sincere, as unbiased as such a report could be, based on far greater judgment and practical experience, and with which, with some minor reservations, I concur.

To enforce competitive bidding would, I believe, be entirely inconsistent with the real purpose for which the Securities and Exchange Commission was originally brought into being. It was established by the Securities Act of 1933 for the protection of investors - not the issuer of securities - and even though the powers of the Commission have been broadened by the Securities Exchange Act of 1934, and the Public Utility Act of 1935, that particular purpose has not changed.

Regardless of all statistical studies made to prove the contentions of those on either side of the argument, it takes little imagination to realize that under a system of competitive bidding, higher prices in general would inevitably be paid to the issuer by those in competition for the business. That is one of the prime purposes and the very essence of competition, as developed to some extent here, and I will skip over that, as it was undoubtedly covered yesterday.

Chairman Frank: Do you think the same argument generically could not be made with respect to competition in any other field? In other words, if you take somebody comparable to the investor in other fields of business activity, it would

Compilation Binder - Transcript

Vol I

3. - Lowry Sweeny.
4. - Lehman Bros.
5. -
8. -
9.
17.
21.
32.
35.
38.
40.
83.
85.
99.
109.
112.
113.
123.
125.
183.
187.
196.

Vol II

be, let us say, the consumer, could it not be said that competition in any commodity is likely to increase the price to the seller?

Mr. Kuhn: I do believe that.

Chairman Frank: And therefore, the ultimate consumer pays more. Well, there was a system of economy during the Middle Ages on the basis of a just price, according to which competition was not deemed desirable. I thought that we had moved away from that economy, and the American system was one in which it was deemed that the consumer and the whole economy was better off if you had an active competition, and the fact that the price might rise in those circumstances was one of the circumstances that was taken into account, because it was assumed that, generally speaking, as the result of competition, everybody would be better off.

Now, as I understand it, you think that that criterion which is generally applicable should not be applicable to securities?

Mr. Kuhn: I do in this particular case, because I believe that over a period of time, despite the competitive basis upon which business has been conducted in this country, there has been established a traditional relationship in this particular field which has brought about benefits to both the issuer and the purchaser that might be eliminated by competitive bidding.

Chairman Frank: Wouldn't you say on the whole - I just ask you - wouldn't you say that in any area of business which says that ordinary competitive methods should be eliminated, that it has the burden of proof? I am expressing my own views entirely. I know that at least one of my colleagues does not agree with me. I do not happen to believe that under all circumstances competition is the most desirable method of arriving at the results, but I feel that the burden of proof is on anybody that says that it is not.

Mr. Kuhn: I shall attempt to prove that from my point of view here, sir.

Competitive bidding, in my opinion, would destroy the professional relationship which has existed between the underwriter and his client by which both the client - i.e., the issuer - and the investor have benefited. That sense of responsibility which the investment banker has had, particularly since the passage of the 1933 Act, to get the best possible terms for the issuer and at the same time to protect properly the interests of the ultimate purchaser, would be virtually eliminated. Who would take such responsibility, where, under competitive bidding, the natural and logical impulse would be to cut all possible costs of investigation, legal, accounting, engineering, and so forth, in order to make the highest bid - to look upon the underwriting as merely a job of quick merchandising with little interest in the subsequent fate of

the issue, especially since it would have little bearing upon a firm's chances of getting the next piece of financing of the same issuer, or of any other issuer?

Then, sir, I develop the thesis that the investment banker, as the counsel to the issuer, gives him the benefit of his long experience and his continuing knowledge of the issuer's financial problems to advise him as to the best means of issuing securities, and I say:

Who, under competitive bidding, would give him these benefits? Surely the Public Utilities Division of the S.E.C. is neither prepared nor willing to undertake that advisory function in addition to its supervisory powers under Sections 6 and 7 of the Public Utility Act of 1935. All these things and more are done now with a reasonable degree of success, and the absence of any clamor on the part of public utility managements for competitive bidding well proves that they consider these services to be of inestimable value.

Likewise, the confidence of investors, particularly those professional buyers who represent institutions, both large and small, in the present system of negotiation, is equally well illustrated by their conspicuous restraint from any request for competitive bidding. We, and I now speak of the companies I represent, have purchased some new security issues without any preliminary study of the indentures because of our belief that those investment bankers have

negotiated the best possible instrument to protect our interests. We could hardly do that under competitive bidding in any but the very highest credit rating obligations.

In a recent piece of financing, with which I am familiar, the problems involved were the subject of close, joint study by the issuer and investment bankers for months, with over 30 different plans of financing investigated and innumerable indenture covenants analyzed, during which time the most painstaking and detailed analysis and appraisal of the company's operations and properties were undertaken and carried through.

Chairman Frank: May I ask this question? What do you think was the impetus to the enactment of the Trust Indenture Act? As I know its history, and the members of this Commission know the history of that statute, the investigation by the S.E.C. and testimony brought out before the Congressional Committees convinced Congress that the system of private negotiation by originating underwriters with issuers had led to trust instruments that were shockingly inadequate in their protection of investors, and it was for that reason that Congress felt it necessary to step in and impose minimum standards.

Now, if you are correct that the initiating underwriter is the protector of the investor, then Congress made a great mistake in enacting that statute, and the S.E.C. was completely

wrong. I don't know whether you have ever read our report?

Mr. Kuhn: Yes, I have.

Chairman Frank: It was prepared before I was a member of the Commission, so I have no egotistical pride in it. I don't know whether you have read our report or the testimony that was brought out. The report was before Congress. The underwriters, many of whom are represented in this room today, participated in issues and brought out issues under those Trust Indentures which were shown to be miserably inadequate.

Mr. Kuhn: I believe a great many examples that were given in the testimony at that time referred to issues which had been brought out a great many years prior to that time. It has been my experience that since the Act of 1933 particularly, and giving due credit to that Act, of course, that there has been much more consideration given to proper protecting provisions in the Indentures than ever was given before.

Chairman Frank: Let us take the particular one that, from my own point of view, was the most important provision of the Trust Indenture Act, and that is the responsibility of the trustee. My recollection is, and I may be in error and I will stand corrected if someone wants to bring forward any evidence to the contrary - I may be in error - is that from 1933 to the date of the enactment of the Barkley Act, the Trust Indenture Act, the exculpatory provisions exculpating

trustees from a large part of the responsibility now imposed upon them by that statute, that the provisions of that kind were not put in as a result of the 1933 Act, and that it took the Barkley Act to insure the insertion of those provisions, and yet those were negotiated by the underwriters, and I say many of the underwriters represented in this room, so it took an Act of Congress to bring about that protection.

Mr. Kuhn: That has not been my experience.

Chairman Frank: I am talking particularly now about the exculpatory clauses. Is it your recollection that from 1933 on, exculpatory clauses were markedly modified?

Mr. Kuhn: That is my definite impression.

Chairman Frank: I think you are in error. All that the 1933 Act did - there is a lot of confusion about the 1933 Act, and I think a lot of people here may not understand - all that the 1933 Act requires is that the true facts be set forth, and they were set forth, and the true facts with respect to the obligations of the trustee - Judge Healy, you may remember about that in connection with the 1933 Act?

Commissioner Healy: Evidently Congress did not think so, because four years later they found it necessary to pass the Barkley Act, outlawing exculpatory clauses. I am not aware of any improvements in the provisions regarding obligations as trustees as a result of the Securities Act.

Mr. Kuhn: I did not mean to make that inference. There

is no such provision, of course, but my point was that the provisions of the 1933 Act itself led to a greater awareness of the necessity for greater protection to the investor.

Chairman Frank: As to the exculpatory clauses, I think you are in error.

Mr. Kuhn: I am not claiming that it was due entirely to that.

Chairman Frank: That is the heart of the trust instrument, the obligation of the trustee. The point I am getting at is that underwriters upon whom you say you rely so largely to protect the investor in your institution as an investor, and the other investors, were not insisting upon adequate modification of the "horse and wagon" exculpatory clauses, and it took an Act of Congress to bring that about.

Commissioner Pike: In other words, I think there was a great deal of tightening up in the clauses which were designed to protect the investor, but the mechanics of putting that protection into action was not helped much. The trustee was not forced to do anything, and if he did not do anything he was excused from everything, as I remember it, in most cases, right up to and sometimes including gross negligence.

It is very much like one of these bills that sometimes gets by a legislature, providing for the correction of so-and-so, and just mildly forgetting to appropriate any money to see that it is done. Those exculpatory clauses, I think if you

will check back, I think you will find that the banks protected themselves very largely up to the time of this Act.

Mr. Kuhn: One goes, as you know, on an impression that is built up over a period of years in his experience and takes so many things for granted that he does not bother to present definite statistical data to prove his point. In this case I have not.

Chairman Frank: Our position here makes us so peculiarly sensitive to those matters, and we do not find that the underwriters were seeing to it that those trustee obligations were improved, and when a trustee who, after all, must be relied upon under a Trust Indenture very largely, is in a position where he has very minimal obligations, our experience showed that the trustees were taking advantage of those clauses, then we can not help but draw the inference that the underwriters were not, in their bargaining for the purchase of securities, looking out for the interests of investors to the extent that your remarks would indicate.

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Mr. Kuhn: I would like to make this point, however, that all of this costly and detailed expensive job of investigation which has heretofore been done by the underwriters might be eliminated to a very great extent under competitive bidding, which leads to this statement, that without that, under the 1933 Act, the possibilities of error and omissions of material facts would be multiplied many fold, with the frame-work of the Act becoming a battle ground of legal actions -- an occurence which has been notable for its absence ever since the passage of the Act and the continuation of the business under a system of private negotiation.

Chairman Frank: Let us break that up into two points. First, as to the care and scrutiny. I think you are aware of the fact that the securities we are talking of here are solely utility securities which come under the Public Utility Holding Company Act. I think you are probably aware of the fact that the Commission through its staff first and then through the members of the Commission itself go over those issues with most exceeding care, that we have a power and a duty under the staff too to go far beyond what we do with respect to non-utility securities, and I venture to suggest that there is more disclosed in our files and opinions as to those utility issues than ordinarily is the case with respect to ordinary issues that do not come under the Utility Act, in other words, there is not very much that escapes our staff.

Mr. Kuhn: Isn't it a question then, sir, of the Commission taking the burden to see that all of these facts are disclosed rather than the underwriters?

Chairman Frank: As Judge Healy indicated yesterday, it is the Commission's power and it is the Commission's duty and it has done so. In other words, the notion that the underwriters have subjected the issues to half the scrutiny that we have under the Utilities Act is an illusion. It is true as Judge Healy has said on many occasions in this connection faced with the Barkley Act provision, it means that the Commission sees to it that the trust indenture provisions are pretty stiff. And secondly, the scrutiny of the company's physical condition -- much to the disgust occasionally of the underwriters and issuers, has been made. The underwriters and the insurance companies have not heretofore undertaken that.

As I said yesterday, we have had issues here that were going to be private placed where we insisted upon stiffening up the provisions far beyond what the insurance companies insisted upon.

Commissioner Healy: As a matter of fact, there is not one indenture in ten that comes to us under the Holding Company Act that the Commission does not have to tighten up indenture provisions even now after the Barkley Act.

Mr. Kuhn: That I did not know.

Commissioner Healy: Regardless of whether they are

publicly distributed or privately placed.

Chairman Frank: If you were addressing your remarks to a suggestion for competitive bidding under the Securities Act, much of what you say would be pertinent, in other words if this were to be applicable to ordinary industrials, it is perfectly true that the Commission except as to indenture provisions would be helpless to help the investor in many respects. It could compel disclosures, but that is all; but, remember that the Utilities Act is a very different instrument. It is, speaking generically, a Blue Sky law. It is a law which requires the Commission to say, "You must not give permission to issue the security unless it possesses certain minimum characteristics", and on the whole I would say that the complaint from the underwriters interested in those issues has not been that the Commission has been lax but that it has been too exacting. We have been severely criticized for insisting that additional provisions be imposed. They generally complain to us that it is going to delay the issue, that it is going to hamper the deal or lose the market and so forth. I think you will find that much of what underwriters in an ordinary issue are called upon to perform, this Commission by statute is required to do and does.

Mr. Kuhn: It does not cover the question of financial counsel to these public utility corporations with reference, we will say, to the proper timing of the issue.

Chairman Frank: That is not our obligation.

Mr. Kuhn: Those are valuable services which the investment banker performs.

Chairman Frank: Somebody has to exercise their judgment, of course.

Mr. Kuhn: I shall skip over quickly quite a section here I had as to the relationship between competitive bidding for municipal and railroad trust issues, because in the Public Utility Commission staff report that was practically admitted to be the case, that there was no guide in that method of competitive bidding.

I would like to point out that in times of financial difficulty some of our largest municipal corporations, such as Detroit, Chicago and New York, have abandoned competitive bidding and resorted to private negotiations with investment bankers to gain help to carry them through troublous times.

Chairman Frank: You understand that the proposed rule would permit avoiding competitive bidding on a proper showing?

Mr. Kuhn: Yes, but the thing I am objecting to is the compulsory feature.

Chairman Frank: Yes, but I say that the rule would provide that upon a proper showing, compulsory competitive bidding would not be required.

Mr. Kuhn: But the burden of proof would of course be on the underwriters in that case.

Chairman Frank: Or on the issuer. I think you will find, for instance -- my recollection is and I may be in error -- that the New Hampshire Commission has a rule requiring competitive bidding, and as I recall it in several instances they have relaxed it on a showing that under peculiar circumstances it was not desirable because market conditions or something of the like made that advisable.

Mr. Kuhn: There can be little doubt but that competitive bidding would stimulate the trend toward "private placements", which has developed as an unanticipated effect of the 1933 Act. It is estimated that in the past five years more than $2,500,000,000 of new corporate obligations (in addition to all private placements of railroad, municipal and government issues and issues of less than one million dollars) have been sold by issuers directly to institutions. All of these securities have been taken completely out of the market, with no opportunity on the part of smaller institutions or individual investors to purchase any part of them. The disadvantages of this practice are freely recognized.

Under a system of competitive bidding, large financial institutions would be able to bid freely against investment bankers for purchase of public utility securities, --

Commissioner Pike: (Interrupting) Your institution would not be big enough, would it?

Mr. Kuhn: No. We have participated in one or two private

placements.

Commissioner Pike: Suppose this were made to apply to partial bids so that you could go in there and bid for what you wanted?

Mr. Kuhn: Isn't that likely to be a very difficult operation in making a private placement and forming a group of smaller institutions?

Commissioner Pike: I think it might be, but it is part of the problem. One of the real problems, it seems to me in the private placement has been that only a few outbids could go in there and take a large issue. In competitive bidding, it has seemed to me that there would be no particular reason why a company or a group of companies could not go in and take what they wanted at a bid, and then possibly the bankers also competitively bidding perhaps take the rest or a large portion. I see no inexorable reason why both could not get their portion. I know there are practical difficulties in the way which I presume would have to be ironed out. Possibly they present great difficulties.

Chairman Frank: But it would be possible for you to do what you could not do today where there is a private placement and the large insurance companies take the whole of it and you can not get in. This would make it possible for you to bid, you and a group of smaller companies and say, "We want up to so much".

Mr. Kuhn: Yes?

Chairman Frank: So that you really could break in where today you can not.

Mr. Kuhn: But the smaller investors as a rule are not equipped to undertake such an operation.

Chairman Frank: Would it not be possible -- I am asking for information -- for your company to get together with several smaller institutions and say that as a group you will make an offer for a portion of a certain offering?

Mr. Kuhn: It is perfectly possible, yes, but it would be an operation that requires more than we or most small institutional investors are set up to accomplish. For example, there is a question of leadership in such a situation. In the second place, there is the question of the preliminary investigation which must be accomplished to a certain extent before we or a small institution could make up its mind. There is the question of the psychology of bidding against a larger group with all of its tremendous resources, and I am speaking now of the financial institutions and not the investment bankers, for bidding for part of the issue where it is much simpler for the issuer to sell it as a whole rather than in part.

Chairman Frank: Yes, but if our rule required that they should allow partial bids, then that last point would disappear. It may be that the trend toward private placement is an irresistible one -- maybe it is -- and if it goes on, and if

the volume of offered bonds gets smaller relative to the demand and the demand keeps at its present pace from the large companies, an institution such as yours is going to have considerable difficulty in getting securities.

It seemed to us -- perhaps we are in error -- that the proposed practice might require some new machinery on your part, but that it would give them the possibility of the smaller institutions bucking the trend as far as they are concerned. It would not help the investment bankers any.

Mr. Kuhn: I am not pleading for the investment bankers but for the smaller investors. I think under such conditions, the small investor would be more out of luck than he is at the present time. He would be up against much more intangible forces than he is now with the free and unrestricted matter of issues with investment bankers.

Chairman Frank: But if the big companies keep gobbling up the issues, the investment bankers don't get them and you won't get your share.

Commissioner Healy: I do not want to debate this with you, because I am not sure that this is particularly pertinent to the main issue before us. I would just like to put in a parenthetical note that I do not agree with you that the private placements are the direct result of the Securities Act of 1933.

Chairman Frank: Why don't we discuss it for a moment, since you have raised it? As I understand it -- it has been

brought out here and in many other places -- the investment banker is seldom in a position where he wants to make a firm commitment for any long period, because he needs to get off the hook in a hurry. Whereas the large insurance companies are in a position to make a commitment many weeks in advance because they do not care particularly if the market goes off a point or so. Whether there was a Securities Act or not, the Securities Act -- and I am talking now solely with reference to the utility securities under the Public Utility Holding Company Act -- there must be a period of delay while the securities are going through our hopper under the 1935 Act, is that correct?

Mr. Kuhn: That is correct.

Chairman Frank: The insurance company is in a position, and our records show it, the insurance companies are in a position to make legal commitments in some instances, and certainly in a position to make a moral commitment which while not legally binding would be maintained, but we have actual legal obligations running over a period of weeks from insurance companies in our files in the Utilities Division. No banker could make that commitment, and no banker will make that commitment. Consequently, suppose Congress exempted utility securities under the 1935 Act completely from the provisions of the 1933 Act, there would still be that period of delay, and that competitive advantage of the large security companies which they would have over the investment banker of being able

to say, "We will put the money on the line if your papers are all right if you get an order from the SEC under the Public Utility Holding Company Act". We are seeking that it is not a question of theory but it is a question of actually seeing it demonstrated in the cases coming before us, and that being so it seems to me if there were not any 1933 Act, you would be facing that problem.

Mr. Kuhn: It seems to me, sir, that that is an argument along my line of thought that any change in the system would tend to stimulate that practice.

Chairman Frank: Let us isolate the discussion. You made a statement which Judge Healy challenged that it was the 1933 Act, the Securities Act, that had led to the increase in private placements. Let us assume for the sake of the present discussion -- although I happen to agree with Judge Healy -- that you might make a showing that that would be true with respect to ordinary securities. But under the 1935 Act with respect to utility securities, it would not make any difference whether there were a 1933 Act or not. The same factors that make for the insurance companies bidding still exists if you have a competitive bidding arrangement, and if the insurance companies can not acquire except through public bidding, that is an advantage of the insurance companies -- something you are interested in -- over the investment banker which disappears. They are really in competition because the

commitment can not be made by the insurance company other than at the time it can be made by the investment banker.

Mr. Kuhn: Yes, I see your point.

Chairman Frank: In other words, we thought that there was something -- perhaps we were wrong about it but it still seems so to me -- that there was some considerable advantage to the investment bankers in their struggle with the private placement problem so far as the utilities are concerned, and forcing competition through competitive bidding between the insurance companies and the investment bankers.

Mr. Kuhn: Was there much discussion yesterday, sir, on the question of competition now existing in the business? I have a section on that.

Chairman Frank: No, I think there was not very much.

Mr. Kuhn: May I read that?

Chairman Frank: Yes.

Mr. Kuhn: Despite assertions to the contrary in the report of the Public Utilities Division, competition does now exist to an extreme in the business of sale of public utility securities, as every well-informed investor knows and appreciates. I see plenty of evidence of that, not only through my own meetings with investment bankers, but from general knowledge of the course of financial affairs. It appears to me that the present system well maintains the competitive conditions that are called for in the Public Utility Act of 1935.

Competition is the very essence of the investment banking business. They are always competing among themselves for new clients and for positions in syndicates. Competition must exist, perforce, where varying degrees of superiority are inherent in a service to be sold, just as in the sale of material goods. Not all investment banking relationships are of long standing, but even where they are, other firms are constantly trying to get the business (the Public Utilities Division of the S.E.C. is well aware of that as noted on page 13 of its report) and as a result, frequent changes in those relationships take place. Any corporation entering the market for the first time has a wide choice of firms, each striving to sell his services. If the arrangement finally made proves to be satisfactory, he continues to use that firm, and certainly that is no cause for criticism. If it is not satisfactory, he uses another firm. There is no difference here from any professional relationship.

I will skip over the question of prices as not a thing which requires any occult knowledge, but dwell only for a moment on a little illustration which I gave here on the difference in prices. I have selected for comparison a 30-year 3 per cent public utility issue in the amount of $10,000,000, and I have assumed that in the case of private negotiation the price paid to the issuer would be 103 and in the case of competitive bidding it might be 104. In the case of private negotiation, the effective yield to the issuer is 2.85. In

the case of competitive bidding it drops to 2.80. That is a difference of $100,000 in cash to the issuer, but on an effective rate or amortized basis which is spread over the life of the issue, that $100,000 in cash dwindles to $3,333 per year or on an amortized basis to $1,666 per year, being a difference to the corporation which I claim is a negligible difference in contrast to the benefits to investors of getting a lower price.

But beyond the natural form of competition, there is plenty of other evidence to support the contention that competition is extreme in the business. The securities which have been sold by corporations to large institutions as "private placements", represent the obligations of some 500 issuers. The activity of financial institutions in attempting to purchase an issue outright is increasing rather than diminishing and practically all of this is a direct loss from a profit standpoint to the investment banking business. This, it seems to me, is rather stiff competition.

But that is not all. More and more corporations in recent years, including public utility companies, have financed all or part of their requirements through term loans at commercial banks. Add to that the fact that the United States Government has created some 32 agencies which are in various ways and in varying degrees financing the requirements of borrowers.

Chairman Frank: Not very much of the utility companies.

Mr. Kuhn: No, admittedly, but it may come to that -- but

that is beyond the scope of this argument.

Competition, in my opinion, is present now as never before both from within and without.

On the thesis that there is an unwarranted degree of concentration in the underwriting business rests a good deal of the argument of the Public Utilities Division in advocating competitive bidding. I confess that I am at a loss to understand this statement after attempting a practical analysis to see if it is well founded.

What is concentration of power? Does the leadership of six firms, eight firms or 50 firms constitute concentration? What is the line of demarcation which designates it? And if there is any such line, is there any difference between the investment banking field and numerous other fields where natural processes of growth, the use of good judgment, and the acquisition of additional business through demonstrated ability to handle it, inevitably lead to the emergence of a few leaders in the field able to do a job individually or collectively which the other 90 per cent could probably not do if banded together? How many firms should there be or could there be, who would be able to organize and successfully distribute the issues of our larger corporations?

Of 6,400 member banks in the Federal Reserve System, the 10 largest, or 1/6 of 1 per cent of the number, have resources which total over 33-1/3 per cent of all the resources of the

member banks of the system. Mere size does not necessarily denote concentration of power, -- and then I dwell to some extent upon the concentration in the automobile industry where out of several hundred manufacturers, three have developed which now manufacture 90 per cent of all of the cars in the industry. I draw a parallel to that.

But we find that even though there are relatively few leaders in the investment banking field, the total number, nonetheless, is large. Statistics compiled by the Research and Statistical Staff of the Commission itself shows that 515 underwriters and dealers participated in the underwriting of 745 security issues registered with the Commission between January 1, 1934 and January 30, 1938, which raised capital in the amount of over $7,500,000,000. A very large proportion of that 515 originate and distribute issues aggregating one million dollars or less. It appears that there are some 1,500 underwriters and dealers in the country who have a part in the business of raising capital for industry.

Furthermore, since it is in the realm of opinion, not of fact, if it is conceded for the sake of argument that concentration of power exists, or if banker domination as charged, is the case, how would one explain the fact that approximately 40 per cent of all new utility bond issues during the past two years have been placed privately, despite the fact that the leaders in the underwriting field undoubtedly used all the power at

their command to purchase those securities and distribute them. Many of the issuers of those securities were among our leading corporations where investment banking relationships of long standing had been in force -- witness the recent private sale of one of the largest issues in history by the American Telephone & Telegraph Company.

Concentration is a relative matter and in this case I believe a misuse of the term, but if we assume it to be correctly applied, just what is wrong with that concentration? We have a good machine which has been carefully built to do a good job and not at an excessive profit, which may have once been the case. That machine may need some minor repairs, but it has certainly not been proved that it is obsolete and should be virtually scrapped. The purpose of the investment banking business is to get the job of raising capital done as efficiently and expeditiously as possible. That in my opinion it is doing, and to make any radical change will increase the obstacles under which it operates and render it a much more difficult job. Any reasonable investor will tell you now how hard it is for him to get his money to work. Furthermore, it is hard to visualize how much concentration of power would be diminished under competitive bidding -- it is more likely to be increased.

The human factors in this situation can hardly be ignored. Business is done with the greatest benefit to all concerned with people that one likes. That is largely why most of the relation-

ships now under discussion have continued as they have. To be forced to do business with a firm against which prejudice may exist, just because that firm won with the highest bid, is not conducive to smooth functioning nor to obtaining the best and most desirable results.

A buyer of securities, especially one acting for an institution, gradually builds up relationships with various investment banking firms comparable to those between the firms and issuers. From those connections he is often kept informed of what is going on and is thus enabled to plan ahead, a vital necessity to any financial officer. Under competitive bidding he would be at a great disadvantage in this respect.

I give you this next with some temerity, but I think I can support it. If competitive bidding is approved it is a safe bet that intrigues and manoeuvers of all sorts will come into play to try to avoid the letter of the law. That is no criticism of corporate financial officers nor investment bankers, but is merely a human train which all of us possess, and upon which we act when we think our rights are infringed. A good example of that is the constant violation of the spirit of Section 5 of the Securities Act of 1933, changes in which I have constantly advocated as a matter of honesty. It is impossible to prevent violations of a law or regulation which sets up standards contrary to normal human behavior. Competitive bidding, like Section 5 of the 1933 Act, will surely result in

making unlawful men of some upstanding citizens.

Again, if compulsory competitive bidding is invoked, unexpected results which can not now be anticipated, many of which will be adverse in their effects, are bound to eventuate. Such was the case, for example, with the ICC order requiring competitive bidding on equipment trusts in 1926. The huge volume of private placements resulting from the Act of 1933 is another illustration of startling changes wrought by a radical departure in methods of doing business, of which no conception was in mind at the time of enactment of the legislation.

Chairman Frank: Note Judge Healy's exception.

Mr. Kuhn: All right.

Chairman Frank: And mine.

Mr. Kuhn: I am at least pointing to the fact that it was the startling change which came about and was not anticipated at the time even if you are willing to consent that part of the reason was the 1933 Act.

Chairman Frank: I do not want to use ten-dollar words, but there is a Latin phrase which I think is applicable to what you are saying, post hoc ergo propter hoc.

and that is that if you and I are here this morning and somebody sang a song in Chicago yesterday, it does not follow that the singing of that song caused your presence here.

Mr. Dean: I think, Mr. Chairman, it is only fair for the record to show that prior to the passage of the 1933 Act there

were no private placements, first; second, that there have been no private placements of railroad securities, and, third, nor of municipal securities.

Commissioner Healy: I challenge the statement that there were no private placements before the 1933 Act. I will be very glad to have the citation.

Mr. Dean: I will be very glad to give them to you.

Chairman Frank: When anybody says that "A" happened and then "B" happened and therefore "A" is the cause of "B", he has not made his case merely by demonstrating the chronological sequences.

Mr. Dean: I quite agree with you.

Mr. Rodgers: I would also like to point out that of the many private placements, a great many have been registered.

Commissioner Healy: Right.

Mr. Rodgers: It is interesting to those who are interested in private placements that the non-necessity of registration is no longer the controlling motive. It may have been the immediate occasion of the large growth of private placements, but it certainly has not been the reason for the continuance of private placements.

A Voice: I would like to ask Mr. Rodgers if he has any figures as to the amount of private placements which have been registered or which have not been registered?

Mr. Rodgers: I think I can pick that out for you.

Chairman Frank: It is also true that Hitler began the war since 1933, but the cause and relation is not obvious.

Mr. Kuhn: However, Mr. Rodgers did point out that -- I believe that is the gentleman's name -- he did point out or did admit that the necessity for the registration statement may have been the initial cause for the beginning of private placements even though it might not be the reason for its continuance.

Mr. Rodgers: Although there were some large issues previous to that which were purchased directly and which with the Securities Act in effect would need to have been registered. It is now clear to me after many years in dealing with this that the private placement fills a normal need of corporations.

Chairman Frank: Whether it does or not, Mr. Rodgers, I would like to ask you this question: Is it not true that the insurance companies in many instances make commitments with respect to utility securities several weeks in advance of approval by the S.E.C. required in order to make the issuance of the securities possible?

Mr. Rodgers: Yes. A firm commitment is one of the chief occasions or reasons which managements give. They want to know that they can get the money and when they can get it and on what terms.

Chairman Frank: And you understand that under the Utilities Act, if there were no 1933 Act, there would have to be

approval by this Commission under the 1935 Act?

Mr. Kuhn: I appreciate that.

Chairman Frank: That means inevitably a time lag, and the insurance companies making commitments several weeks in advance have made that obligation. I think you will agree with me that seldom if ever will an investment banker make a firm commitment at a fixed price weeks in advance?

Mr. Kuhn: That is true.

Chairman Frank: Therefore there is a terrific competitive advantage which the insurance company has with respect to the utility securities, quite aside from any 1933 Act provisions. That is the point I make.

Mr. Kuhn: If I were a large financial institution, I would undoubtedly argue in favor of private placement.

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Chairman Frank: I am not arguing in favor of private placement, in fact one of the advantages to the investment banker that might occur out of the competitive bidding requirement would be that they would be able to take away from the insurance company that long period of fixed commitment.

Mr. Kuhn: I don't follow that, sir. You say it would take away the advantage that the large insurance company has?

Chairman Frank: As against the investment banker. In other words, asmatters now stand with respect to utility securities, the large insurance company is able to make a commitment weeks in advance, which the investment banker can not make, and therefore the investment banker is at a disadvantage. If you have competitive bidding, you would have a situation which does not exist in a private placement in that regard, because all of the bids have to be in on a certain date and have to be firm on a certain date, and then the advantage of the insurance company which it now has over the investment banker would vanish. They would still have other advantages - maybe they can bid a better price, but that is a different question, but the advantage that they have of being able to make a firm commitment over a period of antecedent weeks would disappear.

Mr. Rodgers: Wouldn't that be a great disadvantage to issuers?

Chairman Frank: Conceivably.

Mr. Rodgers: Should not the function of the Commission be to equalize all the competitive factors? Some will have one advantage and some will have others. Some institution, for instance, in filling its investment requirements, has a distinct advantage. It can buy in the market --

Chairman Frank: (Interposing) I understand your argument. You think that if there is a rule, there ought to be an exception as to private placements. My only point at the moment is that from the point of view of the investment banker, they ought not to complain on that score.

A Voice: It is a solace to the investment banker, and perhaps the only one they have.

Mr. Kuhn: I would like to read the final part of my statement.

This proposed change is of far greater import than is readily apparent. It would necessitate an upheaval in the whole system of fund raising in the capital markets, undoubtedly detrimental to the interests of smaller institutional and individual investors. There has been, to my knowledge, since the passage of the 1933 Act, no widespread abuse of such power and influence as the leading firms in the business may be considered to have. Mistakes in judgment have, of course, occurred, and will always occur under any system, but by and large a good job has been and is being done. The best proof

of that is, that despite the fact that the idea is as old as the hills, competitive bidding has not been voluntarily adopted as a practice by public utility or other corporations seeking to raise capital, nor has it been sought by investors.

To embark upon a new experiment under presently disturbed conditions and on the eve of a tremendous expansion in industry, with the machine all geared to meet the demands that will be made upon it, is to invite a possible breakdown that may delay the accomplishment of the great ends to be desired.

In my judgment, no benefits to the public will result from compulsory competitive bidding for public utility securities.

Chairman Frank: Thank you very much.

Mr. Eaton: May I ask Mr. Kuhn a question before he steps back?

Mr. Kuhn: Yes.

Mr. Eaton: The opening part of your thesis concerns me, I think, more deeply than any other subject that is being discussed, and that is, what is the position of the investment banker? Is he a professional man or is he a business man? At the outset you said his position was professional like that of the doctor, for instance, and toward the end you gave me some encouragement by saying that after all, it was a business, and that there was competition in it, and a man was as active in the sale of securities as he was in the selling of

materials. My own theory is that the investment banking needs invigorating on the side of salesmanship. I think you mentioned the loans that are now being made by Federal agencies, - I think there are 30 loaning agencies employing about 14 billion in supplying the current economic demands of the country in a great many fields, and yet at the same time it is true that money was never as abundant or as cheap or so much of it idle in the history of the world as there is in this country now.

I do not believe the Government has created those agencies because it wants to be in business; I think it has created them simply because the commercial banker and the investment banker, in bringing together the man who needs the money and the man who has it to loan, has not fully performed his function.

If our business is a profession and purely a profession, we have to bestir ourselves to the encouragement of thrift or to bring to the attention of the investor a given security or pursue an issuer and tell him that this is an advantageous time for him to refinance or encourage him to expand; if we are in the same relationship as the doctor, then I think that the business is completely washed out.

I would like to have you, if you would, for my own benefit, tell me whether it is purely and completely a profession? If it is, then these great organizations are wasting their time.

Mr. Kuhn: I do not agree with that, sir. I class it as a profession in the relation of investment bankers to issuers particularly, just as I would that of a consulting engineer or a lawyer or a doctor, and whether you call it a profession or a business is of little consequence in that, in the legal and medical professions there is similar competition, the competition of the market, so to speak, that a person is free to exercise his freedom of choice as to which doctor he will go to.

Chairman Frank: May I ask a question there? I happen to be a lawyer, and if one of my clients - when I had clients - went to another lawyer, the other lawyer would not say, "I can not take your business until Frank says it is O.K. with him, because I must not poach on his preserves". We have heard that that sort of thing prevails in the investment banking business. Do you think it does?

Mr. Kuhn: I can not say as to that, sir. I can say to you that, having read the report of the I.B.A., the statement is made therein that whereas that may have once existed, they appear to have proved that that is no longer the case.

Chairman Frank: That is to say, if a utility, having done business for the last ten years with a certain banking house, went to another banking house, that other banking house would instantly do their business without first inquiring whether it was acceptable to the original banking

house?

Mr. Kuhn: No, I do not think so. I think that is a perfectly human and practical situation that would always arise.

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Chairman Frank: I am using the analogy of lawyers.

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Mr. Kuhn: Would you as a lawyer if a big client came to you, would you not at least be interested in finding out who that client's previous attorney was and why he left that firm?

Chairman Frank: I do not want to give away the secrets of my profession (laughter) but I can assure you if I were in business as a lawyer practicing and one of Mr. Arthur Dean's very good clients came over and wanted to retain me, I would not call up Mr. Arthur Dean and say "Do you object?". Nor would Arthur Dean reciprocally.

Mr. Dean: I agree. (Laughter)

Chairman Frank: It is true that our profession does have this standard that I cannot solicit business of any kind. I cannot ask Mr. Dean's clients to come with me nor can he ask my clients to come with him, but if they come they are not going to be shown the door or made to wait in the doorway until I have called up the lawyer whom they have left and say "Do you object?". I have never heard of that being done. It is only when the client is an undesirable one that you might have such an excuse if you could not find a better one.

Mr. Dean: I think it would be very interesting if you were to ask the many investment bankers in the room if they would not accept that business pronto.

Chairman Frank: Suppose we do afterwards.

Mr. Stanley: I would be very glad to say now that if any person came to me who had been doing business with any other good bankers in the business and wanted me to do the business, I would do it right away, and I would expect them to do it right away with any client of ours.

Mr. Woods: My name is George Woods, and I am here representing the First Boston Corporation. I concur in what Mr. Stanley has said. In point of fact, Mr. Stanley followed that practice with regard to my firm on an occasion that I can think of. Furthermore, I have had the experience of a chief executive of a holding company calling me up and asking me if we would take over a piece of financing, and we took the financing. The conversation we had with the previous banker was not one asking for permission, it is one stating a fact and expressing the hope that it would be continued.

Mr. R. H. Bollard (Dillon Read & Company) I would like to add my voice to what has been said by Mr. Stanley and Mr. Woods, and further to say that we are today in the position of having recently acted in conformity to the situation outlined by Mr. Frank. This happens to be an industrial concern that came to us a matter of some months and stated that they wished us to do their business which had been done theretofore by another leading banking house, and we accepted that invitation without previously conferring with the banking house who had theretofore done that.

Commissioner Healy: Mr. Kuhn, you have spoken of the professional relationship. Who is the investment banker's client, the issuer or the purchaser of the securities?

Mr. Kuhn: I confess to a dual relationship which has never been clear in my own mind.

Commissioner Healy: If a lawyer got in that position, he would be disbarred.

Mr. Winslow: My name is Pearson Winslow, of Bonbright & Company, New York. I would like to reiterate on behalf of my company what Mr. Stanley and what Mr. Woods just said and to say that I have had experiences with Mr. Woods' company similar to what he said he had with Mr. Stanley's company.

Chairman Frank: Judge Healy, I think, has asked a very interesting question. It is true that the word "profession", as you indicate, can be given under a variety of connotations, but I do not think that you can carry the analogy of the lawyer and an investment banker too far or you would find the investment bankers judged by the professional standards of the lawyer falling very short because, as Judge Healy has said, if the client comes to me, he is my client and I have the sole obligation to him, and if I represent anyone else I am violating my ethical obligations and could be promptly disbarred. The investment banker, as you say, fills a dual relationship. I am not indicating for a

WLC

4

moment that that subjects him to criticism; that is inherent in the nature of things; but I do suggest that you cannot therefore analogize the investment banker to a lawyer because the lawyer cannot possibly play that dual role and stay in business if it is detected.

Mr. Cutler: My name is John W. Cutler of Smith Barney & Company. I would like to state that my firm is in full agreement with what Mr. Stanley and the others have said.

Chairman Frank: Does that mean that you feel perfectly free aggressively to take away from another investment banking house any clients they have without in any manner first consulting them?

Mr. Cutler: Not in any manner, no, sir, but if a company comes to us, we would feel free to go ahead.

Chairman Frank: But if the company did not come to you, you would not feel free to try to get that business away from one of your competitors?

Mr. Cutler: I don't think we would, no, sir.

Mr. Dean: Didn't you use aggressive methods to get the Northern States Power financing done?

Mr. Cutler: There may be degrees of aggressiveness.

Chairman Frank: It is true, is it not, that in ordinary business, in the shoe business or the meat business or any other ordinary business in which there is neither actual nor

WLC
5

legalized monopoly that the various business enterprises in that business feel free to try to get any customer they can from their competitors? That is true, is it not; and that is not true, as I understand it, in the investment banking business? Therefore, we have something different in the investment banking business from what prevails generally in that portion of our economy which is competitive.

Mr. Cutler: I would think so, yes, sir.

Chairman Frank: Therefore, what we call individual initiative and free enterprise ordinarily in most walks of life is to this extent absent so far as the investment banking business is concerned, is that correct?

Mr. Cutler: I did not hear all of that.

Chairman Frank: I repeat that if I am a shoe manufacturer and I want to sell my goods to a dealer in shoes, I do not go to my competing manufacturer and say "Do you object?". I go and try to get that business, every bit that I can. That is what is known as the competitive system. I say that in so far as that competitive aspect of business, it is lacking in the investment banking business, so far as you have just said.

Mr. Cutler: I think there is plenty of competition but it is of a different kind.

Chairman Frank: Yes, but it is restricted in that respect, and that is that you won't endeavor to get away from some other

WLC
6

banking house their business, is that correct?

Mr. Cutler: I would not try?

Chairman Frank: You would not try? Let us be specific. Let us take a utility company, and it has been going to Dillon Read. Will the First of Boston try to take Dillon Read's customer away from them without talking to the other investment banking house?

Mr. Woods: Mr. Chairman --

Chairman Frank: I am not saying that it is wrong, I am just trying to get what the facts are.

Mr. Woods: I quite understand. I think it is fair to observe in connection with the investment banking business that aggressive competition would immediately defeat itself, because if the banker is the aggressor he immediately finds himself in a very difficult position in a matter of negotiation of various terms and conditions of the loan instrument. So that, speaking for the First of Boston, the answer must be that we would not aggressively go out and try to get a piece of business from another party.

Chairman Frank: Would you do it subtly?

Mr. Woods: We definitely would do it subtly, and by that I mean that we would endeavor to get ourself in a position where the management, the principal executive officers and directors of the proposed issuer would invite us to do the business. If they invited us to do the business, we would at

once proceed to do it to the best of our ability.

Chairman Frank: I as this entirely out of ignorance. Maybe Mr. Pike can help us out here. Reference has been made to the servicing of issuers by investment bankers, and a comparison has been made to engineering service. Is it true in the engineering business that one engineering company will not take away a piece of business from another engineering company without first asking its competitors?

Commissioner Pike: I have had all sorts of testimony on that. Some informal hearings and others over a couple of glasses, and I must say that I do not know that there is any general rule. Of course, in a great many engineering things, there will be straight competition for jobs formalized on field men. I suppose everybody would like better to make sure that he is not going to have to bid for every piece of business with a new client. Certainly in engineering and contracting work, the method of field men is a very usual instrument and every apt to come up on each major job to be done.

Mr. Kuhn: May I say, sir, after hearing much of this discussion, that it seems to me that regardless of any particular aspects of any particular phase of the business, that the best way of measuring the effect is by the results, and in my judgment and my experience, the results have been good.

Chairman Frank: Let me interrupt you there. I will say

WLC

8

for myself and solely for myself -- I have not made up my mind on the question of competitive bidding -- but my interest in it is for the most part not concerned with the question of price in this market. It has to do with other aspects of the business and of the consequences and results that you are referring to and I refer back again to what I was discussing with you before, that it does not seem to me that the results do demonstrate that the investment bankers vis a vis the protection of the investors with reference to the trust indenture and the exculpatory clauses in the indentures have proved that the results have been as beneficial as you would lead us to believe.

Mr. Dean: Mr. Chairman, may I ask one question? In your Protective Committee Study, did you cite any abuses from the exculpatory clauses in any indenture in the case of an operating utility company?

Chairman Frank: I do not remember; I was not on the Commission at the time, and I don't remember.

Mr. Dean: I don't think that there is.

Chairman Frank: Do you mean to indicate that the usual exculpatory clause was omitted or modified in those indentures?

Mr. Dean: No, sir. All I am saying is that to the best of my recollection, and I would be very glad to be corrected, I do not recall a discussion of the abuse of the exculpatory clauses in the indentures of operating public utilities in

your Protective Study.

Chairman Frank: But the exculpatory clause was present.

Mr. Dean: The exculpatory clause was present until after the case of Hazzard against the Chase National Bank, and I believe that even after that there was a very definite movement on foot to start eliminating some of the worst exculpatory clauses.

Chairman Frank: I think the movement began right in this building, because at that time so far as the utilities are concerned, this Commission under the Utilities Act was requiring standards comparable to and indeed more severe than those required by the Trust Indenture Act.

Mr. Dean: That is correct.

Chairman Frank: So that I think whatever praise or blame may attach to these clauses may rather be ascribed to the Commission than any other cause.

Mr. Dean: I give full credit to the Commission.

Chairman Frank: I know in some instances where we have required it and the underwriter protested.

Mr. Eaton: I would like to find out how far the investment banker can go in seeking business of people on the originating and selling side and still be in good taste and still be allowed to associate with gentlemen?

Mr. Kuhn: It is not fair to ask me that question; I am not an investment banker.

WLC
10

Mr. Eaton: I am trying to discover whether the investment banking industry ought to be encouraged to seek business and to sell securities against their many competitors, trust companies and banks and other Government agencies. Whether that is a proper thing to do, or whether I ought to be a professional man and go to college and get a post-graduate course degree.

Mr. Kuhn: You must be well aware, sir, of the tremendously aggressive campaign that is always exhibited on the part of investment bankers for new business?

Mr. Eaton: Can you reconcile that with a man being in a professional relationship?

Mr. Kuhn: You are arguing about a technical definition which I think is of comparatively little consequence. Whether I call it professional or whether I call it a business relationship, you can take your choice; I don't care.

Mr. Eaton: You do regard it as a business relationship?

Mr. Kuhn: Yes.

Mr. Eaton: And you do not object to competition in it?

Mr. Kuhn: I think that competition exists now.

Mr. Eaton: You see no objection to competition?

Mr. Kuhn: Not as it exists at the present time, I do not. I object to competitive bidding.

Chairman Frank: I think that this witness ought to be excused. Thank you very much.

WLC

11

Mr. Stanley: Mr. Chairman, just for the sake of the record, I think you stated that you understood the investment bankers assumed theirselves to be free to solicit business. I would like to say so far as I am concerned that I do consider myself free to solicit business without responsibility to anyone excepting myself. Every man in the bond business is free to do what he wants. The reason I have not done it is that there has not been business that I wanted that I did not think was being satisfactorily done by others. If the business is satisfactorily done, I would be fair enough to think that the fellow who has it should keep on with it.

Chairman Frank: That is not the custom in most competitive industries, is it? In other words, if I am a shoe manufacturer and I say "Well, my rival is doing a very good job in supplying shoes to a large retail store in Chicago, so I won't interfere with it because after all I want to see the shoe business get along nicely" - I do not act on that assaumption. I say "I want my shoes to be sold", and I send my salesman in and he does everything he can to get that account, doesn't he?

Mr. Stanley: Anybody can do that if they want to. My friend Stewart has a perfect right to go to the telephone company and ask them for the business.

Chairman Frank: But generally speaking, it is not done, is it?

Mr. Stanley: That is hard to say.

WLC

12

Chairman Frank: Your firm does not actively try to take away business from the First of Boston?

Mr. Stanley: If there are cases that I know of and I thought it was not being doing satisfactorily, I would go after it, because I think the continued relationships are valuable to the borrowers and the bankers. And just one second more. You cannot compare commodities with dealing in credit.

Chairman Frank: I did not say it could be compared; I was just trying to make the point whether that competition was absent.

Mr. Weiner: Mr. Stanley, am I correct in my information that your firm has never done any public utility financing of companies which were not subsidiaries of the United Corporation?

Mr. Stanley: I do not think that is quite true. There are only a few that were not so-called legal subsidiaries.

Mr. Weiner: You don't recall what those were?

Mr. Stanley: There was the Indianapolis Water Company, and the Central Hudson Gas. I think the Philadelphia Suburban Water.

Mr. Weiner: The Central Hudson is the Niagara Hudson Company, is it not?

Mr. Stanley: Yes, but it is a minority company.

Mr. Weiner: Do you find that that result is a product of

WLC 13

coincidents, or is it the fact that you have been associated with that system?

Mr. Stanley: You mean the Central Hudson?

Mr. Weiner: No, I mean the fact that your utility business has been almost entirely confined to the United Corporation, and I should assume that in these other companies there must be opportunities for business of a very considerable amount judging from the number of securities that we see pass over our desks.

Mr. Stanley: We have not asked the management of those companies to do their business, but in the case of the companies you mentioned, we knew the people and were after them.

Mr. Weiner: So that the reason that you have not done any business for other than those companies is because you were not asked by the management of those other companies?

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Mr. Stanley: I do not think of any cases where we were asked. There may have been some we declined, but their business was being well done and why shouldn't they continue?

Mr. Weiner: And you declined for that reason, that the business was well done?

Mr. Stanley: I don't think you understood me, Mr. Weiner.

Mr. Weiner: I want to be sure that I have not misunderstood you.

Mr. Stanley: Would you repeat your question again?

Mr. Weiner: I thought you had said that there may have been other instances where you were asked, but in those cases the business was being well done.

Mr. Stanley: I can not remember of any case where we were so asked. There was another case in the utility company that we tried to get which is part of the U.G.I. system, the Connecticut Light & Power, and someone else got the business.

Mr. Weiner: That was due to special considerations, was it not?

Mr. Stanley: I can not imagine what they were. It was Putnam & Company. We both talked to the management about doing it, and they got it.

Mr. Weiner: Putnam & Company is a Connecticut house with important local connections?

Mr. Stanley: Yes, and I say that we were both trying

to get the business. And he got it away from us.

Just for the record again, it was pointed out to me that you referred to utility financing, and the Consolidated Edison Company of New York, with which we have done a large volume of business, is not a subsidiary of the United Corporation.

Mr. Weiner: I think that is technically right.

Chairman Frank: I am afraid that we will have to move along, because we want to get through today.

Mr. Stewart: Do you want to hear from these others?

Chairman Frank: Yes, anybody that wants to be heard, but we do hope that repetition will be avoided.

Mr. Weiner: May I ask one more question of Mr. Stanley?

Mr. Stanley, do you recall whether, apart from that Connecticut Light case, any other underwriter has, in the past five years, handled an issue of any subsidiary of United?

Mr. Stanley: I don't think so. I don't recall it. But the Consolidated Edison --

Mr. Weiner: (Interposing) You mentioned the Consolidated Edison. And that it was not a subsidiary. I could re-define it, perhaps, but I would not try to.

Mr. Stanley: There have been a great many private placements of those.

Mr. Weiner: Yes, I would be glad to discuss that later,

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but I do not think we want to do that at the moment.

STATEMENT OF R. O. DEUBLER,

Vice-President of First National Bank of Scranton.

Mr. Duebler: I have a prepared statement here. I did not know what features would be discussed.

Chairman Frank: You can file the statement. It will help us, because we have so much to hear. If what you say in your formal statement is repetitious, could you just make an extemporaneous statement of what would not be repetitious?

Mr. Duebler: Well, naturally in discussing this situation, I must cover the same ground as has been covered.

Chairman Frank: Have you got any different points of view than those heretofore presented?

Mr. Duebler: Except from the standpoint of the institutional buyer rather than from the investment banker.

I noticed a statement published in the New York Times yesterday by Otis & Company that was either made at this hearing or submitted to the Investment Bankers Association, and I would like to disagree with their opinion as to the effect on the small dealers. Our bank is in an interior town, of course, and while we are close to New York and Philadelphia, there is a great deal of competition there in representatives of distributing houses. We also have some independent dealers. I talked to one of the dealers last week and he told me that in the event of enforced bidding, he would definitely not be able

to get bonds because he would have no knowledge as to who the bidder was until he saw it in the newspaper, and by that time when he applied for the bonds they would all have been divided up particularly if it were of the higher grade bonds among the larger distributors who were able to act more quickly.

Now, that might not be important from the standpoint of the Commission, that is the fate of the small dealer, but I would like to respectfully submit for the consideration of the Commission that I think it is important from the buyer's standpoint.

Included in my statement I have made this statement:

"Analysis of our own purchases of new issues during 1940 reveals many such purchases from firms who are in my opinion not really to be classed as underwriters although they might have a small participation in the underwriting group, because they are not equipped to handle an issue as the head of an underwriting group, and from some dealers who were not members of the group at all but merely were allotted bonds to distribute at retail among their customers.

And I think that in the event, as I said before, of forcing competitive bidding, these smaller dealers who do account for a great deal of the distribution and on whom we as interior institutional buyers must rely to obtain bonds are not going to be able to get them.

I know of no demand on the part of any public utility

corporation for enforced competitive bidding, and it is my contention that we together with other small banks and individual buyers must rely on the carefulness with which the indenture provisions are set up, and by that, sir, I do not mean the things that are covered by statute; I mean the technical differences which within the law might differ and which might either add to the attractiveness of a bond or spoil it from the buyer's standpoint.

Commissioner Healy: Would you give us some example of two or three of those?

Mr. Duebler: Where the price would drop -- for instance a bond is set up with an initial call price of 107. If we buy that bond, it is our practice to amortize it and set up a reserve of the premium. If under the terms of the indenture, that price drops within a year say three points, our amortization would not have kept up with it, and we could be forced by the Comptroller of the Currency or his examiner to immediately write down the price of the bond to the existing call, which would throw out our amortized yield. Does that answer your question; is that clear to you? It is merely given as an illustration of the technical differences in setting up the bond. It is not one of the features that is covered by statute, but on the things which make a bond attractive to the individual bond buyer.

Also in determining the maturity of the bonds.

Chairman Frank: Do you think that the selection of the maturity dates has been very happy? I must confess that some of us are beginning to be disturbed by the fact that the bulk of the utility maturities as a result of recent refundings will all mature within one decade. That has been the result of the negotiated method, and whether this Commission needs to do something about it in the future is a problem that is disturbing us. But do you think that the bringing about of that situation where I believe over half of the maturities of the utility industry will come due in a single decade is desirable?

Mr. Duebler: No sir, I do not.

Chairman Frank: That has been something that is one of the things that is outside of the statute -- I don't know whether or not it is. Perhaps this Commission from now on should pay more attention to it. But that has been the result of what has been negotiated.

Mr. Duebler: If I may venture to differ with you, sir, it is not entirely due to them. It is due to a change in the interest rate by which these corporations were able to call in their high coupon bonds where they were callable --

Chairman Frank: (Interrupting) You have reference to the maturity date?

Mr. Duebler: Yes; but the maturity date has of course been fixed by the fact that when interest rates were cheap -- our study of this whole investment problem shows that when interest

rates are cheap, any corporation attempts to borrow for as long a period as possible. When interest rates are high, they try to put out a five or a three or a two-year bond.

Chairman Frank: Yes, but I just want to direct your attention to this. You say that the investment bankers have with their care in exercising their judgment in the interests of the investors looked after such matters as the maturity dates, and I call your attention to the fact and I think my figures are correct -- do you recollect, Judge Healy -- over half of the maturities of the utilities industry will as a result of negotiations by investment bankers and private placements as well -- let us take those exclusive of private placements -- are coming due in one decade. Or as Commissioner Pike points out that in even a shorter period we have got a terrific bunching in the period of 1965 to 1970. I suggest that that does not show a terrific concern exercised by the investment bankers to date on the question of maturity dates.

Mr. Hall: There is a mitigating factor there which I presume your staff is aware of, and that is that now in most cases the indenture contains a provision that the bonds can be called in the last two or three or sometimes longer years at par, so I think that period would be extended and gives a flexibility which would run through that.

Chairman Frank: That is true, but there is this horrendous possibility of this bunching of maturities.

Mr. Ford: Many of these issues are serial debenture issues, and the original mortgage would be considerably reduced, and the sinking fund is operating on the mortgage bonds. The coming due at a given date is not as grave a danger as would appear from a casual glance.

Chairman Frank: I would be glad to be corrected if I am wrong, but there is a terrific volume of securities coming within that short period. I am not sure that the Commission has not been remiss in the matter of getting at that and preventing it, but my point is that it has not been presented.

A Voice: If there were competitive bidding, would the issuer set the maturity when he wished to sell?

Chairman Frank: He would in so far as this Commission permitted him to.

A Voice: Experience has shown that issuers at present under prevailing market conditions desire to get their money for as long a period of time at these rates as is possible and if there were competitive bidding, would not the tendency then be to concentrate this very situation of which you are speaking?

Chairman Frank: I am assuming and I say this subject to modification -- I am assuming that the Commission has some power in the premises. I believe it does. And that power we have not heretofore exercised. Therefore we could meet that problem should it arise. Indeed, I think we could meet it as it is arising today.

My only point in bringing it up at this moment -- it has nothing to do with competitive bidding -- but it is an answer to the suggestion that the investment bankers have been looking out for an adequate maturity date from the point of view of the investor. I say if it is true, and I may be entirely in error -- that the negotiated transactions have led to a bunching of maturity dates in a short period, that the Commission ought from this period to step in and we probably shall. If we did it, we would do it in both the private and negotiated.

Mr. Duebler: There is a saying that the Scotchman is strong and healthy not because he eats oatmeal, but in spite of it, and perhaps this condition exists not because of the present system but regardless of what system might have been in effect, because I still maintain that corporations tend to borrow at low rates for as long a period as possible.

Chairman Frank: But the fact remains that somebody negotiated those issues.

Mr. Duebler: Yes, surely, and it was the best judgment of the investment banker and his lawyers, and his legal staff, his engineers, the counsel, and everyone who had gone over that situation in consultation with the issuer, and I am told that is the way these things are set up, and that the price and maturity is determined as a result of these conferences based on what would be attractive to the buyer and to the issuer both, and the price to be fair to both -- the bid price.

Commissioner Pike: Isn't it a legal practice in a great many States having to do with the eligibility of trust funds, that there is a limitation on the length of the maturity? Is it 30 years? Thirty years has gotten to be the pet term for these recent bond issues.

Mr. Dean: In New York State, in order to be legal for savings banks, two-thirds of the revenues must be derived from franchises to extend at least three years beyond the maturity of the bonds. It is not directly on the question, but it is in substance on the question.

Commissioner Pike: Then the Massachusetts rule seems to be the governing thing at the moment?

Mr. Dean: Yes. On the other hand, if you want to reach your savings banks and your trustees market, then you must adjust your maturity to your length of life of your franchises.

Mr. Weiner: Does that play much of a role in New York?

Mr. Dean: Yes, it plays very much of a role.

Mr. Weiner: Would you mind mentioning one or two instances, because so far as I know we have not run across that.

Mr. Dean: Yes, I would be very glad to.

Chairman Frank: Will you proceed, sir?

Mr. Duebler: I have felt and I have so stated in my statement, which you have said that I might file, that there is considerable advantage to the buyer in having these advance consultations on the actual technical setup of the bonds. A

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firm of underwriters who are compelled to submit a bond at public auction is not going to spend money in advance doing this work. The smaller banks and individuals are not able to hire such work done; they must rely on the carefulness and the adequacy with which it is performed by someone, and in the event competitive bidding is enforced, it is my opinion that the bidder is interested only in trying to get the lowest price at which he can get the bonds, and after he gets them to sell them as quickly as possible before the market changes due to some condition over which he has no control. I have seen no evidence of any desire for competitive bidding by any public utility company or by any banking institution or any individual buyer, and I have not seen any statement which in my opinion can be fortified by facts or by any argument which would in my opinion justify enforced competitive bidding.

Chairman Frank: Thank you very much.

(The statement directed to be filed by the Chairman is as follows:)

STATEMENT OF MR. R. O. DEUBLER,

Vice President of The First National Bank of Scranton,

Scranton, Pennsylvania.

The present method of distributing new bond issues of Public Utilities and other Corporations, under rules and regulations of the Securities and Exchange Commission now in force, provides the most satisfactory conditions, from the standpoint of the bond buyer, that have existed in the past thirty-five years, in my opinion, and the proposed compulsory competitive bidding would cripple if not completely destroy the smoothness with which the present system functions.

Banks and other Institutions as large as the Bank where I am employed, and of course all smaller Banks and most individual buyers, cannot afford to hire a lawyer to pass on the provisions of the indenture and on other legal matters, when considering the purchase of newly issued bonds, but must rely on the honesty, integrity and ability of the lawyers employed by the underwriting firm to do this work.

The present method provides ample time to do this work carefully and accurately, and there is grave danger that this might, because of lack of time, be hurriedly done by the attorneys employed by the firm to whom the bonds were awarded after the bids were opened.

I cannot see that any firm of underwriters would incur the expense of doing this in advance of bids being opened, with no

assurance that such firm would be the successful bidder, and it might not even be given a participation in the selling group by the successful bidder. In the latter event, the legal fees would of course be a dead loss, with no hope of reimbursement from the commissions received from the sale of bonds.

The borrowing corporation may have very capable attorneys, who, however, may not be familiar with the kind of provisions which should be in the indenture to protect the buyer and the issuer, covering sinking fund terms, call prices, escrow provisions, depreciation and maintenance requirements, etc.

In a negotiated contract with one of the leading underwriters, the advice and counsel of the members of that firm, together with their engineers, accountants and attorneys, should result in a much safer and more attractive bond from the buyer's standpoint, and would undoubtedly make the bond more saleable and insure a more stable market for the issue, than for a bond issue, the details of which had been prepared without the benefit of such advance consultation.

Inadequate provisions covering these factors and other factors, which enter into the analysis of the safety and attractiveness of the bond, might produce a bond so unattractive to the buyer, regardless of the high quality of the bond, its intrinsic value, its ability to meet the legal requirement of most states, and the high credit and reputation of the issuer, that the invitation to bid on the issue would result, not in

obtaining the maximum price for the issuer, but possibly of no bids at all being received, requiring the whole job to be done over again, and creating needless and unnecessary expense for the issuing corporation.

The present method, of course, would prevent that happening, but might result in the underwriting firm, after careful investigation, deciding that the proposed bonds should not be issued, which in my opinion is much to be preferred to the offering for sale of bonds which are not suitable for offering to the investor.

Under the present method the underwriting firm has sufficient time analyze the balance sheet, earnings statement, rate structure, depreciation policies, plant values, type and age of plant, change in operating conditions that might have occurred, and the effect of such changes on future earning power, operating policies, changes in management, if any, and numerous other factors, careful analysis of which would not be possible because of lack of time, under competitive bidding.

Having never been employed by any broker, the writer has, however, had some contact with the under writing of new issues. Until prohibited by statute, our Bank purchased a great many of its bonds through participations in Underwriting Syndicates. Through these contacts I have been impressed with the intention and earnest effort on the part of the leading underwriters to do a good job - to fix a price that is fair to both issuer and

and investor, comparing favorably with yields on existing comparable securities, or on those that are most nearly comparable and to work out the best combination of maturities, call prices, sinking fund provisions, yield, agreements to refund State Taxes, and other factors which either improve or detract from the attractiveness of the bond to the potential investor.

Certainly the leading underwriters are large Concerns, but after all it is not possible to buy a 100 Kilowatt generator at the ten cent store-large organizations are required to handle big deals. But what about the small dealer?

Competitive bidding would create an undesirable situation for the investors, in that the small dealer would not be able to get a participation in the distributing group, because by the time he learned who the successful bidder was, and sent in his application for bonds, the issue, particularly if of the highest grade, would have been divided among the larger distributors, who were able to act more quickly.

Under the present method, the small dealer has a chance, and does get bonds to sell, except perhaps in very small issues. On receipt of the "New Issue Card" he is able to determine whether a bond of that type can be sold in his territory, and make application to the manager of the syndicate, with whom he had previously established a reputation based on the record of his handling previous deals, and state the number of bonds he thinks he can distribute.

Analysis of our own purchases of new issues during 1940 reveals many such purchases from firms who are in my opinion not really to be classed as underwriters, although they might have a small participation in the underwriting group, because they are not equipped to handle an issue as the head of an underwriting group; and from some dealers who were not members of the group at all, but merely were allotted bonds to distribute at retail among their customers.

Should the fate of the small dealers receive consideration? If not, at least the effect of the proposed change on their customers, who are the ultimate buyers of the securities, should be carefully considered before a decision is made.

In the opinion of the writer, wide distribution at a fair price is more important than obtaining the maximum price for the issuing Corporation, and above all the retention of the present method of careful analysis and preparation of a bond that has adequate provisions for the protection of the investor, and the issuer, and is sold at a price which has been carefully computed to be fair to both the buyer and the issuer, is vitally important.

I hope we will not be forced to change from this system which is functioning so satisfactorily, to merely wrapping up a peice of merchandise and auctioning it off to the highest bidder.

Why this urge to upsetthe applecart? Should the recommend-

ation of a group of employees of a regulating commission, whose opinion is based on theories, and may not be based on any actual experience in either the buying or selling of bonds, receive more consideration than the opinions of the distributors, the investors, or the issuers?

I know of no demand for and certainly of no expression of approval of competitive bidding on the part of institutional or individual investors.

The Investment Bankers Association of America has expressed emphatic disapproval of enforced competitive bidding. While I know of two firms of distributors who are vociferous in their demand for a change, it might be, possible that they are disgruntled, and also that they have no overwhelming superiority as merchants, and are therefore unable to entice business away from their competitors. All of the smaller distributors with whom I have talked are most emphatic against any change.

Why all this talk about a monopoly, and what is so sacred about "Arms Length Bargaining"?

Morgan Stanley & Co. have managed a great many syndicates since the formation of that firm, but the probabilities are that they did not actually originate all the deals in which their name appears as managers.

One of the smaller underwriters, or even a firm which only occasionally may participate in underwritings, may through personal contact of a representative out in the country, or through

some other circumstance, find a refunding job that can apparently be done and has the tentative approval of the issuer. If it is too big for him to handle he takes it to one of the leading Underwriters. No one is going to risk the capital and reputation of his firm by allowing some small inexperienced firm to manage the syndiacte. Therefore the name of that firm appears at the head of the list and overzealous statisticians add the total amount of the issue to the business of that firm, thereby building up impressive but meaningless totals.

Just as in the legal, engineering, medical, or any other profession, business naturally tends to go to the outstanding leaders in those professions and every job that is well handled adds to the prestige and increases the probability of that firm receiving opportunities to take on new jobs, but the firm must continue to maintain high standards and do good work or it will find its customers fading away.

Competition is still keen and any issuer who thinks he can get a better deal elsewhere has many houses from which to choose.

My understanding is that there can be no domination or control of Public Utilities by Bankers under present statutes, because the ownership of 10% or more of the voting stock, let alone actual working control, automatically classes the owner, whether individual, firm or corporation as a Public Utility Holding Corporation, and interlocking directorates are forbidden by statute.

Just as in other professions, Investment Banking Firms, continue to act as Bankers for certain Corporations over long periods of time, and continue to function between periods of issuance of new securities. This continuing interest in bonds which have been previously sold, and the furnishing of counsel and advice on financial and other policies is of great value, in my opinion, and should not be disturbed. Competitive bidding would in my opinion absolutely destroy this relationship.

The bidder at an auction is interested only in fixing the lowest price that he thinks will win, and if awarded the bonds, in dumping them as quickly as possible to cash in on the profit which he figured in his bid before it vanishes, because of changing conditions, or because the potential buyers discover that he has paid a rediculously high price for an egg that is not too good.

I have seen no evidence of any desire for, or approval of competitive bidding, indicated by any Public Utility Company, and so far as I know there are no statutes which forbid such action, but the only cases which have come to my attention where bonds have been sold under competitive bidding have been where state laws require that method.

Because of my deep interest in the subject and the importance of it, I have carefully read everything which I have seen in print, particularly articles in favor of adopting this method, and even though I have earnestly tried to consider such articles

with an open mind, I have not seen any statements which can be fortified by the facts, or any argument which, in my opinion, would justify enforced competitive bidding.

Mr. Dean: Mr. Chairman, might I correct one statement in which I think Judge Healy would be interested? The question whether or not there have been direct placements of railroad securities since the passage of the Securities Act of 1933 -- I am indebted to my friend Mr. Rodgers of the Metropolitan Life Insurance Company who tells me there have been three railroads privately placed, the Canadian Southern Railroad, the Wheeling and Lake Eries Series D, and the Cleveland and Mahoning Valley. There have been five issues of Terminal Railroad. Union Terminal Company of Dallas, the Chicago Heights Terminal Transfer Company, The Tulsa Union Depot, and the Houston Belt & Terminal Corporation, and the Atlanta Terminal Company.

Chairman Frank: Those are securities which are required to be registered?

Mr. Dean: Those are securities which are required to be registered. They are a relatively insignificant total compared to what I believe is approximately 4 billion of securities privately placed.

Chairman Frank: There have not been many of those securities placed?

Mr. Dean: No. If the re is anyone else that knows of any railroad issues that have been privately placed, we would be very to get the names of them.

Commissioner Eicher: Do you still insist on your statement that there were no private placements prior to the Act of 1933?

Mr. Dean: The term "private placements" never came into being until after the passage of the Securities Act.

Chairman Frank: We don't care about the name of a dog, whether it is Fido or Nero.

Mr. Dean: That was not a significant method of financing prior to 1933.

Commissioner Healy: Going back how far?

Mr. Dean: As far as anybody in the investment banking business at the present time can recall, or as far as any record that we have. Of course, if you go back to your period around 1900 when you had private financiers and private capitalists and various things like that, you get into very difficult questions of compilation.

Commissioner Healy: Isn't it true that during the period from about 1918 up until around 1930 or 1932 that the method of distribution was quite different than those which obtained in the earlier periods?

Mr. Dean: Yes sir, I think so.

Commissioner Healy: Isn't it true that back of the days of the Liberty Bonds and so forth, that the small investors, people of small means, were much more apt to put their money in the savings banks and insurance companies than they were to respond to the blandishments of bond salesmen that suddenly descended upon them after 1920 in swarms?

Mr. Dean: Yes sir, I worked in a country bank in 1917 and

1918 and handled the Liberty Loan ledger, and many people used to come in and hand money in along with their coupons thinking that that was what they owed the government.

(Laughter.)

Commissioner Healy: Isn't it possible that the small investors are reverting to their earlier habits of investment by turning their funds over to those whom they regard as expert investors? Aren't they reverting to their old habits of turning their money into the savings banks and insurance companies?

Mr. Dean: Sidewalk economics is a very dangerous diversion, so I hesitate to make any statement on that.

Commissioner Healy: I am not relying entirely on sidewalk statistics in making that statement. Our studies show here that there is a basis for what I say, and furthermore it shows that the ownership of securities issued before 1929 of high grade securities, that the ownership has been shifting over the past 10 years from private into public or quasi public hands, and there is definite evidence that the investing habits of the public are reverting back to what they were before the war.

Mr. Dean: Yes, but I think the statistics overlook the fact that the interest rates from 1920 on were very high. I remember very distinctly when public utility bonds were selling in the 80's, and they were issuing 8 per cent bonds. Your bond market was very active up to the middle of 1928 when your financing changed to equity financing. If you will take your

statistics of your total securities sold at that time to institutions, and your securities sold to private individuals, you will find that the private individuals, estates and trustees played a very important role.

There are many people who believe that if your present era of low interest rates were reversed, that the private individual would again play a very important part in buying long term or fixed securities. As you know, a great many institutions -- Leland Stanford in particular has gone to court and asked to be relieved of the duty of investing only in fixed term securities, and many people investing trust funds are under a very great hazard at the present time in trying to get income for the life estate men or the remainder men, and many of them are trying to go into preferred and common stocks because of their higher yield.

Chairman Frank: I think it is very excellent judgment, I may say. I will write myself down a fool in your eyes by saying that.

Mr. Dean: That is too long a subject to discuss here. I think it is difficult to draw conclusions on the part that private investments play without taking into consideration current money rates, because current money rates play a very important role.

Commissioner Healy: I think still that during the 20's, there was a change in the method of distribution, and many small

investors got the idea that they could pick good bonds, and I think a great many of them have changed their minds on that subject.

Mr. Connely: May I say that I disagree to some extent with that? I think those people who do have funds for investment are still continuing to do business with their country investment bankers. I do not think that I am particularly equipped to answer that question, but there are many dealers in this room who have customers who rely on them to a very great extent in the selection, advice in the selection of their securities.

Commissioner Healy: I used to be an investor myself before I came to work for the government, and I do not ever remember of seeing bond salesmen in my office back in 1920, and from then on down until about 1928, you could not shake them off.

Mr. Dean: They had not graduated from Yale in 1920.

Commissioner Healy: They did not all come from Yale.

Mr. Dean: If you want to make an analysis of the sales records of the various investment bankers, you will find that at any point where there is a higher yield, that the sales to the individual investors goes up.

Mr. Stewart: May I carry on with the smaller dealers who are still here? If it please you, I should like to ask Mr. Whipple to discuss the position of the smaller underwriter under the proposed competitive bidding idea.

Mr. Rodgers: Before he begins, I think I might give you figures that would be apropos of your point. These figures only go back through 1932. Of course, that precedes the passage of the Securities Act. They were prepared by Major Edwards, one of the insurance examiners for Western States, and I was interested to note that for the year 1932 he lists as private purchases by the Metropolitan $22,463,400 of which $495,000 were public utility issues. I do not vouch for those figures as I did not prepare them, but it is significant.

A Voice: May I ask Mr. Rodgers a question in this connection? A few moments ago you spoke of private placements which had been registered and you thought you had some figures. Have you those figures?

Mr. Rodgers: Based on my rough figures here, I would estimate about 12 per cent of the private placements were nevertheless registered, but that is a rough estimate.

STATEMENT OF JAY N. WHIPPLE,

Bacon, Whipple & Company, Chicago, Illinois.

Mr. Whipple: My name is Jay N. Whipple of Bacon, Whipple & Company, Chicago. I think possibly since this group over here (indicating) seem to hold to my views, that I had better address my remarks to the other side of the room.

Chairman Frank: You might let us in on it, too.

Mr. Whipple: Our business was started about 15 years ago for the purpose of underwriting and distributing principally

corporate securities, but we also conduct a municipal department. In this connection I would like to bear out what Mr. Connely has said about the fact that we have done business largely with small investors and the principal part of our business at the present time is with that type of investor including a large number of individuals.

Until the business depression and the Securities Act of 1933, our normal earnings largely resulted from the purchase and sale of small industrial and utility issues such as a $600,000 first mortgage Bond Issue of Sidney Wanger & Sons, $450,000 first mortgage Real Estate Bonds, $300,000 Milk Dealers Bottle Exchange first mortgage Serial Bonds, 20,000 shares McWilliams Dredging Company, convertible preferred stock, $200,000 Wieland Dairy Compan Guaranteed Preferred Stock etc. In all of these deals the proceeds from the sale of the securities were used for construction or the expansion of a business, and all of the securities of this type we underwrote during this period were desirable and satisfactory investments from the point of view of our clients with one exception.

I mention this to justify our existence in the entire scheme of things although perhaps from the statement of the Commissioner yesterday that is not necessary.

Our second most important source of revenue during this period was derived from our participation in selling groups and a few so-called banking groups.

During the past few years we have continued our efforts to purchase desirable issues of bonds and stocks from relatively small concerns and have done some business of this type, but the profit from our participation as underwriters in national syndicates headed and managed by large houses has become an increasingly important factor in our earnings. In fact our income from participations in underwritings of utility issues during the past four years has contributed so substantially to our earnings, that were it eliminated, we would have suffered a net loss for the period of $38,000.

I am approaching this problem, Mr. Chairman, from the point of view of a small underwriter and a medium sized distributor as distinguished from the dealer who participates only in selling.

I should like to confirm the testimony of Mr. Van Court of Los Angeles, and Mr. Scribner of Pittsburgh, the last ones to appear at yesterday's session, particularly that part of it which pointed out that the position of the dealer in serving his customers would be more difficult without the firm bonds reserved in the selling group in the case of deals resulting from private negotiation because of a reasonable margin of profit as against the subject subscriptions provided in the case of deals sold at compulsory competitive bidding. While they did not mention it I should like to point out that in the latter situation we in Chicago are at a disadvantage in relation to New York to the extent of one hour and on the Pacific coast it is three.

As a medium sized distribution and smaller underwriting firm, we are opposed to compulsory competitive bidding, because we believe it will deprive us of an important source of revenue and our customers of the opportunity to buy certain desirable investments for the following reasons:

1. Because of our limited personnel, experience, capital, and lack of dealer following, we could not look forward to organizing and managing groups that could compete successfully for issues sold under a rule requiring compulsory competitive bidding.

2. Under present conditions we are rarely invited to participate in small underwriting groups, and our opportunity for participating in groups formed to bid competitively would be reduced, because under compulsory competitive bidding the smaller the group the better its chances of being high bidder. This assumption is based on the fact that a group with a few members, each having a large enough interest to insure a reasonable profit in the event of a successful deal, would be justified in bidding more aggressively than one made up of a larger number of underwriters located in different parts of the country, with a larger initial overhead charge against each 1000 principal amount of bonds, and a potentially smaller net profit per group member.

3. It is our opinion that the business of underwriting issues affected by the proposed ruling will be concentrated more than

ever in the hands of a few large firms. They have the capital, the experience and the personnel to handle a large volume of business on a small margin of profit. Why should they clutter up an account with a number of smaller underwriters scattered all over the country. There can be no suggestion from management that, for reason of public relations and a desire to have a part of the securities distributed in the territory, local underwriters be included in the successful group.

4. There would in our opinion be a decided change in the organization and method of operation of certain large underwriters. Those having no retail selling force would undoubtedly establish one and others would increase the size of their existing retail organization. The reason for this is the fact that spreads would undoubtedly be smaller and in order to maintain their profits underwriters would be obliged to sell at retail.

An indication of that is the fact that Mr. Stanley said yesterday that they would be forced to go into the retail business.

Chairman Frank: That is not a specifically enforceable obligation, I assume. I mean that you could not compel him to do that.

Mr. Whipple: That was his statement, I believe.

5. Compulsory competitive bidding, with its attendant necessity for quick decisions, and secrecy regarding the price to be bid, would make smaller underwriting groups, restricted to one

geographical center, more effective and tend to eliminate firms like ours from participation.

6. Because our business is largely with individuals and smaller institutions and not with so-called informal buyers, we would not be able to compete successfully against larger houses under conditions of competitive bidding where speed is essential to success.

7. Deprived of the opportunity to participate in underwritings of this type, it is doubtful if firms of our general character could survive.

Mr. Stewart: Mr. Wickliffe Shreve of Lehman Brothers has some interesting statistics which bear on the problem.

Chairman Frank: Before you proceed, are there any of the smaller dealers that are still to testify?

Mr. Stewart: Yes, there.

Chairman Frank: Why don't we hear them first? These New York people can get back to New York pretty quickly.

STATEMENT OF EDWARD C. ANDERSON,

Richmond, Virginia.

Mr. Anderson: Mr. Chairman, our firm has been in business for nearly 50 years in Richmond, and we are underwriters of local securities as well as distributors of bonds at retail in the selling of securities, and occasionally are members of the larger underwriters' groups distributing nationally. The success of our business primarily is dependent upon our ability to assist our

customers to invest wisely. We are very much alarmed at the possibility of the overpricing of securities which may result from competitive bidding, and we feel that we will be greatly handicapped in the procuring of a supply of securities for our public -- our customers -- if we are to have these large underwriters go into the retail distribution of securities on the very small margin of profit which will be available to them.

It seems to us that that is about the only source from which they can increase their bid by reducing their profits, and if they reduce their profits, we can not see how they can continue to allow us profits which we need and must get. They already have gotten down to a point where they make it very difficult to make both ends meet.

Chairman Frank: You mean for you?

Mr. Anderson: For us, yes.

Chairman Frank: You don't know whether that is true as to the originating underwriters?

Mr. Anderson: No, I am speaking only from our own standpoint. That phase of the business, that is the retail distribution of the nationally underwritten issues is a very significant part of our earnings at the present time. We are members of the New York Stock Exchange, and of course have been suffering from the very slow markets and the very small volume that has been resulting under these conditions that exist today.

I think that competitive bidding is going to probably force

dealers such as us to retire from the investment business. Whether or not we can remain in the business on the basis of the other services which we perform is something that only the future can tell. The opportunities to do local underwriting are not in themselves sufficient to build up our earnings to the point where we can meet our overhead and show a reasonable profit to ourselves. We hope very much that the Commission will take into consideration the effects of this regulation of the communities such as those in the State of Virginia and in other States which are remote from the large financial centers, and that they will not precitipate the building up of large chainstore types of distribution of securities which would crowd us out of business.

I thank you.

Chairman Frank: Thank you very much.

Mr. Spencer (of the S.E.C. Public Utilities Division): You spoke of financing local enterprises.

Mr. Anderson: Yes.

Mr. Spencer: There has been a lot of talk about Public Service refinancing their outstanding bonds running into large sums of money. Granted that the small dealer would have to have assistance of the large houses to handle a refinancing engagement, and I think what we have been talking about recently has been very largely what has been brought about by refinancing, but in the normal course of events when the refinancing is over and these companies come into the markets for their annual or bi-

annual requirements, the amount of money to be raised by bonds or common stock or preferred stocks may be a very minor fraction, in fact would be, of what it is at the present time. Now, you are thoroughly familiar with your local utilities. I suggest that possibly when the time comes that those companies are in the market for simply their new capital requirements that it might readily be possible for a group of Virginia firms to take care of and dispose of the issue, and that might be well within their financial resources. Have you given any consideration to what will come in when utility refinancing is over?

Mr. Anderson: The only reply that I can make to that is that while it might be possible for us to organize a group that would bid for the smaller issues of bonds of local utility companies where they are borrowing two or three million dollars, we have found in the case of municipal bonds that we are in competition with some of the largest buyers in the country even on the very smallest size municipal issue. We would then be confronted with the same question of competition with them who cover a much wider territory than we do and who frequently have access to buyers who buy on a very much lower return rate than a local market such as exists in Virginia would buy.

Mr. Spencer: That of course would be true because as the volume of securities diminishes, the appetites of the large buyers might become more keen, and for that reason in the first two or three years of competition you might suffer. But that

has nothing to do with competitive bidding.

Sha[redacted]fls.