price of Tidewater flopped so badly that the first payment was enough to pay for the whole block of stock. The wind-up was that these investment companies dropped their entire investment, and did not get a single share of Tidewater stock.

We did not tell you the story of the investment trust control of which was obtained by Kenyon. I think that is an excellent illustration that one can do the same thing with an open-end trust as with a closed-end trust. Kenyon got control of a few open-end companies and cleaned them out. He was not here to tell the story.

We did not tell the story of the Eastern Utilities Investing Corporation, an investment trust controlled by Hopson, where the company wound up with every dollar of their money in Associated Gas & Electric stock. In the end the investment company would up in the wringer in 1935 with practically no money. They started with $130,000,000.

We did not tell you of Utility & Industrial organized by Byllesby & Co. The investment company raised $30,000,000. Byllesby & Co. as principal sold $23,000,000 of securities to that company. The company wound up with approximately $2,000,000. Included in the $23,000,000 of securities sold by Byllesby to the investment company was the stock of the Federal Public Service Co., which went broke. They sold the investment company a waterworks down in Mexico, which in 2 years after it was sold, was confiscated by the Mexican Government. They sold the investment company about $1,000,000 of Deep Rock Oil Co. Mr. Justice Roberts' opinion in that case said the company was broke from its very inception. One of the directors of Standard Gas who appeared before us said that Deep Rock was only two steps ahead of the wolf at the time the stock was sold to the company.

In addition to that let us take the case of Charles V. Bobb, which is an excellent example of the necessity for legislation. He got control of several investment trusts and cleaned them out. They had to try him three times. Two juries disagreed—before they convicted him. He likewise raised the defense that the transaction was fair. If you have a provision that one cannot sell securities in those circumstances, fair or unfair, that would end it.

And we have example after example after example of that kind which we could show you. However, I think that point has been explored sufficiently by this time.

We have not developed to any extent the amount of loans that were made to officers and directors, but if you are interested we could give you some over-all figures.

We did not tell of the loans made by Unginleider Financial Corporation and by Insuranshares of Delaware to former Judge Manton. Remember, this was the people's money which was being disbursed. The only thing we are asking is that the safeguards be set up in order that this sort of thing shall not happen again.

Now, I would just like to discuss very, very briefly section 25 of the bill, which deals with reorganization of investment companies. You made a suggestion, Senator Herring, about the situation where a court has jurisdiction of the reorganization. Of course we have no difficulty with that suggestion. We think that is the sensible approach.

The situation that is disturbing is the one where there is no court to take a look at the plans. And this is not a small matter when you consider that in the short period of time the investment trusts were in existence in this country there were over $800,000,000 of securities which were issued by investment companies in exchange for the other fellow's investment company securities. It was like printing their own money—they printed $800,000,000 of securities and exchanged them.

In those circumstances there was nobody there to advise the stockholder as to what the exchange offer really meant, whether he was getting a fair shake, or whether the plan was fair.

Now, what does our study show? You take in the case of the Atlas Corporation. They started out with a fairly small company and they grew to a substantial size. Their increase in assets was not due to the fact that they picked representative stocks which went up. Their increase in assets was by far due to the fact that they made exchanges with others, and got control of other investment trusts, and merged them into one big company.

Now, what was the technique used on these exchange offers made by various investment companies? The technique was substantially this: Investment company securities were selling at a discount in the market. Their market value was less than their asset value. What they did was this: After they had made a connection with these investment companies they made a series of exchange offers. These offers were almost uniformly like this: They gave a little more than the market value and a little less than the asset value. So that the money was made by buying the other fellow's dollar at 90 cents or 80 cents. They had these exchange offers which sometimes had one alternative or maybe two or three alternatives.

Now, the fact is that the ordinary investor is in no position to appraise the fairness of the exchange offer, particularly in view of the fact that the assets of a company may consist of situations which are appraisal situations. He is helpless.

But, further than that, he was not helped in the least by his own fiduciaries, by his own people, to whom he entrusted his money and who were supposed to manage it.

What was the technique used by the companies which made exchange offers? They would pay certain emoluments to the incumbent managers to recommend the exchange to their stockholders.

Now, what form did those payments take? In some instances just an out-and-out payment of cash. In one case they paid $200,000 to the management and then the management sent out a letter saying: "We recommend that you accept this exchange offer." And that was done without any disclosure that they were getting $200,000 for doing it.

Or, if there was no cash payment and if the management had option warrants which were not worth a dime, they would buy the option warrants and then the management would make the recommendation to the stockholders to accept the exchange offer. In some cases there was a disclosure of this purchase of the warrants.

If the incumbent management had a management contract on which they had not made a nickel in years, the persons seeking to obtain control would buy the contract. If a man had stock in the company they would pay him a big price for his stock, and then buy the stock of the other stockholders below its asset value. If the insider did not have stock, or option warrants, or a management contract, or were not paid cash, what would the new interests do? They would say: If you help us in this exchange offer, then when you sever your connection with this company we will continue to give you the brokerage business.

What did that mean to the stockholder? That left the stockholder in this situation: Suppose he went to his own management and said: "They want to give me so many shares of the Atlas Corporation in exchange for my shares. Shall I take the offer?" In that case the stockholder could not get an unbiased opinion as to whether or not that offer was a fair exchange.

If the stockholder went around to the broker or to the banker he was confronted with this situation: That in connection with all these exchange offers, of Atlas, Equity, or Associated Gas and so forth, why, they used to pay brokers and bankers a commission on every offer accepted. He could not get any disinterested advice there; so there he was stymied.

All this bill says is where you have these exchange offers, they should be submitted to the S. E. C. and the S. E. C. should either approve or disapprove. I will talk about that approval or disapproval. You can take two approaches. You can say that the S. E. C. should not help the small investors—and the majority of the people holding only $500 worth of securities cannot go out and hire first-class lawyers and statisticians to advise them whether to accept this offer. You can also empower the Commission to make an advisory report or to approve voluntary reorganizations.

Let me take up the subject of the advisory report. Some statements were made here about trying to force upon a stockholder something that he might not want to take, or are preventing him from accepting something that he might want. That is not unusual. In connection with judicial reorganizations, regardless of the fact that the majority of the stockholders approve the plan, the Supreme Court of the United States said it is still necessary to find out whether the plan is equitable. The fact of the matter is that in the case of the merger of Alleghany and Chesapeake, the management had the requisite votes to put over the plan and yet Tri-Continental went into court to get a restraining order.

The purpose of section 25 is to fill in the gap where you do not have anyone to perform that function performed by the court.

You also have other difficulties. You find that the stockholder, in certain circumstances, does not have an appraisal right. If he dissents, that is all he can do about it; because, as I understand, under the Delaware law he does not have any appraisal right in certain cases.

Now, under the Delaware laws, if it takes the form of a sale of assets, he does not have an appraisal right. In connection with the voluntary recapitalization of the capital structure of the company, he does not have any appraisal right.

What happens? The people who own the common stock can really change the whole nature of the holding of the preferred stockholders, and affect their dividends, and so forth and so on. We think it is an important problem.

The fact of the matter is that Mr. Odlum himself, said quite frankly:

I should like to add this for the record: That it is a poor man who does not gain knowledge as he grows older. I am some 7 years older today than I was when we started this investment trust acquisition program, and there were many things we found in the way of technique, mechanics, and methods that, today, based on the experience, I would probably not do the same way. That goes even to fundamentals; and purely from the standpoint of the good of my own stockholders, I think I gave more effect to the acquisition of trusts than should have been given for the profits obtained.

He said that maybe he could have made more money otherwise. He did make a substantial amount of money, and I think the record should indicate that all the money made did not go to Mr. Odlum, but was allocated among his Atlas stockholders.

Mr. Odlum went on to say:

Personally I would welcome some public body or arbiter who could pass on the equities as between divergent interests in such matters as mergers, reorganizations, and exchanges of securities, not to substitute their judgment for that of the management, but to see that things are at least within the range of upper and lower limits within which reasonable men can properly differ.

That is the problem, and it is not an academic problem; because when did these exchanges take place? There is no fun changing dollar for dollar; you cannot make any money that way. The only time an exchange pays is when you can buy somebody's dollar for less than a dollar. All these exchanges took place when investment company securities were selling at a discount and when they could entice or induce the person to make the exchange—say, where there was a dollar asset value for the security, but it was selling for only 80 cents on the market. They could give him 90 cents, which would be 10 cents more than the market but 10 cents less than the asset value.

We have that same situation today. Investment company securities are selling at a discount; and I personally feel that if you do not pass this legislation, you are going to get these elaborate exchanges, with small companies trying to build up their fund in that way, particularly in view of the fact that they cannot at the present time raise new capital through the sale of securities.

So we think this is an important problem which merits the consideration of the committee, and that the Commission ought to be given the right to approve or disapprove the exchange of securities, within those limits and circumstances.

There is just one other thing: I should like to introduce a memorandum on section 25, which discusses the problem——

Senator HUGHES. Could you state—and your recollection is better than mine—just as briefly as possible what opposition was made to that?

Mr. SCHENKER. Oh, the opposition that was made.

I think the objection was that the provision was undemocratic—that the majority could not have its way.

Curiously enough, the person who asserted that noble sentiment—is a person whose company was the one that refused to abide by the judgment of the majority. It was his company that went in and got an injunction in connection with a particular merger, you see.

Of course, as I said in the case of a judicial reorganization, the Supreme Court of the United States did not have any difficulty with this "undemocratic procedure" of protecting the minority stockholder, even though the majority wanted that particular exchange to take place.

Now, this statement discusses the law and shows the impotence of the minority stockholder at the present time.

We are submitting this memorandum in connection with section 25.

Senator HERRING. Do you want that memorandum in the record, or just filed?

Mr. SCHENKER. Yes; I think it ought to be reprinted.

Senator HERRING. Yes.

Senator HUGHES (presiding). Yes.

(The memorandum "Statement of the Securities and Exchange Commission with reference to section 25 of the proposed investment company bill" is as follows:)

STATEMENT OF SECURITIES AND EXCHANGE COMMISSION WITH REFERENCE TO SECTION 25 OF THE PROPOSED INVESTMENT COMPANY BILL

A. OBJECTIVES OF THE SECTION

Section 25 of the proposed investment company bill is intended to erect a safeguard to protect investors in investment companies from unfair treatment in the case of voluntary and involuntary reorganizations of their companies, ahd the rights, preferences, incidents and values of their securities.

Reorganization plans of insolvent investment companies drastically affect the rights of creditors, bondholders, and stockholders. Although priorities of claims must be respected, the necessities of the situation may require bondholders to become stockholders. Preferred-stock holders may be required to become common-stock holders. Assets values, dividend rights, and other incidents of securities may be changed by such plans. However, as will be pointed out, security holders are afforded a substantive measure of protection where the reorganization is supervised by Federal courts under the Chandler Act.

Similarly the rights and values of security holders may be severely altered in voluntary reorganizations, effected by exchange offers of securities, "switches" of securities from one company to another, mergers, consolidations, sales of all the assets of investment companies to other investment companies, recapitalization and dissolution plans.

Recapitalization plans have for their purpose the readjustment of the rights, privileges, and values of existing securities of a single investment company. For example, where preferred stocks have large dividend arrearages, it is possible by such plans to eliminate such dividend arrearages by reclassifying the securities of the company and exchanging new securities for the old preferred stocks. These plans may be highly advantageous to the common stockholders. Such plans may enable the common stockholders to obtain dividends on their stocks which in the absence of a recapitalization could not be paid because of the dividend arrearages on the preferred stocks. Write-downs of capital accounts may also be effected which will create surplus available for payment of dividends to the common stocks, thus pro tanto destroying the "cushion" of assets for preferred stocks. These are only two examples of the changes in the rights of stockholders which can be effected by voluntary recapitalization plans.

Dissolutions of investment companies may also result in unfair treatment to stockholders where a large proportion of the assets of such companies consist of securities for which no quoted market values are obtainable. Since the management under State laws is almost invariably vested with the function of determining the aliquot portion of the assets distributable to stockholders, the values they give to portfolio assets may favor one or more classes of securities. For example, assume that the investment company has outstanding $5,000,000 of preferred stock and a common stock. The assets consist of securities which have no ascertainable market value. If their assets are really worth only $5,000,000 or less, the entire assets must be distributed to the preferred-stock holders. However, a management with substantial holdings of common stock may evaluate the assets at an extravagant figure in order to justify distribution of a portion of the assets to common-stock holders. About the only remedy the preferred-stock holders would have in such case is a lawsuit to restrain the unfair distribution of assets. However, as will be pointed out later, legal proceedings are beyond the means of the average stockholder in an investment company.

The ultimate result of mergers, consolidations, and sales of the assets of one investment company to another is the concentration of the assets of one or more formerly independent companies in one of the old companies or in a new company. Securities of the successor company are issued for the securities of the old companies. In the achievement of this result, a nonjudicial reorganization of the rights, privileges and financial position of the stockholders of the various companies is accomplished. As will be developed later, stockholders are singularly helpless to protect themselves against unfair voluntary plans of reorganization and recapitalization even though the facts which render such plans unfair may be fully disclosed to the stockholders.

These voluntary reorganizations of investment companies have been of frequent occurrence in the past. On the basis of balance sheet valuations of the acquiring companies all exchanges of securities in connection with or immediately preceding merger and consolidation or sales of the entire assets of investment companies to other companies, involved the issuance of $873,000,000 of securities during the years 1927 to 1935. Almost 50 exchange offers of its own securities were made between 1933 and 1935 by The Equity Corporation for the securities of 11 investment companies which it absorbed during that period. Atlas Corporation made 43 exchange offers of its securities for the securities of the 21 investment companies which it acquired. Associated Gas & Electric Co. made approximately 60 exchange offers for the securities of Eastern Utilities Investing Corporation which it controlled and the assets of which it had used to further its own purposes.

A significant stimulus for the effectuation of voluntary reorganization is the fact that the securities of closed-end management investment companies are selling in the market at prices approximately 30 percent less than their aggregate asset values—a condition which has existed since 1929. In this situation a profit equivalent to this 30-percent difference between the market value and the asset values of closed-end investment company shares can be made by acquiring through exchange offers, merger, or consolidations, the outstanding shares of such companies for a consideration in securities equivalent to or less than the market value of the exchanged securities. This in essence was the purpose of both the Atlas Corporation and the Equity Corporation in their extensive campaigns between 1930 and 1935 to acquire investment companies. These two companies alone absorbed over 30 other investment companies from 1930 to 1935.

The extensive voluntary reorganizations of investment companies which have occurred in the past have substantially affected the rights and values of stockholders. For example, the stockholders of 21 investment companies who accepted the exchange offers of Atlas Corporation between 1930 and 1933 suffered aggregate losses in asset values at the time of the exchanges of approximately $13,000,000. (See pt. 3, ch. IV of the Commission's Report on Investment Trusts and Investment Companies.)

Almost invariably the preferred stockholders of the companies acquired by Atlas Corporation became common-stock holders of Atlas Corporation as the result of their acceptance of exchange offers. Similarly, stockholders of the investment companies who accepted the exchange offers and agreements of merger and consolidation of The Equity Corporation suffered losses in asset value in excess of $2,000,000. Preferred-stock holders of the various companies absorbed by the Equity Corporation received securities having liquidating preferences $8,400,000 less than the liquidating preferences of the securities they had previously held. Preferred-stock holders of the various Founders companies which were consolidated to form the present American General Corporation were required to relinquish approximately $4,000,000 in dividend arrearages on their existing preferred stock. In addition, they were required to accept preferred stocks of the consolidated company with a substantially smaller dividend rate than that possessed by the preferred stock which they had previously held.

The recently proposed merger of Atlas Corporation and Curtiss-Wright Corporation is also illustrative of the effect in another direction that voluntary reorganization plans may have on stockholders of investment companies. Under this proposed plan preferred-stock holders of Atlas Corporation, an investment company, will be asked to become preferred-stock holders of a company engaged in the manufacture of airplanes, a radical change from their previous position as stockholders of investment companies.

These examples illustrate the extent and seriousness of the change in the rights, preferences, and values of securities of investment companies held by a large number of small investors which are accomplished by plans of voluntary reorganization.

It is important to note that if these voluntary reorganizations are approved by the required majorities of shareholders, minority stockholders—unless they exercise certain remedies which will be described later and which are generally beyond the reach of the average stockholder—will be bound by the will of the majority.

As now drafted section 25 prohibits the solicitation of proxies, consent and authorizations to voluntary and involuntary reorganization plans, the submission of such plans to United States courts and the approval of such plans by such courts until a declaration with reference to such plans has been submitted to the Securities and Exchange Commission and has by order of that body become effective. The Commission can refuse to permit a declaration to become effective only if the plan is not fair and equitable to all classes of securities affected thereby, is not feasible in the case of a plan of reorganization, or is inconsistent with the purposes of the bill.

The section also makes provision for the exemption of reorganization plans from the other provisions of the bill if the Commission find that such exemption is consistent with the public interest and the interests of investors, and is necessary or appropriate to the effectuation of the plan of reorganization or offer of exchange. For example, the plan to be fair to all classes of securities holders may require the issuance of preferred stock or even bonds by an investment company. In such cases section 25 permits the Commission to exempt the plan from the provisions of section 18 which prohibit the issuance in the future of senior securities by investment companies.

The provisions of section 25 with reference to judicial reorganization were modeled upon similar provisions in the Public Utility Holding Company Act of 1935 and in section 77 of the Bankruptcy Act which requires the Interstate Commerce Commission to approve railroad reorganization plans prior to their submission to the courts.

However, at the suggestion of Senator Herring it is understood that the section is to be revised in the case of judicial reorganizations of investment companies in the Federal courts to provide that the Commission shall merely render an advisory report on the fairness and feasibility of plans of reorganizations. These advisory reports which are in some cases already rendered by the Commission to the courts pursuant to chapter X of the Chandler Act will not be binding upon the courts. However, the Chandler Act makes it mandatory to submit plans of reorganization to the Commission for advisory reports only where the indebtedness of the insolvent company exceeds $3,000,000 although the courts may submit plans to the Commission for advisory reports in any case. It is proposed in this bill that the courts will be required to submit to the Commission for advisory reports suggested plans of reorganization for investment companies irrespective of the amount of outstanding indebtedness of such companies.

In the case, however, of voluntary reorganizations which are consummated outside of and beyond the supervision of the courts, the Commission urges that the present provisions of section 25 be allowed to stand. The safeguards erected for investors in judicial reorganizations do not exist in the case of voluntary nonjudicial reorganizations. The differences in the protection afforded to investors in the two types of reorganizations will be described later.

(1) *The approval of voluntary reorganizations by Government bodies is not without precedent.*—Mr. Quinn, of Tri-Continental Corporation, in his testimony suggested that the provisions of section 25 of S. 3580 insofar as they apply to voluntary reorganizations by investment companies by exchange offers of securities, mergers, consolidations, sales of the entire assets of such companies to other companies, and recapitalization plans were unprecedented. In fact, similar provisions already exist in three States so that this section marks no new departure in administrative law.

The California Securities Act (laws of 1917, ch. 532), enacted as long ago as 1917, contains in section 4 the following provision:

"Pursuant to this Act the Commission has been and is authorized in the instance of an application for a permit to issue securities in exchange for one or more bona fide outstanding securities, claims or property interests, or partly for cash, to approve the terms and conditions of such issuance and exchange and the fairness of such terms and conditions, after a hearing upon the fairness of such terms and conditions, at which all persons to whom it is proposed to issue securities in such exchanges shall have a right to appear."

The South Carolina Securities Act laws 1937, Act No. I, section 11 provides:

"The commissioner is authorized and empowered on application to consider and to conduct or hold hearings upon any plan of reorganization or recapitalization of a corporation organized under the laws of this State, or domiciled or having its principal place of business within this State, proposed by such corporation or by its stockholders or creditors by which proposed plan of reorganization or recapitalization it is proposed to issue securities in exchange for one or more bona fide outstanding securities, claims, or property interests, or partly in such exchange and partly for cash, to approve the terms and conditions of such issuance and exchange and the fairness of such terms and conditions after a hearing upon the fairness of such terms and conditions, at which all persons to whom it is proposed to issue securities in such exchange shall have the right to appear; also to approve fair and reasonable terms and conditions for any resale of such securities issued in such exchange to the end of preventing fraud or deception in any such exchange or the resale of any securities so issued in such exchange."

The West Virginia Securities Act (W. Va. Code (1931), ch. 32, art. I sec., 11), although not an approval statute permits the securities commissioner to make changes in any plan of recapitalization and reorganization which he deems necessary for the protection of investors. The act provides:

"Securities issued or to be issued to the security holders or creditors of any person in the process of a bona fide reorganization, recapitalization, merger, rearrangement of capitalization, or any other plan or proposal for the readjustment of the business of such person * * * shall be registered as provided * * * by this article.

"Registration must be made prior to the time of the solicitation and prior to the offer or proposal of any plan * * * to the security holders or creditors of such person.

"* * * The commissioner may also require information about or related to any plan * * * and the commissioner may rsquire any change to be made in such plan * * * he deems necessary for the protection of the interest of investors."

Mr. Quinn of Tri-Continental Corporation in his testimony before this committee asserted that the determination of what was a "fair and equitable" plan was a matter in the sole discretion of the Commission.

Mr. Quinn, however, ignores the fact that the elements of a "fair and equitable" plan of reorganization have been defined with considerable precision by the courts in the field of judicial reorganizations (*Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106 (1939)), and in the field of voluntary nonjudicial reorganizations by mergers, consolidation, sales of all corporate assets, and recapitalizations. See part III, chapter IV, of the Commission's Report on Investment Trusts and Investment Companies; and part VII of the Commission's Report on the Work, Activities, Personnel, and Functions of Protective and Reorganization Committees.

Section 25 of the investment company bill does not give the Commission arbitrary powers. Its orders promulgated pursuant to that section are reviewable by the courts. The principles enunciated by the courts for determining the fairness of plans thus constitute precedents which the Commission must follow if applicable to the facts and circumstances of the plans scrutinized by it.

B. THE PROTECTION PROVIDED FOR INVESTORS IN JUDICIAL REORGANIZATIONS

Under the Chandler Act investors and creditors of insolvent companies in reorganization obtain the protection of (1) full disclosure including in certain cases an advisory report by the Securities and Exchange Commission on the fairness and feasibility of proposed plans and (2) independent scrutiny of the fairness of the plan by the court. In general, the Chandler Act requires the following procedure: Plans are submitted to the court and those plans which the court deems worthy of consideration are, if the indebtedness of the company exceeds $3,000,000, transmitted by the court to the Securities and Exchange Commission for our "advisory" report as to their fairness and feasibility.

After the submission of the advisory report, the court must independently approve the plans. Thereafter the plan is submitted to the creditors and stockholders affected for their approval or disapproval. No solicitation of proxies or consents is permitted until the court has approved the plan and ordered its transmittal to the creditors and security holders affected, accompanied by the Commission's advisory report and such other documents as the court may determine. The investors affected are thus given the advantage of full disclosure and impartial analysis of the fairness of the plan. Following the approval of the plan by the required vote of the creditors and stockholders, a hearing is held to confirm the plan. At the hearing objecting security holders and creditors may oppose the plan. The plan becomes effective only after it has been finally confirmed by the court after such hearing.

Mr. Quinn of Tri-Continental Corporation in his testimony before the committee professed to find something novel in section 25 in that such section permitted the Commission to override the "democratic" rule that the will of the majority without interference shall govern the minority. Nevertheless the courts in reorganization proceedings are required to scrutinize a plan of reorganization for its fairness even though it has been approved by the required majority of creditors and security holders entitled to vote on the plan. If the plan, although approved by the majority, is unfair in the opinion of the court, it must refuse to confirm the plan. In its most recent pronouncement on the subject, the Supreme Court has stated: [1]

"* * * Where a plan is not fair and equitable as a matter of law it cannot be approved by the court even though the percentage of the various classes of security holders required * * * for confirmation of the plan has consented * * * Accordingly the fact that the vast majority of the security holders have approved the plan is not the test of whether the plan is a fair and equitable one. * * * The contrary conclusion in such cases would make the judicial determination on the issue of fairness a mere formality and would effectively destroy the function and the duty imposed by the Congress on the District Court under sec. 77B. That function and duty are not less here than they are in equity receivership reorganizations where this court said 'Every important determination by the court in receivership proceedings calls for an informed independent judgment.'"

To sum up, in judicial reorganizations investors obtain the protection both of full disclosure and independent scrutiny of the fairness of the plan.

C. PROTECTION FOR INVESTORS COMPARABLE TO THAT IN JUDICIAL REORGANIZATIONS DOES NOT EXIST IN VOLUNTARY REORGANIZATIONS

In the case of voluntary reorganizations investors in investment companies usually have at present neither the protection of full disclosure nor of independent scrutiny of such plans. With the exception of the three States which have approval statutes, the fairness of plans of voluntary reorganization and recapitalization are subjected to no governmental scrutiny. Nor is any disclosure of the nature, terms and effects of such plans on existing securities generally required. The Securities Act of 1933, although applicable to exchange offers of the securities of one company for those of another effected by the use of the mails and the facilities of interstate commerce, is not applicable to mergers, consolidations, and sales of corporate assets effected pursuant to the provisions of State laws. Recapitalization plans by which new securities of an investment company are exchanged for its existing securities are subject to the provisions of the Securities Act only if remuneration is paid for the solicitation of such exchanges. The Securities Exchange Act of 1934 requires full disclosure in connection with plans of voluntary reorganization only in the case of securities listed on national securities exchanges. However, over 75 percent of existing investment companies with assets aggregating $1,769,000,000 at the end of 1936 had no securities listed or admitted to unlisted trading privileges on national securities exchanges. Thus, investors in investment companies owning a substantial amount of the total assets of the investment company industry are without the protection of the disclosure provisions of either the Securities Act of 1933 or the Securities Exchange Act of 1934 in connection with the merger, consolidation, recapitalization of their companies, or sales of their assets.

The State incorporation and blue-sky laws almost uniformly do not include within their provisions a requirement of full disclosure of the terms and conditions of mergers, consolidations, sales of assets, and recapitalization plans.

Thus, at present, managements are comparatively free to propose to the stockholders and to consummate unfair plans of voluntary reorganization, unless restrained by the courts—a remedy which for most stockholders is largely theoretical. The unfairness of the plans need not be disclosed and scrutiny of the plan by an independent body is nonexistent. In the past many investment company managements have utilized such plans to further their own interests to the detriment of the stockholders. Numerous examples may be found in part 3, chapter IV, of the Commission's report. Two examples may be given here. In September of 1931 National Securities Investment Co., a company sponsored and controlled by A. G. Becker & Co., Inc., of Chicago, had net assets of $11,000,000. It had outstanding preferred stock entitled to a liquidating preference of over $13,000,000. The common stock thus had no asset value. Two-thirds of the common stock had been acquired by A. G. Becker & Co., Inc., at cost of $1,900,000. This stock (which represented control of the investment company) A. G. Becker & Co., Inc., offered to sell to Atlas Corporation for $1,900,000.

However, Atlas Corporation refused to invest $1,900,000 in this worthless stock unless A. G. Becker & Co., Inc., agreed to aid Atlas Corporation to purchase or acquire in exchange for its own securities, the preferred stock of National Securities Investment Co. for a total consideration less than the asset values of such preferred stock. This the banking house agreed to do, it being understood that Atlas Corporation would pay the $1,900,000 for the banking firm's common stock

[1] *Case* v. *Los Angeles Lumber Products Co.* (308 U. S. 106 (1939)).