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STATEMENT OF CHARLES B. ENGLE

of Engle, Adams & Co., Denver.

My name is Charles B. Engle, of Engle, Adams & Company in Denver.

We are essentially a distributing house upon the national scene.

My partner and I have had over 20 years experience in the securities business, although our firm is only slightly over seven years old.

We have never in those seven years, been an underwriter, in a nationally distributed corporate issue.

On January 11, when I addressed a letter to Mr. Frank, asking permission to either file a statement in the record or appear and make a statement, I stated that I felt our set-up represented the small houses throughout the country, who were serving individual small investors, largely on a personalized basis, and in accordance with that request, I prepared a statement in Denver based essentially on this release of the 19th, which is naturally in our files -- 19th of December, that is -- because I had not seen then the complete report of the division.

Now I have brought that statement of mine down here from Denver.

Certain phases of it would be very repetitious.

I have included some very simple incidents in my own

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personal life to illustrate what I consider the principles involved of competitive bidding.

I want to file this.

I would appreciate if the Commissioners will look at it.

But there is one thing in this statement of mine which I feel should be emphasized, and that is the question of how compulsory competitive bidding would affect the smaller cities and the smaller investors in those cities, and with your permission, I will read certain parts of this.

It is my conviction that thrift still deserves a high place in our national planning and that it should be given encouragement. One distinct method of encouragement is to make available to small communities and small investors the securities of those companies which have earned national recognition for successful operation under demonstrated managerial ability.

What is termed "private placement" has materially reduced the amount of high grade bonds which individuals, trusts, insurance companies, endowment funds and banks may obtain and this applies especially to the smaller cities. Should competitive bidding be made mandatory the supply of desired securities will be further decreased if not entirely stopped.

Under negotiated underwritings --

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Chairman Frank: Will you explain why, in your opinion, that is so?

Mr. Engle: Yes, sir. It is my opinion, sir.

Chairman Frank: For instance, have you considered the bonds that have been sold competitively -- utility bonds -- in New England states. Has it been true that less of those go out to the small investors than those issues that have been negotiated. I am asking you as a matter of information.

Mr. Engle: All I can say is that I have never -- our little shop has never had a wire to the best of my knowledge and belief on any of those competitive issues from New England.

Now, I will grant you that some of those issues, normally wouldn't amount to much, anyhow, disguised as such, but even on the Boston Edison where the amount was over \$50,000,000, as I remember it, under a negotiated underwriting I think that the wires would have come into our community.

Now, some of the utility houses in Denver might have had such wires. We didn't.

Chairman Frank: Is it the implication of your remarks that private ^{and} [price] placement would be augmented by competitive bidding.

Mr. Engle: Well, I have a little more there that I would like to submit now.

Chairman Frank: My supposition would be to the

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contrary, that perhaps there is some likelihood that private placement would be reduced as a result.

In other words, that where today a few larger insurance companies, ^{by} means of private placement, as we are told, absorb all of an issue, that there might be a liability of a larger portion of desirable issues finding some part of their distribution with a smaller institution throughout the country.

Mr. Hilliard: Mr. Chairman. Could I possibly give just a little piece of information there.

In municipal sales in the middle west, where competition is very heavy, private placement by indirection has been not an infrequent occurrence.

That is, a dealer has been unwilling to meet the competition and to put in a bid unless he has a whole issue sold at one particular place.

Chairman Frank: That hasn't been altogether unknown in the case of negotiated issues either, has it?

Mr. Hilliard: No sir, but I say it is a very frequent happening in our country, where the competition in municipal issues is very great.

Mr. Engle: I have a couple of illustrations here which I believe reflect the feeling of my country at least. Under negotiated underwritings, the investment house and investors in the smaller centers have access to the securities so underwritten.

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When an issue is of particular interest to a particular area, that area is recognized in the distribution.

Two issues privately negotiated were of great interest to the Denver area.

A liberal opportunity was afforded to our investors to obtain these issues when originally offered, but under competitive bidding, I question if any of the securities would have been obtainable.

Chairman Frank: Well now, why? What experience have you to lead you to that conclusion.

Mr. Engle: : I have some figures here -- not trying to postpone an answer if you please.

Chairman Frank: That is all right. You answer it in your own way.

Mr. Engle: On June 9, 1938, \$27,750,000 Mountain States Telephone & Telegraph Company, three and a quarter percent debentures were publicly offered.

That was \$30,000,000 authorized as you may recall and the dividend went into the pension fund.

Now, Poor's Institutional Holdings of Securities for 1940 shows \$20,822,000 of this issue was held by 66 institutions, of which 39 held \$100,000 or less. These holdings were scattered from coast to coast and my computation shows that six of the so-called big seven life insurance companies among themselves owned between \$11,000,000 and

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\$12,000,000.

Now, I have a note here, admitting it is my understanding that this issue would not have come under the proposal, although it is illustrative.

It is not clear in my own mind, and I admit it, as to whether the communications systems would be effected or not.

Chairman Frank: No.

Mr. Engle: It would not.

Chairman Frank: Our statute relates solely to gas and electric utility companies.

Mr. Engle: Well, I have a gas and electric one.

On November 28, 1939, \$40,000,000 Public Service Company, of Colorado, first mortgage three and a half percent, bonds were publicly offered.

Now, Poor's Manual for 1940, shows twenty-four million plus of this issue was owned by 118 institutions of which 89 held one hundred thousand or less.

These holdings also were scattered from coast to coast and six of the so-called big seven owned eleven million and a half.

In the first case, the big insurance companies, as I compute it, and maybe I don't understand who the big seven are, but my computation showed that forty-two percent was held by so-called big group there, 33 percent was owned by sixty

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other institutions with the balance of 25 percent presumably in the hands of all other investors. In the second case the big six owned 28 percent of the issue, 32 percent was owned by 112 other institutions with the balance of 40 percent presumably in the hands of all other investors. Contrast these figures with the very great probability that under competitive bidding 100 percent in each case would be in the hands of a group of life insurance companies not exceeding 12 to 15 in number, because as I understand competitive bidding, a group of life insurance companies would be permitted to bid if that issue had been placed on the auction block.

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Chairman Frank: So could a group of small institutions.

Mr. Engle: Well, \$40,000,000, still, of course, out our way, that is quite a lot of money.

Chairman Frank: It is around here, too.

Commissioner Healy: Let me ask you: When that issue of Public Service of Colorado was registered, wasn't there in existence a writing under which the Company undertook to give one firm of perpetual bankers a first call on all issues of that company?

Mr. Engle: I don't know; I can't answer that. Stewart & Company were the underwriters that we got our allotment from, and I can't answer that question.

We felt that the issue was set up properly. It was fairly priced on the market at that time and we did know that our people out there were interested in the name and we were provided and they can still have access to those bonds on the market if they want to pay the current price, and I feel very definitely that this statement of mine reflects the sentiment of our community, because I have discussed it.

I have discussed it with our investment houses out there and I have discussed it with our banks.

Now, as a -- the question of shutting the door -- I mean these two names are interesting to our country -- in our country out there, and I say it because they are high rated bonds that I believe -- under competitive bidding -- that I believe that

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they would have been absorbed by a small group in the East, and our people could not have had them.

Now, I would like, with your permission, to submit a paragraph from a letter addressed to Mr. Frank from the Denver Clearing House Association, dated January 13. The paragraph reads:

"There will be a further definite threat to the ability of our member banks to obtain eligible issues for their own portfolios and trust accounts under their control.

"Compulsory competitive bidding would result, we believe, in the best names being absorbed by small groups of large Eastern banks or insurance companies, whereas, under current conditions, an opportunity to obtain such issues is customarily afforded."

Now, the president of the Denver Clearing House Association told me that he wanted me to state very clearly that the question of that absorption by large Eastern banks was not intended to infer that the banks would bid direct, because there would be a very great question of their eligibility under certain circumstances, under the question of marketability, if they were to count in their own portfolios.

With that qualification -- now, I would like to read the final paragraph of this statement of mine:

The small investment house is not opposed to proper regulation of the securities business.

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We have -- and I believe small investment houses in many states have -- cooperated in passing sound laws relating to the issuance and sale of securities in the statutes of their states, but we feel, and I believe they feel -- I have "warranted" in there; I think that is rather a weak word -- I feel I would like to use a stronger word; I would like to say "impelled" -- in voicing objection to the present proposal which would directly penalize the small investment houses and small investors throughout the country.

I would appreciate very much, gentlemen, if you would read that through.

It is a simple little document from a small dealer in a small town.

Commissioner Healy: Have you got a number of copies of the document?

Mr. Engle: I think I have about two carbons.

Mr. Weiner: Mr. Engle, we have had a number of letters from Denver dealers.

The others haven't specifically asked to be heard here.

Would it be fair to assume that you represent their sentiment?

Mr. Engle: I think I stated that I feel that I reflect the feeling of the dealers very generally in Denver, because I have discussed that with them.

Mr. Weiner: You have talked with a good many of them?

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Mr. Engle: Yes.

Mr. Daley: I presume, Mr. Engle, that you are familiar with the first \$10,000,000 Colorado highway bond issue, and then the second \$15,000,000 Colorado bond issue, both of which were sold competitively.

The first one, three firms were bidding for it. I have forgotten the number on the second issue.

Do you happen to know what proportion of those Colorado highway bonds found its way into the accounts of Colorado investors?

Mr. Engle: No. I have no way of knowing that. I think that you headed that account. You would have that.

Mr. Daley: There was a very substantial amount, wasn't there?

Mr. Engle: I think, in fairness on that situation, that you should say that you had a commitment from one name in Denver for a very substantial amount of those securities before you submitted your bid.

Mr. Daley: You are telling me something that I didn't know at the time, but the fact is, isn't it, that a very substantial part of that issue did find its way into Colorado territory?

Mr. Engle: I think initially, yes.

Mr. Daley: And it was sold through competitive bidding, is that correct?

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Mr. Engle: That is correct.

Chairman Frank: Thank you very much.

Mr. Spencer: I thought this might be an appropriate time,

Mr. Chairman --

Chairman Frank: Come up here, Mr. Spencer; we can't hear you.

I have heard that those in the back of the room have a little difficulty in hearing, so I suggest that everybody speaking from now on talk a little louder than normally.

STATEMENT OF GEORGE O. SPENCER

Assistant Director, Public Utility Division

Mr. Spencer: We receive a great many letters, as has been indicated this morning, from small dealers, in which they almost unanimously said that they felt that their position under competitive bidding would be worse off than under private deals, and used as an illustration their actual experience in municipal dealings, so, in order to try and find out something about it, I spent three days -- which admittedly is an inadequate time to cover such a broad subject.

The first thing that I found out was this, that municipal deals as such rarely if ever have a selling group organized by the manager of the deal.

The reason for that being that municipal issues as a rule are serial issues and it is practically impossible to allocate serial issues.

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Mr. Stewart: May I ask, Mr. Chairman, whether that would be the view of the municipal dealers?

I doubt whether it would be their views.

Mr. Spencer: That is what was told me by the municipal dealers and, among others, Mr. Sylvester of your organization.

Mr. Stewart: I would question that, unless we have Mr. Sylvester here.

Mr. Spencer: All right.

Chairman Frank: Is there an issue of veracity?

Mr. Stewart: Not an issue of veracity, no. As to whether the fact that there are serials of municipals is the reason for not forming a selling group.

Mr. Spencer: I talked with 15 or 20 of the principal municipal underwriting houses, and they all gave that as one of the principal reasons why they did not organize a selling group and why the commitments with municipals were joint and not several, so that the liability of various underwriters was not discharged when they took their percentage of the total issue, but remained until the whole thing was disposed of.

Mr. Stewart: Isn't it a fact, Mr. Spencer, that the large New York City issues have not been serials but have been corporate stock, long term bonds?

Mr. Spencer: As I said, three days is not enough to completely exhaust the issue and, in the last two or three issues, they were serials and in the story of those particular

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deals, that was the information given me.

Mr. Scribner: I think that I would like to say here ^{are not yet available} that our house in 1938 and 1939, (1940, figures, purchased more individual issues of Pennsylvania municipal issues than any other house in the country. ✓

We never formed a selling group on any of them. The reason we didn't was because competitive bidding gave us a gross profit which did not justify our forming a selling group.

Mr. Spencer: I was coming to that point next, and that is that municipal deals as a whole averaged much smaller than corporate deals with which we have been familiar during the last five years.

Consequently it is perfectly possible for the small dealer and the small underwriter, organized groups, to buy two or three, or a million, dollars worth of bonds that have a local appeal and, inasmuch as the spread in municipal securities is so narrow, the tendency is to keep it all to themselves and not redistribute it.

However, in the large issues, where it is necessary to get the help of the underwriting firms that have at their disposal large sums of capital, we find that they take down bonds and then sell them, either to the ultimate consumer or through dealers, depending upon their own method of doing business.

For example, one house gave me some figures of eight deals

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which added up to \$104,000,000.

Their share of that \$104,000,000 was \$5,800,000. They sold \$6,200,000, and of that \$6,200,000 they sold to dealers \$1,757,000, or about 28 per cent of what they sold went to dealers.

Some other underwriters who do not depend upon dealers, would not make nearly as much -- nearly as large a percentage available to dealers.

In fact, one of the houses, after an investigation, where they have a large distributing organization of their own, told me that, as a result of the investigation he made for a day or so, that not over 15 per cent of their commitment was resold through dealers.

Another organization told me about 25 per cent was sold through dealers.

Another organization, that is a very large factor in the municipal field, that has a large distributing organization of its own, but who is dependent upon dealer good will, made available between 40 and 50 per cent of their commitments of municipals to dealers.

So it is almost impossible to generalize as to whether or not a particular issue will be made available to dealers or not.

Those houses depend upon underwriting and those houses, the impression that I receive is that those houses who are

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dependent upon dealer good will make it a matter of policy to give dealers a share in the fast moving deals as well as in the deals that don't move so rapidly.

So much for the municipal sales and the amounts that are available to dealers.

While I was in New York I took an opportunity to canvass what had happened in the 16 deals that we mentioned in the report of the New England securities that were sold competitively and --

Chairman Frank: (Interposing) You mean New England Utilities?

Mr. Spencer: New England Utilities, yes, sir.

The Boston Edison deal was mentioned. It is interesting to find that in the First Boston Edison deal, five years ago, about 20 per cent of the issue was offered to a selling group comprising 276 names.

Of those 276, 256 absorbed all that were offered.

In the group last month, the offering was made, ⁴⁰ between ₁ four and five hundred deals, ^{ers} and 320 accepted an opportunity to resell at the dealers commission, which I think was list less a half in both cases, and there again --

Mr. Stewart: (Interposing) May I ask a question? I think it is a fact, on the second issue, that the bonds were offered through subscription.

It was somewhat different from the usual practice.

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Mr. Spencer: Yes, but the facts remain that between four and five hundred small dealers -- that is, talking about a man that doesn't care to risk his capital in an underwriting enterprise -- between four and five hundred of them had an opportunity to initially participate in Boston Edison deal.

320 of them accepted and took about 20 per cent of the issue.

I think that those that didn't initially accept had an opportunity later on.

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Mr. Stewart: May I also ask this, Mr. Spencer, have not, unfortunately, subsequent events proved that the Boston Edison issued was overpriced?

Mr. Spencer: I think so, yes.

Mr. Stewart: Which goes to show that there is always lots of opportunity to get an issue that is overpriced?

Mr. Spencer: I am merely saying that initially they sold at the offering price less 1/2 and 320 dealers accepted.

Mr. Stewart: And the allowance to the dealers was less than the normal allowance?

Mr. Spencer: Yes, the spread was rather narrow on that, as you will recall.

Now, take another issue some years ago. You have a situation similar to that prevailing in the municipal field. It was a much smaller issue. There were about \$20,000,000 of bonds involved, and no selling group as such was formed. One of the underwriters who took a substantial amount of the bonds but who was dependent, as I said a moment ago, on the dealer goodwill, resold about half the bonds that he took, to dealers. Another one of the underwriters, a house that falls into the group of having good retail distribution and capital that they are willing to risk as underwriters, and so obtained the maximum profit on the deal, they could never take more than they feel they can dispose of themselves, that house took all of the bonds that were given them and bought some more bonds and did not sell a

single bond to a dealer because that particular deal happened to be a good deal.

Now, something was said a moment ago when the deal is a little sticky, the small dealers have plenty of opportunity to buy them. Again, in one of these competitive issues where the group was almost identical, the house that I spoke of a minute ago that took all of the bonds and sold them all to their own customers had no concession in this second deal, and they kind of felt atremble, they wanted to get out, in which event they sold something of the order of 30 per cent of their commission to dealers.

In privately negotiated deals, one house that is very prominent --

Mr. Stewart: (Interrupting) Are you still talking of the municipals?

Mr. Spencer: No, I am talking about corporate deals now. They have offered dealers varying percentages from as little as 27 per cent to as much as 73 per cent of the issue in the initial offering. Another house that bought a deal in competition which was a fast moving deal, nevertheless they initially offered over 50 per cent of the issue to dealers as distinguished from their partners in the underwriting. In half a dozen other issues in which they were the leading underwriter, they offered to dealers privately negotiated somewhere between 30 and 35 per cent.

Now, we can generalize as to whether the dealer is going to be worse off one way or the other, and I think it is a very

difficult thing to do. The indications are that it will depend somewhat upon the type of the house that is successful in purchasing the issue. If it is a house that has little distribution of its own and wishes to stay in business, it has just as much necessity, it would seem to me, and the facts seem to bear out, to retain dealer goodwill whether they make their commitment on the auction block or whether they make their commitment on a privately negotiated deal. If the deal happens to go to a house that has very substantial retail distribution, then the chances are that they will keep more for themselves, and that is borne out in the municipal field, as this gentleman just indicated where he and some others bought municipal deals and kept them all for themselves.

Mr. Scribner: May I ask one question of Mr. Spencer?

Chairman Frank: Yes.

Mr. Scribner: Excuse the interruption, but in talking of corporate securities, you said that the house which has the largest retail distribution will tend to keep more of the issues for themselves. I fully agree with that. Doesn't that logically follow then that the house with the largest retail organization would be in a position to bid higher because they could work without having to allow a wholesale profit to others, that being true by virtue of the fact that it would keep more for itself and less would go to the smaller dealer?

Mr. Spencer: I think you have got to take a broad picture

and again look at the house, because the illustration that I see here is -- if a house is going to keep its participation within the limits of what it expects to be able to sell at retail, then there will be very little reason for letting the dealer in. On the other hand, if you take a house which wishes to do a two-barreled business, a retail and a wholesale business, there will be just as much, in my opinion, just as much reason to make bonds available to dealers whether they acquire them on the auction block or whether they do not, and within the time at my disposal that seems to be what is indicated, because I talked to the members of these Municipal Departments, and they all said, "Why, yes, we must keep the dealers' goodwill. We are in business and we spend any amount of money in cultivating dealers in telephoning and telegraphing to dealers and our business is not confined to deals that we originate, we do a very large over-the-counter business", which again would be distributed through dealers, and they say, "If we expect to maintain their goodwill, we have got to let them have the good things as well as the bad ones".

I do not think there is anything else.

Mr. Stanley: (Statement inaudible.)

Mr. Spencer: In half a dozen issues in which you were good enough to give me the figures, we had a variation in 27 per cent and 73 per cent.

Mr. Stanley: It of course depends on the size of the

underwriting, but in the aggregate in our issues, I may say about half were sold to the selling group and about half to the underwriters.

And may I say something more about the people who have not got a selling organization? As far as we are concerned, we have not changed our method of selling, but conceivably under other conditions, it may be necessary for us to do so.

Mr. Stewart: I do not wish to interrupt, Mr. Chairman. We did not finish under Item 2 but we moved over into another subject, and I wonder if you will agree that we should finish on Item No.2?

Chairman Frank: Before we do, it seems fairly obvious that we are not going to be able to finish tomorrow, and we will go on tomorrow. But I have a note here from Mr. Ecker, Vice-President of the Metropolitan Life Insurance Company, who is here, which asks if it is convenient that he would like to go on this afternoon, as he has an engagement which will prevent him being here tomorrow. Although it is disjunctive.

Mr. Stewart: If you will let Mr. Drayton speak, that will finish Item 2.

Chairman Frank: I just want to be sure that Mr. Ecker will have an opportunity to speak.

Mr. Stewart: Yes. Mr. Drayton.

STATEMENT OF G. W. DRAYTON,

Insurance Co. of North America, Philadelphia.

Mr. Drayton: My name is G. W. Drayton, and I am Vice-President

of the Insurance Company of North America. If I might just qualify myself a little bit not so much to rest on my own glory but to show you that I am associated with some other people, our company was organized in 1792 and I am in charge of their portfolio of about \$120,000,000. In addition, I happen to be Chairman of the Finance Committee of the Peoples Hospital which has some \$3,000,000, and a director of the Corn Exchange Bank in Philadelphia, and on their Trust Committees, and also on Home for Incurables, and I happen to be a director of the Utility company which recently had a couple of financing deals, so I have seen something of that side, because I was fairly active in them.

First I want to say that I think that this report -- I have never met Mr. Weiner, but I think that he has gotten up a very wonderful report which I have read over, and except for a few facts on which we differ very materially, I would come to the conclusion that he does but my experience leads me to a little different angle.

First of all, I think a criticism might be made that this report is written as of business conditions today and today only. We have had very very different conditions in the last 20 years, and I have been in the investment business since 1915, as a seller to 1927, and from that time on in the buying end, and I think that he has rather taken the present situation where we have had an advancing market and a pretty high market for a number of years.

On that basis, as far as municipal bonds go, from my experience I think that so far as competitive bidding is concerned, equipment trusts selling should be optional with the railroads, but mortgages and debentures are very different things from our standpoint. To properly investigate an issue, I think requires a very large sum of money depending upon the issue at stake. We might take a quarter of a million or a half a million with the parent company and varying amounts in other companies.

We have looked in the past as we will in the future, a great deal to the underwriting house. While the Securities and Exchange Commission as presently constituted is very much like Caesar's wife, above suspicion and they are going to go on for a long time, you gentlemen won't live forever, and corruption has gone into various branches, and if you were the sole decider as to whether an issue was proper or not -- not this present Commission but perhaps others -- I think great evils might occur from that.

Much has been said here of the secondary market. I do not have any figures to give you as to how many times a 30-year issue turns over -- probably twice or three times. Now, in these committees that I am on, we have probably four or five hundred meetings year all for the purpose of investing money or deciding whether our investments are in proper form. I do not want to get into too controversial an issue, but almost every time we speak about some issue that has been outstanding in the market, the

point comes up "Who is the issuing house?". I do not say that all houses are not good nor do I have any evidence to bring before you that any house is bad, but the buyer gets the idea that there are varying degrees of caveat emptor in the attitude of different houses as they issue their securities, and I think one thing you have got to think about very carefully before you give up the present relationship between the banker and the issuer in utilities is, - has the utility no right at all to consider who the doctor should be and his reputation?

We recently had this piece of financing, and I would just like to spend a second on that. It was a little bit involved. There was a first mortgage falling due and there were men on the board with investment experience who felt that due to recent rulings of the Federal Power Commission it could not be re-financed. We went into it at great length, and the underwriting house was very helpful, they were familiar with our situation and had been for many years, and we finally issued a bond that was at a very fair rate -- I think the company got a good price for it, and it took in the market so well and was so well accepted that very shortly after that we were able to refund another issue.

That was very much in point. If the issuing house had not had knowledge and confidence in it, they might conceivably have had the thing done in the way that one of the directors wished to do, to have the mortgage extended when it fell due through bank loans. I was very much opposed to that and I was very glad it

worked out the other way.

So that when you eliminate the issuing house, the utilities choosing their issuing house bear in mind that while the reputation of your own commission here, as I have said, is of the highest, in the years to come -- remember that these bonds run 30 years and even longer -- people will be meeting and going over and considering whether to buy secondary mortgage bonds or not, and possibly a great deal of the credit of the utility in question will depend upon how the buyers view the house that issued it and how much money and time they spent going into it. That was taken up but I think it was passed over a little bit too lightly from the buyer's point of view. We think a great deal of the people who bring out the issue, and we know something of the time and trouble they spend on them. That will be all gone if securities are sold in competitive bidding. We will look only to the Securities and Exchange Commission, and on that I would just like to say -- this may be going pretty far afield, it may seem so to you gentlemen, and I have no direct proof nor can anyone be arrested for it, but a bond house in dealing with a person who is unfamiliar with securities in his verbal talk has been known to go fairly far -- and he again as you may find much to your surprise may verbally -- and I realize that he can probably be arrested for it -- but bond salesmen will take the attitude that if the thing has been through the Securities and Exchange Commission, that is the end of it and it is perfectly safe and

they will probably be going out and telling their customers or leading them to believe that it is a government obligation. You may believe that is quite far afield, but it is not, and it would ^{not} take them very long to --

Chairman Frank: (Interrupting) It would not take us very long to find it out and do something about it ourselves.

Mr. Drayton: I think things said verbally are pretty hard to tie down. That is a point that would come up.

Chairman Frank: There are a fair number of gentlemen in jail at the moment for doing that same thing.

Mr. Drayton: And despite this report, there are a great many gentlemen still in business who are doing pretty much that very thing.

(Laughter.)

Mr. Drayton: There may be collusion between the issuer of the bond and the utility company bringing it out, in other words, the arm's length thing seems to me to be of great importance, and I do not say that there is an intimation here that the utilities are allowing someone something or paying someone something sub rosa to do things, but the arm's length attitude is undoubtedly entered into to prevent any relationship between the house of issue and the utility company.

Chairman Frank: I think you misunderstood if you think that there was any imputation of dishonesty. It is true that the statute does seem to enjoin upon us to see to it that there is

arm's length bargaining. One of the reasons -- which has not been brought out here at all today but which I trust will be brought out tomorrow -- one of the reasons suggested for the competitive bidding rule has nothing whatsoever to do with prices. It has been assumed throughout the discussion that the sole reason urged for competitive bidding is to procure the best price, the highest price. That is not all by any manner of means. There is another consideration which has not anything to do with dishonesty and has to do with whether the utility company -- the question has been raised by the staff -- whether a utility company as matters stand today is getting the opportunity to get different kinds of judgment as to what would be the best type of securities to sell, whether it ought to refund at a given moment having refunded two years before, whether it ought to be selling entirely bonds to do a refunding job or a new construction job, or bonds and preferred and/or common stock.

Those considerations have nothing to do with pricing. There is no imputation of dishonesty, but the question is raised whether you have, as there seems to be in some situations and one that Judge Healy referred to this morning, a situation where one banking house has a corner on the business of a certain company, and reference was made to the Colorado Public Service, and where therefore no other banking house can be consulted whether the best advice as to the type of security is being procured by the utility company. There is no imputation or indication that anybody is being dishonest; it is just a question of whether

the notions of competition which govern in a good part of the business world should not have some application to this part of the business world.

Let me ask you while we are here, a stupid question. The suggestion seems to be that if there is full and unrestricted competition in this business, that the consumer, in this case who is the investor and not the consumer of the article -- is going to be injured. Let us apply that particular principle generally. Then our whole competitive system must be a great injury to the consumer, if I follow that. Perhaps I am being over-logical. It must also follow if I understand it, that where there is competitive bidding in the world outside of investment banking, the person that bids is likely to bid so high that he is not doing a good job for himself unless he can pass on the headaches which he buys. If that is true, I should think that the contracting business would be completely busted because contractors bid on buildings daily. I do not see that they over-price their bids so that all of them are in bankruptcy; on the contrary they seem to be some of them in pretty flourishing condition, - some in as flourishing a condition as some people in the investment banking business might well envy them.

Mr. Drayton: You take the view that it is merely a commodity like oranges or eggs?

Chairman Frank: No. I say, is the situation fundamentally different from the point of view -- from Mr. Stewart's suggestion

it was that we discussed the second point -- overpricing -- and I thought that we were addressing ourselves at this moment to that question, and my question was whether restricting ourselves solely to the question for a moment, why is it that you get a danger of overpricing with the investor when you are dealing in securities and not in connection with the other matters? Why does the principle of free and open competition which is the notion of free enterprise in this country, why is it inapplicable to the securities business?

Mr. Drayton: I do not think I can give you a very good answer, but the fact is that ^{to} most people -- I am not trying to be facetious in this -- a security is a very mysterious thing. I do not think that your vast majority of buyers -- not the big life insurance companies, but the average investor -- they want a certain color of bond --

Chairman Frank: (Interrupting) A color?

Mr. Drayton: The ignorance, or the lack of time that people think they can spend on investing their money without losing it is very remarkable. I have spent a great many years in this business and I think I know whereof I speak. To them an issue is a very mysterious thing. The investor is terrified when he sees it go down and he thinks there is something about that issue that he does not know is going to happen and he feels that he is losing his entire principal.

In overpriced issues, there are going to be mistakes -- wars

are going to break out -- you can not avoid declines, naturally. But on the whole, I can not believe that overpricing works to a company's benefit. If the X company brings out an issue at too high a price, whether I buy them or not and I have the feeling the next time they bring it out that it is too high and that it is a company that always tries to get the highest price and I will wait until it breaks. The investment houses know the feelings of people and therefore he makes a lower bid.

Chairman Frank: Then there would not be any danger of overpricing because he would get his fingers burnt once or twice and not continue doing that.

Mr. Drayton: I am referring again now to the company. The company makes \$1,000 or \$10,000 more by that action, but I think that they will lose \$20,000 or \$25,000 by their bad name on the next issue. You will find in certain issues, I think you will find the expression used, "We will have to make this one attractive, the boys did not like the last one, and we will have to make this one attractive to make it go". That means attractiveness in price.

Commissioner Pike: As I see it, you reason just the way I think of that. In the eagerness to go out and get the first lot, they overbid. And then the next time they underbid. And before it has gone on very long, they will find out pretty near what they should bid, and we have the pricing just about the same way as we have it now. I think the logic follows that naturally if

this rule went into effect and some ardent advocate of competitive bidding just wanted to show what he could do, he would probably get the first issue, like somebody wants to buy the prize steer at the show, and he might overbid a couple of points. I agree with you that he won't repeat that mistake many times. I also think, if I understood you correctly, that after you have had two or three experiences and maybe gotten your fingers burnt a little, that you are apt to get about to as close as what the price ought to be, just as you do now. I think that is what you said?

Mr. Drayton: No. I said that the net result to the company, in my opinion -- to the issuing company -- would be that they would get less actual dollars in the two or three issues if they had a bad one, and the total amount be less. And if we go back to the market of the 1920's and take the municipal obligations, my experience in a very minor way in the industry was that issues got bid up so high that they finally flopped over.

I think if you get this competitive bidding in utilities you will have the same thing. Mortgage bonds and debentures, I think are very different than municipal obligations and equipments. People realize that in municipal obligations it is more a question of price. The equipments are pretty much on the same basis, - their history has been extremely good, but it is very difficult to apply the same thing to debentures and mortgage debt, even of utility companies. I think some of these things

are of importance to the investor. You just want to keep the discussion to the overpricing?

Chairman Frank: Yes, at the moment. We will be glad to hear from you later on on other subjects. If you wish to suspend here, I have no objection, but I would like to hear from Mr. Ecker because he has made the request.

STATEMENT OF F. W. ECKER,

Vice-President Metropolitan Life Insurance Company.

Mr. Ecker: As requested by the Commission, I wrote a letter under date of January 18, 1941 on this subject. I have here some extra copies of that if the Commission would care to have them.

It was our feeling that as a fairly substantial investor, we had a certain responsibility to express our views on this subject. Our views are fairly exhaustively expressed in this letter, and I will endeavor not to repeat although the subject has been so thoroughly covered that this is going to be rather difficult.

But to sum up, at the beginning it is our feeling that to compel competitive bidding on these issues would not be in the interests of the investors, in fact we really feel that it would be doing them a disservice.

As has already been said, we share the view that what this tends to do is to have the issuer write his own ticket. Now, I am not unaware and I am quite appreciative about the safeguarding

by this Commission of the interests of the investor. I am quite appreciative also that there have been a number of occasions in which they have been most helpful and have insisted on certain provisions which were protective of the investor's interest going into those issues which probably would not have been there otherwise. At the same time, from the broad aspect we feel that it relieves the real responsibility of the investment banker. It can well be argued that he still has the responsibility legally, but the Commission obviously can not take that responsibility, and we feel that the investment banker is not in a position to argue in setting up the issue from the standpoint of his clients. The issue is set up in advance of his getting into the picture.

We therefore feel that the tendency would be that the investment bankers would become largely a group of pencil sharpeners to see the highest price that they could bid, and that might well in turn lead to certain of the evils of high pressure salesmanship.

Chairman Frank: We are supposed to be here to see that high pressure salesmanship does not lead to this consequence.

Mr. Ecker: I know, Mr. Chairman, that is so and undoubtedly you will fulfill that duty to the best of your ability, but, of course, you are only human. We deal with a great many issues in this country, and I respectfully must disagree with that point of view.

Chairman Frank: Remember now that we are talking solely of utility issues of public utility holding companies registered, and their subsidiaries.

Mr. Ecker: I understand.

Chairman Frank: And the question is whether high pressure salesmanship will result in that contingency? Has it in the case of the utility issues that have been sold out of New England where competitive bidding is required? Has it been true there, has there been high pressure salesmanship there?

Mr. Ecker: I would not be at all surprised if in some of these issues that have not gone well because the educated investors had not bought, that there was high pressure salesmanship and an attempt to move out of the liability. I don't know, I am not in that business.

Commissioner Pike: Do you suppose that there is any more than in the case where there are sticky goods on the shelves?

Mr. Ecker: No, Mr. Commissioner, I think there are more apt to be sticky goods in a rising market. Speaking on the matter of prices, I practically consider it of secondary importance to the other points that I am endeavoring to make. I think in a rising market, the issues are apt to be overpriced, and in a falling market they are apt to be underpriced.

Commissioner Healy: You spoke a moment ago, Mr. Ecker, as I understood you at least, about the beneficial results that would follow from scrutiny of the underwriter. Was that your point?

Mr. Ecker: I feel that there is a responsibility and that he does fulfill a purpose and there are beneficial results to the investor from his being in that position, yes, sir.

Commissioner Healy: Now, I would like to ask you this, - how many millions of dollars worth of utility company securities has your insurance company bought in the last two or three years where there was no underwriting and when there was a direct private placement with your insurance company? Do you feel that in those instances you lost the benefit of those functions, of the underwriter that you have just referred to?

Mr. Ecker: No, sir, I think we are quite capable of taking care of ourselves. On that particular point I was addressing myself to the public distribution of securities. At a latter part of these remarks, if I may be permitted, I will speak on this subject of private placements.

So that we sincerely feel that the net result of such a ruling would be in the long run a deterioration of the investment banking group to the disadvantage of the investor. Up to this point, most of those in the room here I think have shared my views. At this point I probably depart from their point of view. If notwithstanding the views expressed on this subject to the contrary the Commission feels that competitive bidding must be undertaken, then we would respectfully put before the

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Commission that we believe that an exemption should be made for the purpose of private placement. We believe that private placements make a natural and direct and simple and economical form of transacting business. From time immemorial, the direct negotiation between the borrower and the lender has taken place. It is always present -- not always present, but it is generally present, of course, in such loans as bank loans, mortgages, and other types of security.

Chairman Frank: Do I understand the implications of your remark to be that you do not feel it possible for your company to bid competitively together with a group of other companies if there were required competitive bidding?

Mr. Ecker: No, sir, I do not.

Chairman Frank: You would not so bid?

Mr. Ecker: Oh, no, we would so bid. I would anticipate that we would so bid. Now, this is rather a fine distinction, because I have been talking before from the standpoint of the investors generally, ourselves and others. I think it might well be, as has been pointed out by some of these gentlemen here today, that from our own short term personal standpoint, we would be better able to fulfill our requirements under the system of competitive bidding than we would under our present system, but I am leaving that idea out of my remarks and I am looking to the broad effect on investors.

Chairman Frank: You would not favor --- perhaps this is

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digressing a bit -- but you would not favor an amendment to the Securities Act that would require registration where the securities are bought by insurance companies even though purchased "privately"?

Mr. Ecker: See if I understand you correctly.

Chairman Frank: That is, there has been a suggestion, - you must have heard of it - that it is unfair that the insurance companies should be permitted to buy unregistered securities, and that regarding the insurance company as a collective group of many persons consisting of all of its policy holders, insurance companies should not be permitted through an exemption in the Securities Act to buy unregistered securities, but that securities should be purchased by them and considered substantially the same as if they were publicly offered and therefore should be registered.

Mr. Ecker: My view on that, Mr. Frank, is this, that that exemption in the Securities Act was made because it was felt that the Securities Act was there to protect the uninitiated investor, and that the initiated investor did not need that protection, that he could make his own investigation. Therefore, I would not think that such registration were necessary. I would think that the more comparable thing would be that if all corporations that had any securities dealt in by the public at all, that they might be required to register if it was seen fit, after appropriate hearings before Congress and so forth, - if Congress

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decided to extend that legislation that far, but for the purpose of private placements where there is no public buying involved, I do not believe that is necessary.

Now, to return. As I think I have already intimated and as is well known, Congress has recognized this matter of private placements and the propriety of it in both the Securities Act and the Trust Indenture Act. The real advantage involved to both parties which would be eliminated in this particular group of issues if an exemption were not provided for. It seems difficult to follow the reasoning in the report on this particular point because presumably one of the objectives is to preserve and increase competition, and yet one place where competition stands out is in these private placements, and that competition would be done away with.

Commissioner Healy: I do not quite follow you. Are you intimating that possibly competitive bidding would do away with private placements?

Mr. Ecker: Well, it was my understanding that, as recommended by the Division, there was no exemption of private placements if their recommendations were carried through. I favor such an exemption if competitive bidding is to be insisted on. I hope it will not be insisted on.

Commissioner Healy: If it is insisted on, then what is your position?

Mr. Ecker: Then I believe there should be an exemption

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for private placements.

Commissioner Healy: If the bonds are privately placed, there should be no competitive bidding?

Mr. Ecker: That is correct. In the same manner as the competition for 10-year unsecured bank loans, as in the original draft.

Commissioner Healy: I wonder where the elimination of competitive bidding in respect to private placements would lead us? Wouldn't that carry us to the point of saying, I assume, that only one insurance company would be allowed to bid for issues being privately placed?

Mr. Ecker: I do not believe I get your question, Judge Healy.

Commissioner Healy: Well, if you eliminate all competition in connection with issues privately placed, that simply means what insurance company has the inside track, doesn't it?

Mr. Ecker: Oh, no, I am not referring to an insurance company; I am referring to the view that the issuer would be permitted to have his choice, as today he exercises that choice, whether he will obtain his funds through the means of a private placement or through a public distribution.

Commissioner Healy: Assume that he makes his choice in favor of private placement; what competition then results?

Mr. Ecker: The same competition that there is in private placements today.

Commissioner Healy: What do you conceive that to be?

Mr. Ecker: All other investors who are so situated -- of course, that makes a difference. It depends on the particular issues, Judge. There is, of course, competition with investment bankers, and there is competition between insurance companies.

Commissioner Healy: Do you visualize that competition between the private buyers continuing?

Mr. Ecker: Yes, sir.

Commissioner Healy: In the form of shopping around?

Mr. Ecker: I think an issuer should be left free to choose whatever method he feels is in his interest to pursue in that particular case.

Commissioner Healy: That would not carry you to the point of saying, would it, that he could be free to negotiate with just one insurance company and not any other?

Mr. Ecker: If he felt that it was easier for him to do business that way and that he would get an appropriate price, I would see no objection to that, no.

Commissioner Healy: Well, have you intended to cover or have you covered this matter? I would be interested to know your ideas, as to whether the enforcement of the competitive bidding rule would tend to increase or diminish the volume of private placement?

Mr. Ecker: Well, if the rule were carried out as recommended

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by the Division, as far as this particular group of securities were concerned, it would eliminate private placement because it so provides.

Chairman Frank: You want to be sure that it does not?

Mr. Ecker: That is correct.

Chairman Frank: That is, if there is anything implicit in the proposed rule, you would like to make it explicit that we should exempt private placement if there is to be such a rule?

Mr. Ecker: Right.

Commissioner Healy: Is that one of the points where you think perhaps your point of view would be in conflict with that of the investment bankers?

Mr. Ecker: Yes, sir.

Commissioner Healy: We have assumed that he did not like private placements.

Mr. Stewart: May I ask Mr. Ecker a question?

Mr. Ecker: Yes.

Mr. Stewart: If Mr. Ecker is not going to be here tomorrow, I think it is important that we ask him this now, because it seems to me that this whole question of private placement goes directly into the question as to whether or not there is domination by investment bankers over the issuers. Your company has, I think, purchased a great many issues of public utility companies directly from the issuers?

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Mr. Ecker: Yes, sir.

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Mr. Stewart: Did you think that those issuers were under domination of the investment bankers who prevented them from doing business with you?

Mr. Ecker: I think the answer is obvious that they were not.

Mr. Stewart: The statement has been made by the staff that there is banker domination of these companies, and it seems to me that one of the most striking evidences of the utter and complete absence of that domination is the very fact that the private placements took place, and I should like to make that clear on the record.

Mr. Ecker: It is one of the real competitive situations that exist today, and this recommendation of Division 4 would remove that competition.

Chairman Frank: In other words, you think that private placement ought to be retained as a means of competition, is that right?

Mr. Ecker: I think that is true, Mr. Chairman, for various reasons.

Mr. Stewart: Unfortunately, Mr. Ecker's proposal would insure competitive competition for investment bankers but not very much competition for the insurance companies.

Commissioner Healy: That is the point that I am very much interested in, as to whether you would not get more real competi-

tion if the investment bankers and the insurance companies were competing against each other for these issues. If you give a complete exemption for private placements, I do not quite see how that kind of competition could exist.

Mr. Ecker: Judge Healy, one point that I would like to make clear; I make this differentiation that in the case of private placements, we can sit down and negotiate with the issuer and set up such safeguards as we feel are necessary and appropriate, and one of the things that I fear is that over a period of time the issuer would tend to write his own ticket and the type of issue would deteriorate.

Chairman Frank: Mr. Ecker, our experience has been in several instances at least, that there have been private placements composed where the bond ratios were considerably higher than we felt desirable, indicating that the insurance companies were less regardful of an adequate ratio than we. Indeed, testimony -- not testimony, but comments made by prominent insurance men at a symposium in this city sometime ago indicated that the insurance companies because of their need for acquiring bonds were buying bonds on a basis that they themselves considered considerably short of what was ideal, and I think that the private placement situation indicates that we are more regardful of what are adequate bond ratios, in some instances, than the insurance companies buying at private placement.

So that I see little indication from our own experience that there is likely to be a deterioration, for remember that even if there is a competitive bidding rule, that is not going to do away with the application of the standards of our Act or the use of these standards. When you say that the issuer is going to write his own ticket, not while this Commission sits.

Mr. Ecker: Mr. Frank, each one of these particular issues must be judged on an individual basis.

Chairman Frank: Indeed.

Mr. Ecker: I respect your opinion, and on this point I just disagree with you.

Chairman Frank: I say that our experience has demonstrated it. We have had issues where insurance companies were willing to take them on private placement where we have exacted more rigid standards than the insurance company did, and there are quite a number of those, which, as I say, go to show that there is not likely to be a deterioration but the contrary on that while this Commission sits in the standards that it will impose pursuant to the statutory standards, and they will be on the whole not below what the insurance company will require on a private placement if there were no Commission.

Mr. Ecker: I just repeat what one of my predecessors has said, namely, that this Commission does know their business, but this is a long term business that we are talking about.

Chairman Frank: We are talking about a rule to be put into effect, and if it works it will work, and if it does not, it does not. If you make the assumption that you have, Mr. Ecker, that the Commission will deteriorate, then if it does then this whole matter of utility regulation will be in a very unfortunate condition. We do not think we can proceed on that assumption.

Mr. Ecker: I am not laying my case on that, Mr. Frank, I am laying my case on the fact that in our judgment the investment banker does perform a real service. It is not possible, I believe, for this Commission to negotiate all of the issues that will be put out over a period of time. It just is not humanly possible.

Chairman Frank: We do not negotiate them, but we do very carefully scrutinize them.

Mr. Ecker: Who is going to negotiate from the standpoint of the investor, then?

Chairman Frank: By "negotiate", you mean impose standards protective of the investor? And then I repeat my statement that our experience demonstrates that we have, -- and we have been criticized for it -- we have imposed more rigorous standards than the investment banker or the insurance company has been willing to impose, in many instances.

Commissioner Healy: Do you know who induced the American Gas & Electric Company to transfer part of its debt claim against the Appalachian Company into common stock?

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Mr. Ecker: No, sir.

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Chairman Frank: Was it the insurance company in that instance?

Mr. Ecker: I am not familiar with the case.

Chairman Frank: That happened to be a public offering. It certainly was not the investment bankers. They were ready to take a deal that was far less protective of the investor than the one that finally went out.

Mr. Ecker: I have already said and I would like to repeat that I appreciate the work that has been done by the Commission in protecting the investor, and I will repeat that just as strongly as I can, but that does not change my point of view one iota on the broad principles involved and on what I think may happen over a period of time.

I would also point out that there is considerable difference in the issues, and the more junior the issue becomes the more difficult it becomes to set up any standard set of appropriate provisions.

Mr. Fournier: In response to an earlier question as to, in the event that the proposed rule should become effective, whether or not the Metropolitan Life Insurance Company would bid, I believe you replied that probably they would. Then I understand Judge Healy asked you a little later if you expected -- whether you believe that the private placements in the event of

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competitive bidding would increase or decrease, and I believe you replied that there would be no placements under the rule?

Mr. Ecker: I do not think that is correct. If that is what I said, I did not understand his question the same as your question.

Mr. Fournier: I want to ask you again in a slightly different way. I should like to know in the event if there were competitive bidding rules for public utility securities whether you anticipate that the volume of public utility securities, not the number of issues but the volume taken up by the insurance companies through direct bidding would tend to increase as against the amount which would be publicly distributed through underwriters and dealers?

Mr. Ecker: You mean direct bidding in competitive bids?

Mr. Fournier: Successful bids.

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Mr. Ecker: Yes, I think they probably would increase.¹⁵⁸
I think we would probably get a larger share.

Mr. Fournier: Then how do you reconcile that with your other statement that you anticipate that in the event competitive bidding went into effect, over-pricing would likely ensue?

Mr. Ecker: I think there are times when we have a pressure to put out funds, and I think we would be in a position to fulfill our requirements in the best of the issues by merely gauging the market and paying 1/4 or 1/2 a point higher, and over a long period of time, a 30-year bond, that extra half a point would not be terribly important in the yield.

Mr. Fournier: In the event that issues were over-priced as a general practice, and they were sticky, wouldn't you anticipate that the insurance companies would have no difficulty in filling whatever requirements they would have by simply staying out of the bidding and waiting?

Mr. Ecker: That has taken place at times.

Chairman Frank: Is there anything further that you want to say, Mr. Ecker?

Mr. Ecker: Yes, I would just like to finish in only a moment.

We do feel that the investment bankers play an important role even in the matter of private placements. At times, you know, they act as a middle-man - broker - and serve as an

adviser to the issuer and also to the purchaser. Generally speaking, this is one house which is the underwriting house, or at least the leader in the underwriting group - the distributor's field is another field. I think that service is to the investor in their community. They do not fulfil a very economic need, as far as our purchases are concerned.

Commissioner Healy: There was one point that you made a little earlier; I am not quite clear what your position on it was.

Mr. Ecker: I would like to make it clear.

Commissioner Healy: I did not quite catch what you said, but it was something in the direction of favoring some sort of universal registration?

Mr. Ecker: I did not say that I favored universal registration. I said that I could not see the logic in my own interpretation of that portion of the Securities Act which exempted private placements. My understanding of the reason for that was that the Securities Act was written to protect the uninitiated investor. The writers of the Act, and Congress when it passed it, recognized that there were situations of the initiated investors who did not need this protection.

Commissioner Healy: Would you favor the situation under which all corporations of a certain size with more than a certain number of public security holders whose securities are dealt in from day to day, either over the counter or

elsewhere, should file certain types of financial information with the Commission and keep it current from year to year?

Mr. Ecker: Judge Healy, I don't know that I want to answer that question right now. I have not given a great deal of thought to that, and it is a pretty broad question. It goes a great deal further than just the subject that we are discussing here today, I think. In general, I do believe in full disclosure and full information to the public and to the buyers of securities.

Commissioner Healy: Perhaps I misunderstood you. I thought you did say something along that line.

Mr. Ecker: What I did say along that line was that if the point of view was expressed that that was the view held, I could see more logic to that than the requirement that all new issues of securities be registered even though they were purchased privately.

Commissioner Healy: Do you recognize the possibility that some of these bonds that you buy without registration, which are privately placed, may at some time subsequent to that time come into the general field of interstate commerce?

Mr. Ecker: I recognize that possibility. I doubt whether it is a probability.

Chairman Frank: Has it not occurred with your investments in railroad bonds?

Mr. Ecker: Not as far as I know. You may be better

informed on that subject than I am. As far as our own purchases are concerned, we have never re-sold a privately purchased issue.

Chairman Frank: But you have re-sold issues that you have purchased?

Mr. Ecker: Oh, yes, but not private placements.

Chairman Frank: But the volume of private placements has greatly increased in recent years, so that the past would not necessarily govern the future. What Judge Healy is inquiring about is whether, in view of the fact that you have sold railroad securities in former years that you have purchased, whether there is not some likelihood that in the future you may need to dispose of utility securities that you have privately purchased?

Commissioner Healy: Even assuming that you do not dispose of them, isn't it your point of view that it is desirable that you own in your portfolio securities that are marketable?

Mr. Ecker: Yes, but we have so many securities besides those that are purchased privately, that I think that we have ample marketability in addition to those.

Mr. Stewart: I think it is true that a good many of the insurance companies have sold quite a substantial amount of rail securities in recent years. I wonder if it is not true that if the insurance companies decide that the outlook for the utilities which they purchased privately, might change,

that prudence and good judgment would compel them to sell them, even though they had been purchased privately?

Mr. Ecker: I think that is a possibility; I do not think it is a probability.

Mr. Stewart: Perhaps not so much with your company as with some of the smaller companies that have purchased them.

Mr. Ecker: That is possible.

Chairman Frank: Have you anything further, Mr. Ecker?

Mr. Ecker: In conclusion, I was just going to say that we believe we understand and are sympathetic with the Commission's problem in this matter, but that we do not feel that it should be attacked in this way, that it does require a difficult procedure on your part, but that the appropriate way to attack it is on a judgment on the facts as to whether or not arm's length bargaining is present, and not to use this means of solving your difficulty, which I believe would not be to the interest of investors generally.

Commissioner Healy: May I ask one more question?

Mr. Ecker: Yes, sir.

Commissioner Healy: If this competitive bidding rule were put in force, and if there were no exemption or exception in favor of the private placement, what, in your judgment, as to its effect on the amount of bonds that you would be able to purchase?

Mr. Ecker: I think that we would be able to purchase

more bonds at the issued price than we are today. We would make the issued price ourselves under those circumstances, and of course buying for investment, we would not have to count on the spread that the investment banker must count on for his distribution.

I think I might also like to add at this time the personal view of this matter of private placements. Although I believe it is economically sound, I think it has been used to a greater extent because of the special conditions of the last few years than would be the case under normal markets.

Mr. Stewart: Might I ask one more question, Mr. Ecker?

Mr. Ecker: Yes, sir.

Mr. Stewart: There has been competitive bidding in municipals and in railroad equipment trusts. I know that probably you have bought a great many equipment trusts through dealers, but I believe the fact is that you have not bid directly for municipals, isn't that so?

Mr. Ecker: We have on occasion. We have generally used the method which has been referred to here, that a dealer comes in to us with the knowledge that he can immediately resell, and consequently can operate at a very small margin of profit.

Chairman Frank: If we are going on tomorrow, it seems to me that it might be helpful to orient the discussion tomorrow if we heard now from someone who had some first-hand experience on the operating end of the utility business. Mr.

Chamberlain is here. Would you care to discuss it?

Mr. Weiner: Mr. Chairman, I would like to ask Mr. Ecker a question, inasmuch as he won't be here tomorrow.

Chairman Frank: Yes.

Mr. Weiner: It is our understanding that in the A.T. & T. private placements, two insurance companies did not participate because of the existence of a common director between the particular insurance companies concerned and the A.T. & T. Am I correct in that?

Mr. Ecker: That was true in our case, I know.

Mr. Weiner: I wonder whether you regard that type of situation as fair either to the issuer involved or to the insurance company involved?

Mr. Ecker: No, I do not. I do not think that having one director is indicative of any improper control, and consequently I think it is to the disadvantage of both parties to construe a law or rule as rigidly as that.

Mr. Weiner: I do not know that anybody construed the law in that case.

Mr. Ecker: The A.T. & T. did, I presume.

Mr. Weiner: That I do not know, but would not that type of problem --

A Voice: (Interposing) It was based on policy only.

Mr. Ecker: I am sorry; my counsel here corrects that statement. It was based on policy and not law.

Mr. Weiner: Would it not be desirable to eliminate the possibility of that kind of problem arising, either as a matter of law or policy, through competitive bidding, whereby no such consideration could be charged fairly as having been brought into there? In other words, if this had been a matter of open bidding, would it not have been, then, perfectly clear to all parties concerned that your company, or anybody else concerned, despite the existence of a common director, had both morally and legally been on that issue?

Mr. Ecker: I don't know. I know in the case of equipment trust issues, we have refrained from bidding in at least one situation which comes to my mind because of a director -- we refrained from bidding direct on that equipment trust issue.

Mr. Weiner: As I recall the railroad situation, in so far as the law is concerned, the provision of law is that if you have your interlocking directorate, you must have competitive bidding. Isn't that the Clayton Act provision?

Chairman Frank: Section 10 of the Clayton Act.

Mr. Stewart: There are a number of people in the room who have not had an opportunity to be heard, who obviously can not be heard today. I wonder, before you adjourn the proceeding, if you would just permit them to say what their views are in one word or two words before they go?

Chairman Frank: Yes, indeed.

Mr. Chamberlain, will you proceed, and before you go on, would you mind stating to the stenographer what your position as an executive of issuers has been?

STATEMENT OF WILLIAM CHAMBERLAIN

Formerly Vice President and General Counsel of United Light & Power Co. and its Subsidiaries, and later President of those Companies.

Mr. Chamberlain: Mr. Chairman, I must disavow any right or intention to speak as an issuer, as I no longer have any connection with any issuer except as a director. I was once an executive of issuers, and for a long time I was counsel for issuers. At the present time I have no active duties in respect to any corporation or the issuance of any securities, so such views as I may express are merely those of an individual who has had some experience and some opportunity for observation, and who at the present time is in a modest way an investor and who must find his means of livelihood in the safety of such investments as he can find and make in the market.

I have been somewhat impressed with the thought that this discussion has not yet reached the primary purpose which I understand to be sought by the staff in its recommendation. If I have correctly interpreted the report of the staff, which I have read twice with care, the primary objective is to create a situation which the staff does not believe to presently

exist, that is to say, to create competition between what I may call primary underwriters, originators, the managers of underwritings, the people, in other words, who negotiate and are supposed to negotiate with issuers and carry out the purchase contract in respect to which they later organize syndicates.

Mr. Stewart: I wonder if I might ask Mr. Chamberlain a question.

When you were president of the United Light & Power Co., did you sell your issues by competitive bidding?

Mr. Chamberlain: Not that I recall.

Mr. Stewart: You had a regular underwriter with whom you dealt?

Mr. Chamberlain: Well, we had quite a number of underwriters with whom we dealt.

Mr. Stewart: With whom, chiefly, did you deal?

Mr. Chamberlain: Mostly with Bonbright & Company.

Mr. Stewart: Did you have any other underwriters?

Mr. Chamberlain: Later, the last two or three years, we had a good deal of our business with Otis & Co.

Mr. Stewart: Thank you.

Mr. Chamberlain: But since that question is asked, I may perhaps be privileged to say that I have never had, and I do not now have any interest in any underwriter. That, perhaps, will answer your question better than the direct

answer. And I have no interest in it now.

As I interpret this report, in connection with the Act of Congress, it has been deemed in the public interest that there should be open, direct and independent competition between primary underwriters. Now, I do not, of course, in any way mean to underestimate the importance of the matters that have been discussed today, but they are, I think, incidental to the main question; in other words, it is said, "If you do this thing, if you create this competition between primary underwriters, you hurt the investor; if you force this competition between primary underwriters, you hurt the small dealer".

Those are, without a doubt, matters of importance, but they are incidental to the main issue.

Mr. Stewart: I am sorry to interrupt, but if I may crave your indulgence just so that there will be no misunderstanding of our purpose, since those in the room generally have not seen this rough paper which this side has prepared as the basis for an agenda, I should like to make it perfectly plain that the agenda as set out contains our suggestions, first, for an exploration of the question as to whether competitive conditions exist in the investment banking business as now organized. For the underwriting and distribution of public utility securities; and, secondly, another item of the agenda, an examination of the question whether there is --

Chairman Frank: (Interposing) Mr. Stewart, I do not think it is necessary for you to make this statement. The witness is not under cross-examination. You can bring out your point later. I think Mr. Chamberlain should be allowed to proceed unless you have some specific question you want to direct to him. If you have some answer to his comments, the Commission will be delighted to hear from you at length. May I suggest that you allow Mr. Chamberlain to go on until such occasion arises as when he makes some statement where you want to ask a proper question.

Mr. Stewart: I assumed that you are having a public conference and an informal procedure.

Chairman Frank: Yes, but I think your manner of approach at the moment is approaching heckling, which has not been indulged in up to now. If you want to ask a question at some appropriate time as to some matter that Mr. Chamberlain states, well and good, but if you want to disagree with him, you can do so. He has said nothing which justifies your interruption.

Mr. Chamberlain: If I may be permitted to suggest to Mr. Stewart, it is possible that before I have concluded I may cover the matters which he has in mind. I was attempting to resume as nearly as I can.

I think the staff felt it to be its duty, if I have correctly analyzed its report, to first ascertain whether such

competition as the law contemplated and contemplates does presently exist between primary underwriters. That requires an examination of the facts and a finding in respect to the facts.

Then, of course, if it does not exist and this Commission deems it to be its duty to cause it to exist, if it can do so, the whole thing might come to an end, but if the Commission, having found that it does not exist, concludes that if it should bring it into existence it would do additional harm to other people, and it had discretion in the matter, then it might go on into these incidental and collateral matters.

I therefore propose to discuss first what I consider to be the primary question.

The finding of the staff is clear and scarcely subject to misinterpretation. I read one sentence from page 41, and then I propose to read another sentence from pages 9 and 10.

In its conclusion upon page 41, the staff says:

"The investment banking business is characterized by concentration of management and underwriting of new security issues in the hands of a relatively few firms and by a definite absence of free market competition."

Now, as I conceive it, there is a finding, a finding that this Commission, I think, must feel itself definitely under the duty to make under the statute.

Chairman Frank: You understand, of course, that the Commission has not made that finding. That is the staff's opinion.

Mr. Chamberlain: Certainly. I am speaking only to the finding of the staff. And I do not propose, Mr. Chairman, to attempt to support this finding. I only propose to call attention to it in the course of what I have to say.

On page 9, the Commission sets forth a finding, and I read it as follows --

Mr. Stewart: (Interposing) May I ask that that statement be corrected?

Chairman Frank: The staff has made the finding.

Mr. Chamberlain: The staff.

"Since its formation in 1935" - a firm which is mentioned - "alone has managed nearly 81 percent of all first-grade, managed registered bond issues. Similarly, since its founding, that house has managed 100 percent of the registered, first-grade, manufacturing and communication bond issues, and 70 percent of the similar public utility issues."

There would seem to be some support for the finding of the staff that there is a heavy concentration of its business if these figures are to be accepted as true, and I have heard no one question them here.

Chairman Frank: I am prepared to say in Mr. Stewart's behalf that he has witnesses who may challenge that, or at

least want to discuss it.

Mr. Chamberlain: Yes. I now propose to speak as an issuer, that is to say, as one who must of necessity from his experience feel as an issuer feels.

In the business conducted by public utilities, every consumer that we serve lives his life under conditions of open competition. That is true in respect to the professional men, it is true in respect to merchants, the laboring men, craftsmen, and certainly true in respect to agriculture.

What we pay for money affects the charge that we make to those consumers. The price we pay enters directly into the rate that they must pay, and I for one can see no reason why these consumers, in that portion of the charge they pay for service that represents the use of money, should not have the advantage of competition just as much as anyone else. After all, we do maintain in this country what we are pleased to call a free economy, and a good many of us have had a great deal to say about it in the last 8 or 10 years, but I do not concede that a free economy is achieved by a free economy which applies only to a part of the people of the United States, but does not apply to a certain other part of the people, and oftentimes it has seemed to me that those who most loudly demand a system of free economy are most reluctant to apply it to their own enterprises.

Now, I go further. I think it is of vast importance in

the maintenance of a free economy to have a reasonable number of strong, vigorous and openly competing primary underwriting houses, and without encumbering this record, I think I can make that very clear, and very easily.

After all, we are a great industrial nation and we must have, and there is a constant demand for, new capital. Now, what an intolerable situation it would be if there existed in this country only - and I say this only by way of an example, you understand, and only to make the example - if there existed in this country only one great, strong, primary underwriting house. It is not an exaggeration to say that that house could direct the complete development of the nation; it could say that I could have money and it could say that my competitor could not have money, and it could find many reasons for that. It could say who could deal in securities.

And I have thought as I have listened to these smaller dealers, what an intolerable life they would lead if we came to a situation where we had, say, only one or even two working in concert, great primary underwriting houses. Then those houses could say to any one of those dealers precisely what he could have in the way of securities to sell, they could withhold securities from him, and they could say in what issues he might participate, and if he had spent his lifetime building up a substantial and honorable business, in the untrammelled discretion of one individual they could take his

business entirely away from him by refusing him the right to participate in the selling of groups of security issues.

Of course, we do not have that one, but certainly there is every reason on the part of Congress to attempt to see to it through some regulatory body that this business does not become unduly concentrated - this business of primary underwriting.

I am glad to have had the opportunity to discuss this, even in this brief way, because of what seems to me to be the curious thing that it has not been mentioned here before by anyone, and yet it is the primary purpose and the primary objective, as I understand it, of this law.

Now, I want to go directly - having attempted to point out in a very brief way the great national value which must inhere in having a reasonable number of capable, strong and vigorous primary underwriting houses - I want to go to some of the incidental evils which it is urged would arise should an attempt be made to force the issuance of public utility securities upon a competitive basis.

They fall, I think, fairly under three heads: One is that the price that the utility would receive for its securities might be too high. Of course, as one who has experience and whose sympathy goes to the issuer, it is a little difficult for me to comprehend this argument, because after all, the only price a utility could receive would be the price

fixed by competition, and that is the price the utility pays for everything it buys; it is the price the consumer pays for everything which the consumer buys. But I have not found it possible to be greatly impressed with the arguments made here today in that regard.

After all, if a banking house or a group of banking houses pays too much, the penalty is its own. No one needs to buy securities from them.

And, as in all competitive effort, very shortly any tendency along that line will be found to correct itself.

Another thing: After all, the price of a security is a fluctuating thing. It must always be stated as of a date certain, because the market never stands still, so what may be the correct market price of a security today may not be the correct market price a week from today, and there never is a correct market price in a supported market, as was so clearly pointed out this morning by the Commissioner. No one knows this more than an investment banker. In all the years in which I came to the investment markets, I had it borne in upon me that we must get our issues out quickly in order that the banker can dispose of them immediately upon the signing of his commitment.

Now, that was not in the interest of the investor, because the investor is the fellow that gets it and he is the fellow that has it if the market goes down. It was in the

interest of the banker, and I do not say that critically, because after all, it is the business of investment bankers to turn their security issues over just as quickly as they can, but I do say that it is not an argument supporting the contention that the investment banker is looking after the interest of the issuer in respect to this market price in that regard, because he gets rid of it quickly so that he won't have it when the market goes down, and the investor, of course, will have it. And that is the way that it ought to be, because after all, it is the investor that expects to hold it a long time, as Mr. Ecker pointed out, and it does not make so much difference to him, but the investment banker, if he got stuck with it, it might mean his ruin. He is not engaged in the business of investing money, but merely in the business of marketing securities.

Now, I would like to come to the question of indentures. I confess there was some astonishment with which I heard this testimony today as to the virtues of private negotiation as to the investigation and formulation of indentures. I do not say that it does not have a virtue. I do not say that the investment bankers do not render a valuable and useful service in respect to the formation of indentures, but what I do say is that the record of indentures and of securities under the system of private negotiation is certainly not such as to make one suppose that we are going into nameless evils if we depart

from it in the manner indicated in this report.

Have these gentlemen who speak so confidently of the safeguards which come to the small investors under the system of private negotiations forgotten the years 1929 to 1933? Have they forgotten the innumerable bad indentures that came to light, the countless safeguarding provisions which safeguarded no one, the fact of earnings statements so palpably false as to have been impossible?

Commissioner Healy: You say they safeguarded no one?

Mr. Chamberlain: I said there were some that safeguarded no one.

Commissioner Healy: Weren't there many of them that safeguarded the trustee and nobody else?

Mr. Chamberlain: Yes. There were all of those earnings statements that passed through private negotiations which were so palpably false that the slightest scrutiny based upon sound reason must have disclosed their false character. Did the private investors of the United States not buy many hundreds of millions of dollars worth of foreign bonds which, by any process of rational reasoning, must have been known to be obligations which could not be met? All of this occurred under the system of private negotiation, and our memories are so short that we now seek - that is to say, there are those who apparently seek to have us suppose that that system means the path of safety to investors, and another system the path

to ruin.

I have not called attention to these things to revive unhappy memories or to be unpleasant; I have called attention to them, Mr. Chairman, because they are simple truths, and they shed, in my opinion, a vast illumination upon this suggestion that the small investor is to find his protection in private negotiation.

But I might, I think, fairly not have spoken of it at all, because the recommendation of the staff does not contemplate, as I read it, that the issuer or the investor shall be deprived of any valuable assistance that can be obtained from experts, specialists or investment banking houses.

As I read this document, the field is left wide open and the door of every banking house stands open to any issuer who chooses to avail himself of the services of any expert in respect to the security he may wish to issue, and back of it all stands this Commission.

So, if that is true, then there certainly can be no claim that the private investor will be completely deprived of the services of the investment banker. In engineering - that is a business with which I have had a great deal of contact - in engineering it is not an uncommon practice for an engineering firm to design a power house or a structure and then ask leave to bid upon it, and there is no impropriety in it if the bidding is open and aboveboard. I see no reason

why any issuer is not perfectly within his rights in seeking the advice and assistance of an investment banking house and paying for it and later offering that issue at public sale and permitting the investment banking house to bid upon it, and certainly unless I have failed to observe it, in a careful reading of this report, there is nothing in it that contemplates any other policy.

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After all, it is hardly fair as one who has represented issuers, it is hardly fair to assume that it is the intention of the issuer to put out bad bonds. After all, they have to live with the property. The executive who is with it hopes to have a future and a pleasant one. He wants his property to succeed and his credit to be maintained. Nothing is so important to a growing industry as its credit, and it is not fair to assume, I think, that the issuer even if he were permitted to write his own ticket, would set about to write a loose and weak thing that would ruin his credit. In that respect, he has his own interest to serve, just the same as the investment bankers have.

Those are two of the principal evils which as I understand it it is contended will follow if the Commission takes this action tending to prevent undue concentration of the business of the primary underwriters.

I come then to the small dealers. I do not want to pretend to be an expert in that respect, but I can certainly see some advantages to the smaller dealers in this system, which they do not have, perhaps, under a system of private negotiation, and one of these is I think, and I speak now from the experience of an issuer, I think one of the most certain ways to get rid of private placement is to have competitive bidding in the primary sale of securities. After all, I as a director have urged in the past seven or eight years, I have vigorously urged several times,

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that a private placement be sought, and for the perfectly simple reason that it seemed to me that when we could go directly to an insurance company with a high-grade issue based upon our excellent credit, that it would be in a way a wastage of the company's assets to pay 2 percent or 2 points to an investment banker when we could do the thing practically for nothing.

Now if this competition comes into effect and the spreads decline as everyone here seems to believe they will, then you have the one answer possible to private placement, in my opinion.

So I come back, Mr. Chairman, if I may be permitted to do so, to the original premise that it seems to me that the important issue to be first determined here is whether or not there has been or is a tendency toward an undue concentration of this business of primary underwriting, which after all is the basis of all the securities business. I might say and perhaps be pardoned for saying that to me on this record of percentages if they are true, and I of course have no knowledge of that except as is contained in this report, that upon this record of percentages covering a period of five years, it does seem that competition as between originators has not flourished, to say the least.

And in concluding, let me perhaps say this, that I do not understand that what one gentleman referred to as the fierce competition of the market place is the competition that we are

talking about here. I think the competition he referred to is that competition from which men in the private negotiations gain the knowledge as to what they ought to bid. Of course, that is right. They look over all of the sales which are on a competitive basis, you understand, all the sales which have taken place upon a free competitive basis -- they look them all over and determine what they ought to give, but that does not mean that there has been competition as between the underwriting houses themselves for this business.

I think, Mr. Chairman, I think of nothing else.

Mr. Drayton: May I ask one question? As I took rather the opposite side, I would like to know whether, as he was the head of a utility company, whether it was his practice to sell his securities at auction at that time or through private negotiation?

Mr. Chamberlain: That was not the custom then, and in the the ten years that have followed, I have observed a great deal and I have reached certain conclusions, but I will tell you that we sold bonds at public auction, if that will answer your question.

Mr. Drayton: I just wanted to know if that was your practice.

Mr. Chamberlain: I don't know of anyone in those days selling bonds in this sort of competition that is talked of here. I don't know of anyone doing it.

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Mr. Stanley: May I say just one word, because there was a reference by Mr. Chamberlain to the business done by our firm. I would like to say that we intend to have the figures as to the so-called concentration which we would like to present in due course. I might also say that I am prepared and intend to discuss this question of concentration referred to by Mr. Chamberlain, because I understand it is not yet on the agenda?

Chairman Frank: You will have an opportunity to discuss that point.

Mr. Stanley: I might add that in my memorandum furnished two years ago to the Temporary National Economic Committee, I stated that competitive conditions did exist, and I state so today, and I am prepared to go into further details as to how they exist.

Mr. Chamberlain: Mr. Stanley, I hope that you will ^{not} assume ¹ that I have charged you with anything? I am speaking not as to what may be the facts or what you may be able to show to be the facts, but I am speaking as to what the staff has concluded to be the facts in this report. ✓

Mr. Stanley: I quite understand that your reference is to things in the report. My point is that those figures do not go far enough.

Mr. Dean: I want at this time to ask Mr. Chamberlain a few questions, if it is ^{not} too late? ✓

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Mr. Chamberlain: Very well.

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Mr. Dean: When you were an officer of a public utility company, you tried to drive as hard a bargain as you could for the issuer?

Mr. Chamberlain: I tried to get the best price fairly obtainable under market conditions for all the securities I sold.

Mr. Dean: Did you ever feel at that time that Bonbright and Company dominated you?

Mr. Chamberlain: Bonbright and Company dominated me at that time?

Mr. Dean: Yes.

Mr. Chamberlain: No, I cannot say that I ever felt that they dominated us.

Mr. Dean: Did you feel at a later period that Mr. Eaton or Otis & Company dominated you?

Mr. Chamberlain: I thought that Mr. Eaton in a way dominated us, because he was the largest stockholder we had, but his partners continually complained that his interests were so much greater in our business than in theirs that he was over-riding them. The complaint, in other words, was from the other way. I don't know.

Mr. Dean: Did you at any time during that period ask other underwriters to submit bids?

Mr. Chamberlain: I don't think we ever asked underwriters

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to submit bids. I think we discussed underwriting problems with other bankers.

Mr. Dean: Did you sell the securities at prices that you thought were too low from the standpoint of the issuer?

Mr. Chamberlain: Oh, yes, we did.

Mr. Dean: Was it not your duty as an officer to get the highest price that you could?

Mr. Chamberlain: The highest price we could get was one we thought was too low.

Mr. Dean: Why didn't you ask for competitive bidding?

Mr. Chamberlain: What is that?

Mr. Dean: Why didn't you secure competitive bidding?

Mr. Chamberlain: I will have to say to you, - I will have to disavow any right on my part to manage that. I was merely a vice president; I did not handle the finances. I don't know why, but it was not the custom then as you know. This was 15 or 18 years ago and much has happened since then to change my mind. I am perfectly frank about it. I have changed my mind on a lot of things.

Mr. Dean: But you were a director of those companies at the time?

Mr. Chamberlain: Yes, I was.

Mr. Dean: And you would not have voted for a price that you thought was unfair?

Mr. Chamberlain: Oh, yes, I would.

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Mr. Dean: You have voted for a price that you thought was unfair?

Mr. Chamberlain: Oh, yes, I would because we had to have the money.

Mr. Dean: But you could gone to competitive bidding at the time?

Mr. Chamberlain: Possibly so, but what that would have done I don't know, but I want to make it perfectly clear that there are often times when men must pay for money what they think is unfair. I have done it. We have paid 10 percent for money, and let me say to you that despite the belief I once held that it was a great advantage to an issuer to stick to one banker because that banker would then come to his rescue when times got bad, I never had the experience of having a banker come to my rescue at all, and there is a reason for that and I do not criticize bankers for that. I should have known better myself. They cannot come to your rescue when times are bad, because they are just as bad off as you are and sometimes a lot worse. That is not their business; they do not loan money; they simply buy securities when there is a quick market, and I can tell you from 25 years of experience that they do not buy securities unless they deem the market ripe for a quick turnover, and no matter how badly you need the money, you won't get it.

Mr. Dean: If there is no difference in the price here

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between the price that you get for competitive bidding and the price that you get on negotiated sales - and the data on both sides seems to be ⁱⁿ conclusive - if it is your real question here whether or not there is sufficient competition among investment bankers, so that an issuer is free to turn to whatever investment banker it pleases in order to get the possible price for its securities?

Mr. Chamberlain: I did not expect to discuss that particular phase of competition, but I am quite glad to. I think there is some difference. I think a Government might deem it to be its duty to see that free economy were maintained even if both sides to the transaction were willing to close it. In other words, if I am selling the issues of a public utility company and if I insisted that I was going only to one banker regardless of the fact that another one came to me and said, "I will give you more money for your bonds than this banker does," and I refuse to do it, I think it might be a matter of concern to Government under a system of free economy.

Mr. Dean: I think it is, but in the situation where one banker owned all of your stock and dominated you, today that condition could not exist unless it was a holding company.

Mr. Chamberlain: Yes, but you might have a board of directors that came under that; wouldn't you?

Mr. Dean: Well, that would come under Sections 6 and 7 and also under Section 12.

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Mr. Chamberlain: No one could be more kindly disposed toward the principle of Government that resulted in the establishment of a Commission such as this. I think that the small investor has needed its protection for a long time.

Mr. Dean: I am for that 100 percent, and I am for the Commission, and I am for all the laws that they administer.

Mr. Chamberlain: Perhaps I did not understand your question.

Mr. Dean: But it is not possible today for a banker to dominate a public utility company unless he is registered as a holding company?

Mr. Chamberlain: That is the sort of securities that are under consideration here, as I understand it, the securities of registered public holding companies.

Mr. Dean: And it is not possible for an investment banker to be on the board of any public utility company under the Commission's jurisdiction without their approval?

Mr. Chamberlain: I think that is right.

Mr. Dean: So that at the present time there is no possibility of an investment banker dominating the board of directors, is there?

Mr. Chamberlain: Well, I certainly would not say that.

Mr. Dean: How can it dominate it unless by a stock interest?

Mr. Chamberlain: Well, I will tell you that the ingenuity

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of investment bankers is astonishing. (Laughter)

Mr. Dean: Do you think investment bankers are brighter than the management?

Mr. Chamberlain: I have always been impressed, if you want to know --- I am an old fellow now and out of business -- but I have always been impressed with the manner in which the banking interests of New York draw awfully smart youngsters into their service.

Mr. Dean: Isn't that true of the utilities also, and isn't it true of anything today?

Mr. Chamberlain: We get what the bankers don't get.

Mr. Dean: You got along pretty well, didn't you?

Mr. Chamberlain: Yes.

Mr. Dean: In recent years, Mr. Chamberlain, did you personally participate in the preparation of registration statements?

Mr. Chamberlain: Oh, no; thank God.

Mr. Dean: Since the Securities Act has gone into effect, did you personally participate in the preparation of Trust Indentures or qualifications under the Trust Indenture Act?

Mr. Chamberlain: I gave out before that. No, I did not.

Mr. Dean: Do you think it is possible to prepare one of these registration statements and qualify a trust indenture with all of the various investment bankers who might want to participate in it? Do you think that would be feasible from the

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standpoint of being general counsel of the issue, let us say?

Mr. Chamberlain: I have thought so, Mr. Dean, because as I understood the business -- I may be wrong about this -- but I have supposed so, because in the days when I was active, one banking house initiated, or you might say that he worked up the deal, and the other houses went right along with him, and of course all of the dealers would take securities and sell them from any of the recognized investment banking houses, so I have assumed that that condition continued and that they continued to do that.

Mr. Dean: You know today that under the Trust Indenture Act that certain trustees having certain relationships with underwriters would be disqualified from being a trustee?

Mr. Chamberlain: Yes, sir.

Mr. Dean: Now, in getting one of these issues ready, the issuer would naturally want to pick out his own corporate trustee and work out the provisions of the trust indenture and then qualify him under the Trust Indenture Act?

Mr. Chamberlain: I never have supposed that the relationship between the trust indenture and the trustee was so particularly close or so particularly important. Any good trust company I think would serve the purposes of an issuer.

Mr. Dean: But today that trustee might be disqualified if there were certain relationships ---

Mr. Chamberlain: Possibly yes.

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Mr. Dean: So that if the underwriter that was the high ranking bidder stood in certain forbidden relationships to the trustee, they would either have to throw the bid out or throw the trustee out?

Mr. Chamberlain: Here is the way that I have assumed that it work. Let us say that I am an issuer under these circumstances -- I am just applying my old experience. I would of course look at the market carefully to see whether there was a market, because there is no use in going to New York to sell your securities if there is no market; we all know that. Then if I could not satisfy myself, and I probably could not, as to what was the best type of security under the circumstances to sell, I would then take it up --- I am speaking about what I would do if this were in effect --- I would then undoubtedly go to someone whose advice and judgment I valued and with whom I could have pleasant relations, and I would discuss it with them. That would unquestionably as things now stand be an investment banking house. I might discuss it with two investment banking houses and get their ideas, and for that I would be willing to pay of course, because I would not expect them to give me their time without pay. When I had gotten that done, then I would make the decision with their advice as to what sort of security ought to be sold. And I then would register it under such circumstances as to make it right and then proceed with the advertisement of it. That is the way it has visualized

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itself in my mind.

Chairman Frank: Mr. Dean is asking this specific question: A successful bidder under a competitive bidding system might be an underwriting house which had a forbidden relationship under the Trust Indenture with the trustee that had been selected by the issuer prior to the time the bids were let, and Mr. Dean's question is wouldn't that create a great difficulty? I do not think Mr. Chamberlain knows the statute, and I think I can answer by saying that I do not believe it would create any great difficulty, because we have had the problem within the last two weeks of where difficulties arose and the issuer was able to find another trustee. He had to, and he did.

Mr. Dean: But, Mr. Chairman, assume that the letting had been made on the basis of 30-year 3 percent bonds with XYZ as the trustee, and certain people having great confidence in that XYZ trust company had decided to put in a bid knowing that that particular bank being the trustee would have a great effect upon certain investors. Then the investment banker making the highest bid would be found to be in one of the forbidden relationships with the trustee, so we would have to throw out the top bid or the trustee would have to resign. Wouldn't you then have to have a re-letting?

Chairman Frank: I think we are getting down to minutiae of the rule. I think it is unfair to ask Mr. Chamberlain that

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Mr. Dean: I have no further questions.

Chairman Frank: Had you completed, Mr. Chamberlain?

Mr. Chamberlain: Yes, sir.

Chairman Frank: Do you have some other person who were to be heard?

Mr. Stewart: I merely attempted to say a little while ago that we had attempted to discuss the problems ---

Chairman Frank: (Interrupting) I understand. Have you any other people that you want to be heard?

Mr. Stewart: If you will ask those who cannot be here tomorrow to speak now?

Chairman Frank: Will anybody who won't be here tomorrow and wishes to say something now speak up?

STATEMENT OF JOHN C. LEGG, JR.,

of MacKubin, Legg & Company, Baltimore, Maryland.

Mr. Legg: I do not wish to re-open any controversial subjects, and I am going to be very short.

Chairman Frank: Why not?

Mr. Legg: I know that the hour is getting late and that you all want to get away. I have no any brief to file with you, but simply some notes that I made on the train coming over, but in reading this report of the department's there were a few things that I felt I was not in full agreement with that I would like to take up.

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The thing that I hesitated to bring up was the point of whether or not if the Commission should decide to have competitive bidding for holding company bonds, whether or not that might lead to competitive bidding for other securities. I am aware of your explanation and aware of the fact that there is not anything in the Act now which would lead to that, but I have had a long number of years of experience in this business and I know how one thing leads to another.

Chairman Frank: May I just call this to your attention? Under the very Act which we are discussing, this Commission is required to determine whether a security meets the standards of adequate relation to the security structure, to the earnings, or whether it will be detrimental to the investor, and so on, whether the spreads are fair and the like. That statute has been on the books and has been in operation since 1935 - over 5 years - with reference to utility securities, and daily we have been applying those standards. I have heard as yet no suggestion that the same standards be applied to the security companies other than utility companies, so that if you are correct that such an example would permeate to securities of other corporations, it certainly would be very slow in operating, and why it should be so in connection with this particular problem of whether a security should or should not be sold competitively I do not understand.

In other words, we are dealing not with an ordinary corpora-

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tion but a regulated corporation, a type of corporation which has been regulated in this country for many, many years. Standards have been erected by Congress with respect to them. Nobody is suggesting that those same standards be taken over and applied elsewhere, although they have been operated for five years.

Mr. Legg: I have the feeling that because competitive bidding has been so limited that you really have not had enough examples for investors, generally, to know whether or not they think it is a fair thing. You have given a very small number of companies who under your New England laws have to have this competition, but if it works out that you do demand competitive bidding, it would certainly be because you thought it was fair and in the best interests of the public and investors.

Chairman Frank: In utilities.

Mr. Legg: How could it work in utility bonds and not work in other bonds? If a thing is fair for one brand of securities, namely, the bonds or securities of public utility holding companies, certainly that same thing would apply to industrials and general corporate bonds?

Chairman Frank: There are lots of other standards in our statute which Congress has felt were applicable to utility companies, and they have been working out with considerable fairness for five years, and yet no one has suggested that they be applied to industrials. I won't go into the reason here, but

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the long history of public service companies make them unique. The operating companies have monopolies which are granted by public authorities, they are not competitive, they are peculiarly affected with a public interest. The preamble of this statute prescribes wh this type of company is unique. I say if your analogy is correct and if what is done in this field will very promptly be availed of and taken up in the other fields, then it ought to be true, and it is not true that many other things which are uniquely applied in this statute pertaining to public utility companies would be applied to other companies and it has not been done. This applies to registered holding companies and their subsidiaries, which means operating utilities.

Mr. Legg: Suppose you take a direct operating company. If this thing becomes effective, it would not be a very long step to brokers applying it to the operating companies, the direct operating companies.

Chairman Frank: This proposed rule does apply to the operating companies.

Mr. Legg: Then if it goes into that, then what is fair for this particular type of securities would make it fair for other investments.

Chairman Frank: You still have not followed me. I don't know whether you are familiar with the statute we are discussing.

Mr. Legg: I followed you on that.

Chairman Frank: It applies -- the standards I am talking

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about - apply to the operating companies, and yet those same standards ---if you will see our releases, at least four or five times a week we are applying the standards of that statute to operating utility companies in a manner which nobody has been suggested should be applied to ordinary industrial companies. And it has been five years. Why should suddenly the sole concept of competitive bidding be lifted out of the field of utility companies and applied elsewhere when the other standards, to-wit, as to whether a bond is a proper percentage of the capital structure, which we have been applying for five years to the utility companies, why should that any the less be applied to industrials than competitive bidding? I have not heard anybody suggest that it should be applied.

The reason is very clear, and it is that we are dealing with public utility companies which might I name are quasi public. They are affected peculiarly with the public interest. They are not the same as a dry goods business or any other business where men are competing; they have an unique position in our national economy and Congress so recognized.

Mr. Legg: Well, I just wanted to suggest the advisability of compelling a utility company to put its bonds up for competitive bidding. I can give you a concrete example of how that would have acted to the disadvantage of a company that I am familiar with.

Chairman Frank: You are talking of a utility company?

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Mr. Legg: Yes, a utility. Where a small company started about ten years ago and we supplied it with sufficient money necessarily at a high rate of interest -- they were 6 percent bonds -- I think it was 6 percent -- until that company could start its operation. It grew and the demands for money grew, and several times in the last ten years we have been called on to supply money to the company to take care of its growth. Because we were very close to the company, had seen it start and knew the management and its territory, we continued to inspect its properties and familiarize ourselves with the operation of that company. It involved an inspection trip certainly on an average of once a year.

If we had been faced with the possibility and that company had been faced with the possibility of losing the advice of our firm because some other house could take the business away by a fractionally higher bid, certainly we would never have had an incentive to continue the time and the effort that we put in in familiarizing ourselves with the company. Because of that familiarity we were able to recommend these bonds to a number of our own clients who rely on us for advice. By doing that and constantly replacing outstanding bonds, we were able to keep up with the company's growth and advancing its credit until they were able to refund a high rate 6 percent bond with a 4 percent bond.

What I am driving at is this, that if you have competitive

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bidding and the bankers are constantly going to be changed, you are not going to have that kind of personal contact with the company.

Commissioner Healy: Is there any reason why you do not wish to give the name of the company?

Mr. Legg: I have no objection. It is the Houston Natural Gas Company of Houston, Texas. I think we registered an issue about thirty days ago.

Commissioner Healy: It is no longer subject to the Holding Company Act?

Mr. Legg: No, it is not. I am trying to skip a lot of things that were discussed so that I won't keep you.

The other thing that I did want to bring out, however, is that if a company is forced to sell its bonds to the highest bidder, it is denied a management decision when a company might decide that it would be to their advantage to sell their bonds slightly lower than they could be sold at.

Chairman Frank: As I understand it, the proposed rule would not provide by any manner or means that the other factors could not enter in. The manner of competitive bidding would help to ascertain whether all things considered the thing should go to the highest bidder, but if the company could reasonably show why a lower bid would be ---

Mr. Legg: (Interrupting) It would be one of those exceptions that would not be very often used, but again you con-

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ceive of a company even being advised by their banker friends that the bonds could be sold at a higher price than they actually agreed upon? Well, you could not do that if the bonds were put up for competitive bidding without coming to the Commission and having an exception made, which then would mean a big delay.

Chairman Frank: We do not find it means very much delay to bring up that kind of a question.

Mr. Legg: I just wanted to say this, too, that I disagree with some parts of the report which were rather give the feeling that bankers were unfair to their clients, the issuers. The last large underwriting that my firm participated in was the Consolidated Gas, Electric Light and Power Company of Baltimore. I know that the manager of that group was even more concerned that he had advised the management to sell those bonds too cheap, or as much concerned as he was that he was getting a fair price from his customers.

If I can rest assured that there is nothing to disturb us about this spreading to other issues of securities other than utilities, I will withdraw.

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Chairman Frank: Before we go on, I would like to suggest to Mr. Stewart that it seems to me - this matter is suggested in the interest of fairness - there was some reference made this morning to a report made many years ago by Kuhn-Loeb & Company, and as we are going on tomorrow, it might be well to ask somebody from Kuhn-Loeb & Company whether they care to come in and comment on it.

Mr. Stewart: We have had no conversations with them at all.

Chairman Frank: I was wondering whether you cared to do that.

Mr. Stewart: If you should like me to, I will be glad to.

Chairman Frank: I think it might be desirable.

Mr. Scribner: May I say a few words?

Chairman Frank: Before you do - are you leaving tonight?

Mr. Scribner: No, but I have got this right on my mind, and I would like to get it off.

(Laughter).

Chairman Frank: The sample of your mind that we had here indicated that it would keep overnight. If there is anyone else here that wants to leave tonight, --

Mr. Stewart: (Interposing) I don't know of anyone.

Mr. Van Court: I am leaving tonight.

Chairman Frank: Then we will hear from you, Mr. Van Court.

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STATEMENT OF ALBERT E. VAN COURT
of William R. Staats & Co.,
Los Angeles, California

Mr. Van Court: I am Vice President of the firm of William R. Staats & Co., of Los Angeles, California.

I am speaking not only for the firm that I represent, and the ideas of the partners, but I think that I am also speaking for the other members of the distributing organizations in Southern California, and possibly others in Northern California.

I have been here since Christmas, because my son has been in the hospital, and therefore I have had correspondence and communications with several of them, and I am sure that it is as a result of those communications that I ask to present this testimony, because they were so insistent that their ideas, as well as my own, be expressed.

We are a distributing house primarily. We are an occasional underwriter, but our job primarily is to distribute securities in our market, and consequently we have to look at our livelihood largely from that point of view.

We feel, as other witnesses here feel, that compulsory competitive bidding is entirely injurious to our business, and as a small distributing dealer, and I can only look at it from the selfish point of view - I can not go into the high principles, and so forth, - I am going to tell you just how it affects us as a small dealer trying to make a living.

We feel, as others have here, and I do not want to take

up your time to go into the matter of over-pricing, because I think that this point was fully covered so that would be merely repetition.

There is one thing which I would like to convey to you which I do not think has been stressed sufficiently, and that is that under the present system of negotiated sales, we, as dealers, feel reasonably confident that we will be offered securities whether the deal is a success or not; in other words, the selling group is a thing that is contemplated before the price is set, before it is determined whether or not the issue, when offered, will be a success. Those who have given a certain performance in their distributing ability with the various underwriters, they know that they are going to be offered a certain number of securities dependent upon the size of the issue.

We feel that under competitive bidding that that would not necessarily be the case. Groups in New York or Chicago or elsewhere would purchase the ^{various} securities only after they had determined upon the price at which they purchased in a market by competitive bidding, and that price not determined until then would, having once undertaken the obligation, they would feel that the first thing that they should do is to dispose of their obligation, which is human nature, with no commitments that you take. They would probably take those securities - I am simply surmising what would be the case to

try to think through the situation to see where we would get off - they would sell them as they could and take the entire profit. If they could not sell them, they would in many cases form a selling group, and the selling group so formed would not be nearly so desirable, as you can imagine, as if they made up that selling group before it was determined whether the issue was going to be a success or not.

Consequently, we could not feel nearly as certain of a source of supply of issues generally to offer to our clients in the territory. We must give them good securities, and we must be reasonably certain that we can offer a client an opportunity to participate in issues during the year, and when they come out. If we can not feel a certain confidence in the continuity of the supply, we are at a disadvantage there, which is just as anxious to secure issues when brought out as they are elsewhere.

I do not want to take up your time any longer, because I realize you have been very patient, but we, as a distributing dealer, are definitely in favor of a negotiated sale rather than compulsory competitive bidding.

Chairman Frank: Thank you very much.

Now, Mr. Scribner.

Mr. Scribner: I will wait until tomorrow if you want me to, but I will only take about five minutes.

Chairman Frank: Very good.

STATEMENT OF JOSEPH M. SCRIBNER
of Singer, Deane & Scribner,
Pittsburgh, Pennsylvania

Mr. Scribner: My name is Joseph M. Scribner, of Singer, Deane & Scribner, Pittsburgh, Pennsylvania.

We do a general investment and security banking business in Pittsburgh and Youngstown, Ohio.

There is one thing which I think, from where I have sat today, we have proved, and that is that the small dealer is going to be seriously hurt by competitive bidding. I understood you to say that the Commission did not want that to happen.

If I understood Mr. Spencer's remarks correctly, he developed quite conclusively that the successful bidder for an issue in competitive bidding was probably the house who had the largest retail organization. I think I understood Mr. Stanley to say that he would be forced to change his form of business if competitive bidding came about.

I am assuming by that that Mr. Stanley meant that he would be forced into the retail field.

Mr. Stanley: Correct.

Mr. Scribner: Where does that leave us? Where does that leave the forgotten man? I am a small dealer. I don't welcome Mr. Stanley's competition in Pittsburgh, knowing before he starts to give it to me that he has had to buy an issue with about a point in it or about \$8, and that he

can not afford to give me any wholesale price out of that.

Thank you very much.

Chairman Frank: We will adjourn until 10:30 tomorrow.

I would like to say that the Commission will consider and announce, I think tomorrow, its reaction to a suggestion that as there are certain people who were not able to be here or ready, it may have a further session next week. It will consider that and advise you tomorrow.

(Whereupon, at 5:50 o'clock p.m., a recess was taken until 10:30 o'clock a.m., Tuesday, January 28, 1941.)

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