

If you will take a look at this chart you will see the setup. Equity Corporation was even worse than United Founders Corporation. This chart shows Equity Corporation at the time Founders was sold to Equity.

Now, I would like to introduce, if I may, a picture of the Equity Corporation as of about the time the Equity Corporation got control of United Founders Corporation.

Senator WAGNER. Have you more than one copy of that chart.

Mr. SCHENKER. We have plenty of copies.

Senator WAGNER (chairman of the subcommittee). This chart will be made a part of the record at this point.

(The chart entitled "Equity Corporation" is made a part of the record.)

Senator WAGNER (chairman of the subcommittee). You may proceed with your statement.

Mr. SCHENKER. Now, at the time control of United Founders Corporation was transferred to Equity Corporation, it owned the Yosemite Holding Corporation, which in turn owned Chain and General Equities, Inc., which in turn owned Interstate Equities Corporation, and through these investment trusts they owned General American Securities Corporation, Majestic Fire Insurance Co., American Colony Insurance, Colonial States Fire Insurance Co., and Germanic Fire Insurance Co. Owning all these insurance companies, what did they do? They reinsured the risks and really made investment trusts out of these four insurance companies so that there was this complicated situation. I will introduce a chart in a few moments showing what was above Equity Corporation, but there you have this tremendously complex situation.

Now, what happened? They sold the A stock to an investment company subsidiary. The Equity Corporation, and this A stock had a vote equal to one-third of the total voting power outstanding.

Then the new group started out, with that control, messing round with the capital structures of these underlying companies, all with a view to collapsing the structure and making one company out of it. Ultimately, in 1935 this entire structure was collapsed and the name of the Founders Companies was changed, and it became known as the American General Corporation.

I do not want to discuss in detail at the present time what happened to the stockholders in the process of recapitalizing these corporations and in the process of the exchange phase. That is dealt with in two reports, one by the Commission and one by the protective committee. These reports have been transmitted to the Congress.

Let me take a minute and tell you what happened to General Investment Corporation, which was a part of the picture of Founders. Mr. Stern told you how this company flopped from \$78,000,000 to \$7,000,000 or \$8,000,000.

Senator WAGNER. I did not quite catch that latter figure. Did you say it dropped from \$78,000,000 to \$70,000,000?

Mr. SCHENKER. No. It went down from \$78,000,000 to \$7,000,000 or \$8,000,000.

Mr. WAGNER. Oh, I thought the latter figure was \$70,000,000.

Mr. SCHENKER. No. And that loss was sustained how? Senator Townsend asked whether that loss was not entirely attributable to that fact that there was a stock-market crash. Nobody denies that

that crash contributed to the drop, but that crash did not contribute in toto to the experience of United States Electric Light & Power, and certainly did not have as much to do with it as the transaction of the insiders in the case of General Investment Corporation, when they sold them the South American subway, and Central Public Service when they sold them German and French credits.

Here you have the stockholders taking a beating to the tune of \$70,000,000. Now, what happened? In 1933 another individual is put in charge of the company. His name is George Devendorf. Well, the first thing they do is, George Devendorf, as I recall it, made an investment of about \$100 in preferred stock. By the time he got through he had the corporation, by buying the preferred stock of the company, and reselling it to the company and he realized about \$1,000,000. About \$2,000,000 of the company's funds were used to buy its stock. The stockholders dropped \$70,000,000 in that picture. There is \$7,000,000 left. And where is that? It is in the subway in Buenos Aires. That is the only asset left in that picture, the only straw to which the stockholders can look to get a part of their money back in any eventuality.

Now, let me tell you what happened to the subway.

Senator WAGNER. Before you go to that let me ask you a question: You said \$100,000,000 became \$1,000,000 to one individual. Tell us about that.

Mr. SCHENKER. Well, he started out with—and our report covers it—he started with \$100 and went ahead trading in the preferred stock, building it up until he got a big position which he sold at a profit of \$1,000,000. This is not unusual and we can give you innumerable cases to show it; and I do not want you to think for one moment that these instances we give you are isolated; and I am sincere in this, that I do not intend to impugn this industry, for I think there are people in it who have the highest sense of fiduciary duty. I believe there are people in here who are trying to do the job right. However, our study and analysis over a period of 4 years shows that the very nature of this institution, which is like a bank, where you are dealing with cash, presents a definite situation: You cannot back a truck in at some place and go away with a steel plant, but you can go to a safety-deposit box and take \$1,000,000 therefrom. That is the reason this is a different type of institution. It is an equity savings bank, and ought to be subject to regulation and supervision such as is comparable to the regulation and supervision of similar types of institutions. As I say, I am not intending to impugn the institution. I have been in pretty close relationship with many people engaged in it and I know a large number of them. We have talked with them, have studied the situation with them, and I would be the last person in the world to say there is no ability in the industry, no high-grade men in the industry.

But I do say this in all seriousness: No matter how good a single individual investment company may do its job the unfortunate thing is that all you need is one bad actor and the work the others have done is wiped out; and that has been the experience during even the course of our own investigation. If you take one example, Continental Securities, the experience offsets all the good work ourselves and the industry are doing. We did not intend to mess with people who were trying to do a good job, those who had a real interest in the industry

of investment, but look to special situations like Continental Securities. And that is all that this bill contemplates.

It may be that our language is not precisely accurate. It may be we forgot to put a comma at one place and a semicolon at another place; but after we discuss this bill you will be convinced I think that this bill merely intends to set forth certain fundamental basic principles which good businessmen are obeying, to the end that nobody can enter this type of institution unless he is prepared to observe the proper fiduciary relations.

Now, about that subway: In August of 1936, United Founders Corporation sold its controlling block of stock of General Investment Corporation to an individual by the name of Ernest B. Warriner. I do not want to confuse the record at the present time but during the course of the hearings on the bill we will tell you who Mr. Warriner is. Mr. Warriner bought this block of stock for \$189,000, and as is not unusual—and, Senators, you will see that the same pattern which was applicable in 1928 and 1932 was applicable in 1937. I am sorry as to the date. Well, they sold control to Warriner in August of 1936—did I say that before? Anyhow, I am not talking ancient history but am talking how this thing took place recently. It was during the very course of our investigation. We started our investigation in December of 1935. We had our field study for about 6 months and announced the first examination for July of 1936, and the first company we studied was a company in which Mr. Warriner, and a certain Mr. Groves, whom I will show you is tied up in this picture—and the first companies we had a public examination of were companies in which Warriner and Groves had been interested and had depleted. We will tell you later on how they did that.

At any rate, in August of 1936, Mr. Warriner buys this controlling block of stock of General Investment Corporation, and he needs \$189,000 to do it, and he has not got it. He borrows \$139,000 at some place, and \$50,000 from somebody else, and buys the controlling stock of International Equities. The block of stock that he bought—no; I am sorry, but International Equities he bought from somebody else and not from Founders. Well, he has control of International Equities, and of course the block of stock he has is not majority voting control.

What does he do? He sits down and makes a contract with an individual by the name of Kolb, that he will buy a big block of stock from him personally, and Mr. Kolb does not make any payment on the stock but says, "I will pay it to you later on." Immediately Mr. Kolb's group resigns from the board of directors and Mr. Warriner's board of directors move in. As soon as they move in they adopt a resolution that International Equities Corporation will take over Mr. Warriner's personal commitment to buy the block of stock, and the corporation buys in the stock.

What was the result of that? By buying that stock in they reduced the outstanding stock so that Mr. Warriner's original block, which was only 30 percent of the voting power, now becomes over 50 percent because they had the corporation buying a big block of outstanding stock and thereby reduced the number of shares outstanding.

So you have Mr. Warriner in control of International Equities with the payment of \$189,000. Mr. Groves and Mr. Warriner testified for us in July of 1936. And right here let me tell you, Senators, there

were times, or there was a time during the investigation when Mr. Grove was asking for a recess, and I assumed he was going out to get a drink of water. However, in retrospect I think he was making telephone calls to close the very deals we are talking about. [Laughter.]

The next thing we see, in August of 1936, United Founders sells control of General Investment Corporation to International Equities Corporation, General Investment Corporation being a company which only had the subway in South America.

During all this time and particularly around May of 1936 an individual by the name of Billings, the manager of the subway, had been carrying on negotiations and had received an offer of about \$7,500,000 for the subway. He sent wires up there—and I have a copy of that offer—and I might say that the purchase of this subway was being financed by the Instituto, which corresponds to our Reconstruction Finance Corporation. They were going to finance the purchase of the subway from the investment trust.

Senator WAGNER. What country is that?

Mr. SCHENKER. That is at Buenos Aires, a pretty long way from home, it is true, but that is all right. And, Senators, the practical thing is that this bill says if you want to invest in a Buenos Aires subway, that is perfectly all right under this bill, but you have to tell your stockholders before you sell stock that that is the type of business you are going to invest in, or if you are in a diversified company which is buying various types of stocks, and you make up your mind you cannot make money buying stocks on the stock exchange and want to buy a subway, that is all right, but in order to do so you must tell your stockholders you are going to change the nature of your business, and get their approval for that.

Suddenly there appears as one of the negotiators on the scene an individual by the name of Philip De Ronde. Of course Billings was carrying on the negotiations in Buenos Aires.

Now, at the present moment I am not talking about looters. You may get the impression from my mention of Continental Securities that there were a lot of irresponsible people, but I am talking about people connected with investment trusts. For instance, there is the Phoenix Securities Corporation, involved in this picture. That corporation is not a little penny institution. Today it controls United Cigar Stores, Lofts, Pepsi-Cola, Certainteed, Celotex, New England Bus Co., and a sugarcane company. But that is a different story. We will give you here how Philip De Ronde was associated with Mr. Groves and Phoenix Securities.

Well, suddenly he is sent down to South America to close that deal. They closed the subway deal and got a price of \$7,500,000, \$5,750,000 in cash and \$1,750,000 the investment trust had to keep as participation, and they sent \$5,750,000 up to New York.

I have told you what happened to the subway. Now let me tell you what happened to the \$5,750,000. Mr. De Ronde suddenly tells Mr. Warriner that he has to pay \$150,000 to somebody down in South America, and that he needs it in cash. Warriner says: What is your commission for selling the subway? He said \$250,000.

Doubtless you will assume that if a person is entitled to a quarter of a million dollars as a fee, they would sit down and write a check for

it and pay him. Well, they sat down and wrote a check to Philip De Ronde, Ltd., and then tore that up. Then they wrote another check and tore that up. Then they wrote another check and tore that up. They drew five or six checks, and finally sent a secretary to the bank with instructions: You make sure that you get this money in \$1,000 bills. Do not come back here with anything else.

When I examined Mr. De Ronde I said I had heard of people insisting on getting \$5 and \$10 bills, but that was usually connected with kidnaping activities. I told him I had never heard of anybody insisting on getting \$1,000 bills, and here he was with \$250,000 in cash walking around for a couple of weeks. But Mr. De Ronde got that money and turned it over to the Philip De Ronde Co. When he came on the stand he was asked "Who is that?" and he replied "I can't tell you that." Then there was the question "You cannot tell me. Are you a stockholder of that company?" The response was "No." Then the further question "Are you an officer?" and the response "No." Then there was the question "Well, to whom did you turn it over?" and the response "I am sorry but I turned it over to the corporation." Then the question "Who is the corporation except the officers, directors and stockholders?" and the response "I cannot tell you that." Whereupon Judge Healy says "I will not take such answers to the questions." and he replied "Can I call up a lawyer?" and he was told "Yes". Then Mr. De Ronde stepped off the stand and has never been heard of since, went down to South America.

The judge says his face has been red ever since.

There goes \$400,000 of the \$5,750,000. Mr. Wallace Groves' investment trust, that is, Phoenix Securities Corporation, bought stock of Certainteed Products Corporation for \$3,000,000. This stock had been in arrearages of dividends for years. The first thing we know more than a million dollars worth of the Certainteed stock was sold by Phoenix Securities Corporation to the General Investment Corporation. There goes \$1,400,000 more of General Investment Corporation's cash. Phoenix Securities Corporation also had acquired 40 percent of the common stock of Standard Investing Corporation, another investment trust. This stock had no asset value and was important only for control purposes. However, the existing management of Standard Investing Corporation had refused to turn over control of Standard Investing Corporation to Phoenix Securities Corporation and had been victorious in a proxy fight for the management of Standard Investing Corporation. The management had won this proxy fight although it owned only 5 percent of the common stock of Standard Investing Corporation. Incidentally, this proxy fight illustrates the importance of control of the proxy machinery to managements, because it enables them to keep in power even if they have insignificant amounts of stock of the investment companies they dominate. Having failed to get control of Standard Investing Corporation, the Groves-controlled Phoenix Securities Corporation sold the Standard Investing Corporation stock to General Investment Corporation for \$650,000. That reduced the cash left in General Investment Corporation to about \$3,000,000.

Then Mr. Devendorf, who had this big block of preferred stock—after learning of the transfer to Warriner decided he would like to have a little representation on the board of directors—after all, they were big preferred stockholders—but Mr. Warriner said, "No; no represen-

tation." So he said he was going to get out of this picture. Whereupon he goes to Mr. Warriner and says, "Will the G. I. C. buy my preferred stock at \$87.50 a share?" "No; we can't afford the money. It is the only cash we have got. However, I will take you to Mr. Groves. He will be interested in buying your preferred stock."

Whereupon, he approached Mr. Groves and made a deal with Mr. Groves that he would sell his preferred stock at \$87.50 a share. Mr. Groves said to him, "I will make the same offer to every other stockholder."

This took place about 2 years ago.

Mr. Groves said to the preferred stockholders, "If you will deposit your preferred stock at the Royal Bank of Canada on January 21, 1937, I will pay you \$87.50 a share on January 25, 1937."

Somehow or other, although Mr. Warriner was not interested in repurchasing the preferred stock with the corporation's money, we find that approximately \$2,500,000 of the cash of the General Investment Corporation, is suddenly deposited up in the Royal Bank of Canada, and before that time it never had a cent of the company on deposit. More money was being moved up there by Mr. Warriner of the G. I. C.

On January 22 they know how much stock has been deposited by the preferred-stock holders and they know how much money they need to buy it, and Mr. Groves and Mr. Warriner sat down and wrote out a contract that "General Investment Corporation will pay you \$102.50 for every share of preferred stock deposited in the Royal Bank of Canada"—and that amounted to about two and a half million dollars.

So, on January 22 Mr. Groves takes all the preferred stock which was deposited by the preferred stock holders in the Royal Bank of Canada, turns it over to the General Investment Corporation on January 23. On January 23 the General Investment Corporation, out of the moneys accumulated in Canadian bank pays \$102.50 to Mr. Groves, and he takes \$87.50 and pays it to the stockholders on January 25 and keeps the difference between the \$87.50 and the \$102.50, and made a profit of \$300,000 without even investing a nickel.

Then General Investment Corporation had a little money left, so they went ahead and bought another investment trust, known as Utility Equities.

About this time we started asking a few questions, and Mr. Warriner suddenly got a nervous stomach and started taking pills up in Canada, and he has been taking them up there ever since and has never come back.

You will find that every nickel of the six and one-half million dollars was disbursed in the way I have shown you.

Suddenly the Founders group institutes a lawsuit against the International Equities. By this time Warriner had sold International Equities to somebody else and made \$2,000,000 on his \$189,000 investment in that situation. He sold it to a group controlled by the Henderson brothers up in Boston. The United Founders instituted suit against the International Equities for a rescission of the contract, saying they did not know that Mr. Groves was really behind Mr. Warriner; that he was the one that really bought the company, and that they would not have done it, and so forth. But that is another story that I will tell you. G. I. C. is today back in the Founders group. And who is

one of the leading figures in the General Investment Corporation today? G. I. C. was sold back to United Founders. It today is known as American General Corporation. So that it made a complete circle, from Founders to Warriner to Henderson back to Founders. And Mr. Seagrave, the one who was with the United Founders Corporation from its very inception, was one of the individuals who had the A stock and is still chairman of the board of directors of the United Founders; so that G. I. C. is back partially under the management of Seagrave.

I think that about tells the General Investment Corporation story. Senator WAGNER. This was all done with other people's money?

Mr. SCHENKER. This was all done with other people's money. Did you understand, Senator, that when they paid for the preferred stock that was deposited up in the Royal Bank of Canada that was bought in by Mr. Groves from the money of the General Investment Corporation which came from the money which had been moved up there? So what Mr. Groves did was to pay the public \$87.50 and keep the difference.

Senator WAGNER. Yes.

Mr. SCHENKER. Another little wrinkle, Senator.

Senator WAGNER. But that wrinkle amounted to \$400,000, did it not?

Mr. SCHENKER. The wrinkle was the difference between what he paid the public and what he kept himself out of the General Investment Corporation's funds which were used—about \$300,000.

The agreement whereby Groves sold this stock to the General Investment Corporation also had a provision in it that in the event that the corporation was liquidated within 6 months he would not get \$102.50; he was to get \$112. But by that time we had heard about it, and the stockholders instituted suit, and he said, "All right; let's take the \$102.50 and forget about the \$112."

As a result of this Mr. Warriner and Mr. DeRonde and Mr. Groves have been indicted for conspiracy to use the mails to defraud.

I just want to say one thing, and we will elaborate a little. You may say, "Well, what is the necessity for this legislation? Can you not indict these fellows under the criminal statutes?"

Senator, you have got the toughest job of your life. You have presided over criminal cases, and you know that. It becomes a question of good faith. It is a comparatively simple matter when it involves the selling of the stock of a going concern. The question is, is the stock worth the money? Is there such a discrepancy that you can impute bad faith and felonious intent?

Take the case that Mr. Cook described to you. That case was brought by Tom Dewey's office, up in New York County, and those fellows got away. Why? The district attorney's office had to rely on the tricky theory of larceny. They had to rely on the theory that it was a larceny for those individuals to transport the company's portfolio of securities from New Jersey to New York.

And then you get one of those charges to the jury that "Unless you find felonious intent, intent to steal," and so forth. And the jury says, "Well, they gave him a piece of paper. Who knows whether he intended to steal or not?"

That is why this bill says that you cannot sit on both sides of the table when you are dealing with an investment trust. If you are a director or officer or manager or controlling person you cannot sell

any property to an investment trust, because you are sitting on one side representing yourself where you have a pecuniary interest, and you are sitting on the other side representing the investment trust; and we say that fundamentally that should not be permitted. If that provision had been in effect at the time of the Groves incident and these numerous other cases we will tell you about, then you would not meet this complicated problem of whether the transaction was fair or unfair.

One of the lawyers involved in the *Continental Securities* case told Joe Patrick, of our office, who helped work on the case with me—he said, “Do you think I as a lawyer would have been crazy enough to try to sell the stock to this investment corporation when there was a direct, unequivocal statutory provision saying that a controlling person cannot sell such stock? I was figuring that I was going to go before a jury.”

When you deal with investment companies, because of the peculiar nature of their assets—they deal in securities—it is difficult to convince a jury in certain situations.

That is the approach of this bill, Senator. We tried to set forth broad standards to prohibit transactions like the ones that have been recounted, because we know the difficulty of trying to convince a jury of larcenous intent and conspiracy. We say it is fundamental that these people who deal with investment trusts should not be able to do so if they control investment trusts.

Senator WAGNER. Have you concluded?

Mr. SCHENKER. I am through, Senator.

Senator WAGNER. We will hear Mr. Mathews.

STATEMENT OF GEORGE C. MATHEWS, MEMBER OF THE SECURITIES AND EXCHANGE COMMISSION, WASHINGTON, D. C.

Senator WAGNER (chairman of the subcommittee). You are still a member of the Securities and Exchange Commission, are you not, Mr. Mathews?

Mr. MATHEWS. I am.

Senator WAGNER. Unfortunately you are soon to take leave of that Commission and go into private business, I understand. I want you to know that we all regret your departure.

Mr. MATHEWS. Thank you, Senator.

Senator WAGNER. We recognize the very fine service that you have given to the country.

We would now like to hear from you with reference to this legislation.

Mr. MATHEWS. About all that I want to do with reference to the bill now before you is to state as clearly as I can my position on the question of regulation of investment trusts. It is a characteristic of these organizations that, through them, a body of small investors turns the handling of its funds over to others. Even under the most ideal conditions the individual investor is without any means of effective participation in the management which handles his money. Furthermore, a great many investors turn to the investment trusts for the very purpose of turning over to experts the problems of investment management which they do not feel competent to solve for themselves.