

Harold Stanley  
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Chairman Frank: Mr. Hamilton would like to enter an appearance.

Mr. Fowler Hamilton: Mr. Chairman, and may it please the Commission, I am a special assistant to the Attorney General in the Anti-Trust Division of the Department of Justice, and I would merely like to note an appearance in this proceeding if the Commission has no objection.

Chairman Frank: There is no objection.

Mr. Weiner: Mr. Chairman, might I suggest that there are representatives here of other governmental bodies and they are not listed in the appearances. I think it would be well if they care to, to give their names to the stenographer so that we can have a record of it.

Chairman Frank: There was a representative of the Interstate Commerce Commission here a short time ago. Is he still here?

(No response.)

Chairman Frank: Is there any other governmental agency represented here?

(No response.)

Chairman Frank: Mr. Stanley, will you proceed?

STATEMENT OF HAROLD STANLEY

of Morgan Stanley & Co. Incorporated.

Mr. Stanley: Mr. Chairman and gentlemen of the Commission:

I expect to be quite brief in my comments and will endeavor to try not to repeat all the things that have been said here,

some of which I had in mind going into. We had prepared a memorandum supplementing the letter we sent to you the other day, which we would like to file for the record.

As you know, I have at various times made comments on this question of competitive bidding, and filed a memorandum with the T.N.E.C. over a year ago, and wrote a letter to your Director of the Public Utilities Division last spring and answered their questionnaires on arm's length bargaining. You have all of that information and I will try not to repeat a lot of the things that are said there.

I won't attempt to answer all of the comments in your staff's report in detail for various reasons, including lack of time. I do not think it is necessary to answer some of them.

I do not agree with the report. I have said repeatedly that competitive bidding under certain conditions could be done. In my opinion, the business of issuing can not be as well done that way as by private negotiation. To go beyond that, I do not believe that this rule will work, but I will come to that later.

I would like to say a few and rather emphatic comments about certain references to our firm in the report. As someone else said, a good deal of the so-called evidence in the report is taken from the T.N.E.C. hearings. You know what kind of hearings those were; I mean the witnesses were not allowed to present their views except in answer to questions, largely.

Chairman Frank: You won't be so confined here.

Mr. Stanley: I so understand and I appreciate it.

Yesterday I put in some figures on prices. I won't go into that matter. I am skipping through this memorandum and I am not trying to cover it all, as I hope you all will find time to read it.

I referred briefly to the matter of prices yesterday at your request. I won't go into that further unless you want.

There has been a lot of talk of the effect of competitive bidding on prices and the effect on private placing of competitive bidding, or rather whether competitive bidding won't really result in private placing by a different method. I will be glad to go into that if you want, but I think enough has been said.

I think it is obvious that the insurance companies can bid a proper price, and I think the underwriter can bid a proper price -- whether it is too high or too low, but obviously they have an advantage there. And they can buy a whole quantity of securities direct. It is another method of direct purchases, of paying 1/8 or 1/4 or 1/16 or whatever it is.

Coming to the things that I would like to talk about chiefly and which I think are the most important in the report and what the staff so states to be, there have three reasons, and one of them is "Competitive bidding may be expected to remove the threat (and actuality) of banker domination of utility financial policies".

At the risk of repeating what I have said before -- but this is very short and I would like to read this. In our memorandum of November 29, 1939 referred to previously which was filed with T.N.E.C., I said:

"Whatever may have been said pro and con about the existence of so-called 'banker domination' in the past, the truth is that it simply does not exist today, and any contention to the contrary must be based only on ignorance or wilful mis-interpretation of the facts. Allegations of 'banker domination', like those of the 'spider web' theory of control have been repeated so often and arbitrarily, and so fancifully, that they shape the thinking on economic questions of many well-meaning and intelligent citizens who have never stopped to analyze the matter, or who have had little opportunity to form their own views about industry at first hand. For the most part, such talk has been advanced by persons who have had no practical experience in banking or in industry and in persons intent on creating sentiment for the abolition of private enterprise".

I repeat this statement now despite the fact that your staff on page 24 of their report makes a statement to the effect that denial of banker domination without further supporting data ignores the realities of the opposing case. This just is not so.

Anyone looking at the names of the companies which we have assisted in financing, and who bears in mind the character and the personnel of their management, must know that this could not be so.

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WLC                   The next main point the staff makes is - "competitive  
1                   bidding should result in genuine arm's length bargaining  
for the securities thus sold".

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                  This assertion implies that arm's-length bargaining  
does not exist today. In all the numerous transactions  
with which we are familiar genuine arm's-length bargaining  
did occur. If there are isolated instances where your staff  
has produced evidence establishing that arm's-length bargain-  
ing did not exist we do not know of them.

                  The third main point is that "competitive bidding may be  
expected to reduce the concentration now found in the under-  
writing management of new utility security issues". That  
is their wording.

                  In the first place, there is no concentration in any one  
investment banking house in the underwriting of management and  
new utility issues. We have a large volume of business our-  
selves, as it has happened in certain years, and the statements  
they make are true as to the aggregate of certain houses and  
certain kinds of business done, but no one house any monopoly  
on the business.

                  In talking about competition earlier today or yesterday  
afternoon, perhaps, I said that competition did exist and  
I will come to instances of it later. And that competitive  
conditions do exist and they can exist without competitive  
bidding.

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I also said that I believed in the continuing relations as being of advantage to the borrower. I grant right off the bat that there is not the same kind of competition in the financing of securities as there is in the bricks and mortars and shoes, and whatever else. And I don't believe there should be. I don't think it is appropriate.

I think it is of advantage to the borrower to have continuing relations if the services are well done. You may disagree, but that is my opinion and not as applied to you, Mr. Chairman, but as applied to your staff, with all deference I would say that I have been in the bond business since 1910 - 30 years - and I think that my practical experience ought to give me more information as to what goes on than the views of your staff.

Your staff has figured out certain statistical data or rather I think most of it was supplied at the TNEC, stating that our firm had done a certain volume of certain types of issues. They named particularly manufacturing and communication issues, and also similar utility issues. They called it "first grade issues", and in parentheses stated "graded Aaa". Those statements give an incorrect inference, because there are other issues that are first grade that are not Aaa, for example the Aaa rated bonds would include about a third of our business. Yet they figure 100 percent of something and 80 percent of another. It only applies to a third of our business and does not

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happen to include bonds of mortgage bonds of the Commonwealth Edison Company handled by Mr. Stuart, and the Detroit Edison Company managed by Crawford & Burr of Boston. The figures would be clearer or more indicative if they had used the figures on managed issues that are rated Baa, for example, which are generally as their footnote states are considered suitable for bank investment.

During this period of five years, in the same period that their figures referred to, or maybe this is a little longer period, but during the five-year period anyway, we managed 62 out of 401 issues rated Baa or 15½ percent in number, the dollar figure being 2½ billion dollars or 2 billion 6 hundred.

Commissioner Pike: That would be Baa or better?

Mr. Stanley: Yes. Now, that is a large figure. I will say what I intended to say there apropos of another point.

Our underwriting commitment in these issues was 530 millions or 6.4 percent. I am sorry to give you so many figures, and I hope I can state them clearly.

Included in these figures were certain registered public utility issues rated Baa or better. Of these, we managed 30 issues out of a total of 219 or 13 percent of the number and 18.3 percent of the dollar amount.

I grant that that is a large volume of business, but I do not think there is any excessive concentration anywhere.

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I have a note here to point out that there was this large volume which I thought was about 4,000,000,000 privately placed securities, which also has a bearing on concentration. Of those privately placed issues, there are over 40 issues amounting to over \$700,000,000 that were placed by companies or their subsidiaries for whom we had previously assisted in financing.

During the period 1935 to December 31, 1940, there were issued a total of about 14,000,000,000 of bonds and notes including Governments and municipals and other governmental instrumentalities. That includes railroads and equipments. That figure was arrived at in response to a question by a member of your staff who asked us to furnish him that and certain other information. Of this amount we have managed 2 billion 6-odd or 18.8 per cent, and our share of the underwriting commitment was 600-odd million dollars or 4.8 per cent. A total of 166 different investment bankers joined us in the underwriting, and 169 different dealers participated in the resiling.

If you want to consider just--I quite realize, Mr. Chairman, I am talking of other securities than utilities, but your staff's figures included those and I am making a comparison with your staff's figures. If you take only registered issues, which were managed by an investment banker, we find a total number of issues so registered of 595, and the number we

managed was 62 or 10.4 per cent. The dollar figures were 8 billion 6 hundred-odd, and 2 billion 200-odd thousand, respectively, the latter being 25.6 per cent of the total. That is for the 5-year period.

In some of those years we did a much larger volume of business than others. In the last two years, the percentage of the total volume was 10 per cent or less. In one previous year it was 40-odd per cent. Our underwriting commitment on these issues was 6.1 per cent. Your staff says that their claim of monopoly and absence of competition is proved by the fact that six firms managed a certain percentage of the securities publicly offered. This is a fallacy. There is competition between the six houses, as I stated this morning. They are the six houses mentioned in the T.N.E.C. testimony. I will give you their names if you like. This appears even in the limited testimony of the T.N.E.C. which your staff did not refer to.

I think some one referred to one or two of these instances which I intend to refer to in but one instance. As was brought out in the T.N.E.C. hearing, that was the business of the Shell Union Oil Company, how the underwriting business was first done by Lee Haggins and later by Dillon Read and then by ourselves. I might add that in that case before the business was consummated, we spoke to Dillon Read but not to get their request but simply to inform them that the company had asked us to do the business,

and after that Dillon Read tried as hard as they could to get the business back and we tried as hard as we could to get it.

The second other example in the T.N.E.C. record is the Pacific Gas & Electric business, which I think Mr. Bollard mentioned, or some one did, and the record in the T.N.E.C. hearing shows that there was intense competition there. At first, Lazard got the business, and after a deal or two, some one else got it.

The record shows that several firms sought the Southern California Edison Company.

There are other instances that I know of of competition between these six houses and some other houses in New York,-- for instance, one was the Socony Vacuum Oil Company which we competed for and did not get. The facts there are very brief. We had heard that the business was being considered on an agency basis, and we went to the company and asked if that was satisfactory, that we were willing to make a commitment for it, and they said no, they had plenty of cash and that they did not care if they did not get the full amount of bonds, and they preferred the agency anyway, and they did get the full amount sold.

The Revere Copper & Brass Company which I think it is a matter of common knowledge, but I don't know the particulars, where there was severe competition.

There was severe competition between these houses for the Danish and Norwegian issues. And I repeat again I know that these do not relate to the utilities, but they are the figures that the staff uses and refers to the aggregate business done.

There was the Connecticut Power & Light issue which I referred to this morning where we lost out.

The Central Hudson Gas & Electric Company for whom we had done business where half a dozen people had been competing for a year on a proposed issue.

There is the Allis-Chalmers Company which has had numerous proposals from various bankers. I do not know who they are, but I happen to know it is a fact that because the company wrote us and asked us to make a proposition -- I take that back; a director wrote us -- not the president of the company.

There was the St. Louis Terminal and the Cincinnati Union Terminal issues, the C. & O. issues of a year or so ago, and the present proposed C. & O. issue.

The Northern State Power of Wisconsin, the Illinois Bell, the Louisville & Nashville, the Great Northern -- and I should think that it is perfectly evident that there is competition for business among these people.

Chairman Frank: Did I understand you correctly this

morning -- the word "competition" gets to be vague in its connotations in this discussion, and I would like to define it specifically. I understood you to say this morning that you thought that where a rival investment banking house was handling an issue well, you would not under those circumstances approach that issuer and endeavor to get that business away from the rival banking house?

Mr. Stanley: If I understood you correctly, yes. I have two ideas about competition; first that competition must and should exist in business of various kinds. Latent competition, actual competition, competition of the market, and competition with the insurance companies. Competition does exist. But I also have the idea and I think it is very important and very useful to the borrower and I think the borrower has followed this method of negotiation because he believed it was useful, because he could always have gone into competitive bidding if he wanted to; he did not need to have a new rule -- and in this and other countries it has not been done, it has not been done anywhere in the civilized world that I know of. This is a method that has developed over a period of years and it has benefits, and I think they think so.

When the jobs that are done are satisfactory, why not leave it alone? It is always in the hands of the management. If they are not satisfied they can get anybody they want. Mr. Chamberlain said yesterday that if they had competitive bidding

the door of every house would be open to them as a borrower. Gosh, they are open today and all he has to do is to walk in.

I do not think I mentioned other instances where issuers have changed their bankers or added any bankers. Bethlehem Steel, Panhandle Eastern, Pipeline, Crucible Steel, Republic Steel, Tidewater Oil, Consolidated Oil.

Our next comments about your staff's contention that this recommended policy would reduce concentrations and decentralize is, as numerous other people have stated, that it would tend to reduce the number of dealers in the business and in distribution. I don't need to go into that; I think it is obvious. What our reasons are, you may not be interested in. I think I have said enough about it already, but I do not think I have said it in the language of these words that the business would naturally gravitate to compact groups having capital in a few large groups in the larger cities.

I have some figures on concentration in the municipal business and which is done on a competitive bidding basis that are somewhat different from Mr. Bollard's figures as I was able to follow him, and are probably for a different period which I would like to submit into the record.

Chairman Frank: You can file those.

Mr. Stanley: I would like to summarize it briefly. According to the Daily Bond Buyer of New York, the financing from September 1, 1935 to December 31, 1940, according to the

Daily Bond Buyer of New York, the financing of States and municipalities long term, and by "long term" is meant on their category everything over two years, which includes serials, of course, aggregated 6-billion-odd. Issues of 1 billion and over totaling 3 billion 666,000 -- that is the important figure. Of these, five firms handled 52.9 per cent -- headed it. Those five firms plus five more make 10 altogether headed 69 per cent.

This will be very short and partly repeating what has been said. I believe that under this system of compulsory competitive bidding, the smaller dealers throughout the country will be injured and won't be included to the extent that they are now, because there won't be the same incentive for national distribution that there is now. National distribution is done usually at the request of the borrower. I think it is a good thing for our economy to have it done and have people in the various localities have chances to buy these kind of bonds we are speaking of, but there won't be the same incentive to do it. You won't have a client; you will have a fellow that sold you what is more or less merchandise and you will sell it in the most economical way that you can.

Chairman Frank: Suppose the issuer putting up a bid for competitive bidding would make it a condition that there were to be adequate distribution nationally.

Mr. Stanley: He might not get bids.

Chairman Frank: He might not?

Mr. Stanley: Of course he could.

Chairman Frank: He could ask for bids in two forms?

Mr. Stanley: Sure he could. But today he is willing to allow you a compensation that permits it and he allows you a part of the compensation for that purpose.

Chairman Frank: And I assume if there were competition on those terms, that would be taken into consideration among bidding houses?

Mr. Stanley: Yes, but they still might buy at a price that would not permit them to do it. And from the point of view of the manager of the issue, he does not have the same incentive to do it when he expects to have continued relations with that fellow, and you pay more attention to what the borrower wants done if you expect to continue with him.

Commissioner Healy: Have you prepared yourself, Mr. Stanley, to talk about the distribution of portfolio securities already owned by holding companies? I call your attention to the fact that under 12-b which relates to that very subject, there is a very specific duty to maintain competitive conditions cast upon the Commission by the Act of Congress. Are you prepared to discuss the distribution of portfolio securities now owned by holding companies?

Mr. Stanley: No, I am not prepared to do that. I did not realize that that question would come up in that way. I should



say that we would be very much interested to consider whether we can undertake to help in doing that. Whether we would want to do it by competitive bids, I don't know.

Chairman Frank: That would involve the sale of equity securities?

Mr. Stanley: Yes. We would be prepared to do that. We said that we were willing to do a distribution job the other day which Dillon Read got away from us, namely the Standard Oil of New Jersey common stock.

Chairman Frank: That is very unusual for you.

Mr. Stanley: Yes, we never have done it. But whether you can on a competitive basis under such a proposed rule as this on your utility and integration matters, whether you can handle the tremendous volume there is there on a competitive basis, I don't know, Judge. I don't know whether that was your point or not. I am sorry that I am not familiar with it.

Commissioner Healy: I just wanted to know if you were prepared to discuss competitive bidding with relation to that particular aspect.

Mr. Stanley: No, I am not, but I will be glad to prepare and come down later.

Commissioner Healy: Let me ask you this. Does your concept of competition in connection with original issues, does it take you to the point of visualizing an attitude on the part of the principal underwriter to make a decision as to whether the

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company ought to finance itself with bonds or preferred stock or common stock?

Mr. Stanley: Yes.

Commissioner Healy: Do you think that the principal underwriter could lay out of consideration at that time what may be his own preference for a particular type of security? I am not suggesting that there is something wrong in an investment house preferring to originate and sell bonds; but I do suggest that when that type of a house is presented with the problem of what type of financing is best for the issuer, that there are considerations of their own self interest which ought to be laid to one side. Do you see that aspect of the problem involved in this thing?

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Mr. Stanley: I am absolutely eye to eye with you. I think that it is their duty, and I think if a person does not sell stocks and it is to the interest of the issuer to sell common stocks, he should advise him to do that.

I said we did not have these portfolio distributions. We have underwritten common stocks; we do not limit ourselves to first mortgage bonds.

Commissioner Healy: This method of competition involves something more than price; doesn't it also involve the matter of what type of securities is good for the issuer?

Mr. Stanley: Certainly, yes, sir. I can completely agree in that.

Chairman Frank: I may say as far as I am concerned that it is far more importance to me with the market in its present condition than the matter of price.

Mr. Stanley: I agree with that too.

Commissioner Healy: I would like to ask you just another point regarding this matter of banker domination. We have seen from time to time, and we have in our files, evidence of agreements executed by issuing companies and even by holding companies where specified banking houses had been given the first call and the first option on all future financing of those companies, and in one opinion of this Commission I think we reproduced verbatim a contract made between certain investment banking houses in which they divided up the invest-

ment banking of all the companies in that system, a billion-dollar system, and the record, in addition to that, shows that that is the way the banking was divided up. That was for a period admittedly before the passage of the Public Utility Holding Company Act of 1935.

Now, may I pause at that point before I go any further to ask you if you agree in recognizing that in some instances at least that sort of condition did exist prior to the Holding Company Act?

Mr. Stanley: In some cases it did exist.

Commissioner Healy: Don't you recognize in those facts the source of the interest and the anxiety of the staff on the subject? I mean the fact that that sort of thing did exist at sometime certainly makes it a live topic for the consideration of the staff on this matter.

Mr. Stanley: Judge, in my humble opinion, I don't know that it makes it a live topic. The TNEC's testimony went back 30 or 40 years. I am not familiar with these details of these contracts that were written giving preferential rights, and I do not think they were worth the paper they were written on.

Commissioner Healy: I doubt too if they were legally enforceable.

Mr. Stanley: And I think they were wrong. I would like to say that we do not dominate anybody and nobody dominates us or

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controls us. We never have had a preferential contract, and since you are talking earlier days, our firm has only been in existence since 1935, and I should think that I might add that neither did J. P. Morgan & Company of which I was a partner prior to 1935 have any contracts excepting, as I remember, one with the Belgian Government for the purpose of preventing it from over-borrowing in this market and not to get new business.

And I happen to remember this because it came up in the TNEC hearings, a fiscal contract with the New York Central which I think was cancelled in about 1901. We have no proprietary rights, and I may add very briefly to what has been said on that subject as far as its being a not customary thing that I was present at the hearings where those matters were brought forth, and I told Mr. Henderson, a member of your Commission, at the recess immediately following that testimony, that I personally having been in the business for 30 years had never heard that phrase until that morning.

I think it is not customary. And I think the reference of the staff has blown it up out of all proportion to its real significance.

Commissioner Healy: At least you admit that they did not originate the expression?

Mr. Stanley: I quite agree.

Commissioner Healy: Of course, in the case of the United

4 Corporation, is my memory correct that that corporation was really originated and put together by J. P. Morgan & Company?

Mr. Stanley: And the Bonbright & Company; that is correct.

Commissioner Healy: It is correct?

Mr. Stanley: Yes.

Commissioner Healy: And it is true that at least the first distribution of the securities of that company was pretty well controlled by Morgan & Company and Bonbright?

Mr. Stanley: That is quite true.

Commissioner Healy: They created the corporation?

Mr. Stanley: They did.

Commissioner Healy: And that corporation had important holdings in several of the largest holding companies in the country?

Mr. Stanley: Several of the largest holding companies in the east. I could not quite hear your question.

Commissioner Healy: I said, in the country.

Mr. Stanley: That is quite true.

Commissioner Healy: I think the Federal Trade Commission report showed that the United Corporation had interests directly or indirectly in something like 39 percent of all of the generating capacity of the United States,

Mr. Stanley: I would accept your recollection, Judge, but mine was that it was somewhere nearer 20 percent, but I just don't know.

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Commissioner Healy: You say 20 percent?

Mr. Stanley: A large figure, anyway.

Commissioner Healy: It was a large percentage of the gas manufacturing and the gas capacity of the country?

Mr. Stanley: I would think so.

Commissioner Healy: Of the gas distribution?

Mr. Stanley: Of the artificial, yes. And the Columbia, too, - natural also.

Commissioner Healy: The holdings on the United Corporation went down into the Columbia Gas & Electric?

Mr. Stanley: They did, yes.

Commissioner Healy: Thank you.

Chairman Frank: Mr. Stanley, if the Commission were to adhere to U-12(f)(2) or to a similar rule, precluding an affiliated underwriter from participating beyond a limited percent in the distribution of an issue, or if it went beyond that and precluded it entirely in the absence of competitive bidding or a showing that it was not practicable, wouldn't it be better from the point of view of these particular underwriters to have a general rule requiring competitive bidding, because that would mean that then that underwriter would be able on a free-for-all basis to compete with all of the underwriters, whereas the consequence of such a rule as I have indicated, U-12(f)(2) as modified in that manner, would mean that the affiliated underwriter would lose out altogether?

Let us take your house, for instance. If you were found to be an affiliate - putting a hypothetical case - of the X Company, and if we had a rule that said that where you were the affiliate there that you could not participate at all, - supposing we did - except through competitive bidding - that would mean that the issuer in that event would not go to you but would go to someone else, whereas if we had in lieu of that a rule requiring competitive bidding in all cases, regardless of affiliation, then you would not be at that disadvantage, isn't that correct?

Mr. Stanley: Well, I think your assumption is wrong. I think it is impossible for us to be an affiliate of any utilities company, so I think it is theoretical.

Chairman Frank: Just indulge my assumption for a moment, if you will. You know we have a case in which that question is up.

Wouldn't you be better off if we substituted for that a competitive bidding rule?

Mr. Stanley: I don't know. I think that is trying to cure one wrong by creating another. I don't know whether we would be better off or not.

Chairman Frank: At least you would have an opportunity to bid?

Commissioner Healy: How do you think we ought to handle the situation where the underwriting house is an affiliate of



the issuing company?

Mr. Stanley: We considered that as well as a lot of other people did and wrote you in answer to Mr. Weiner's questionnaire last spring. Of course, the difference is a legal definition of "affiliate" and a legal definition of "controlling."

Commissioner Healy: Let us leave "controlling" out of that completely. We had a situation which was not fully developed yesterday where Mr. Davis owns a large block of stock of the Houston Natural Gas Company and which, according to his statement, his firm does most of its underwriting. Where it is conceded and there is no dispute about it, and assuming that you can establish the fact that there is an affiliation, what is your suggestion as to how we ought to handle it? Do you think that under those conditions the affiliate should be given the inside track to the exclusion of the other investment bankers? I assume that you will say no.

Mr. Stanley: Judge Healy, I think that is a different question to answer if you leave out the domination which you said that you would like to leave out. I think if the affiliate controls the borrower, he certainly ought not to have an inside track. I think if he has 5 percent or 10 percent, or whatever your legal definition is, he has no control over that fellow. I think that there is quite a difference in

the treatment of those things.

Chairman Frank: Let us take Section 12 portfolio securities and stick to that. I do not want to get into a legal dissertation. Assume as Judge Healy has suggested that you had a case that where either by proof or admission you had affiliation. I repeat Judge Healy's question, wouldn't you think that under those circumstances the Commission had something approaching a statutory duty to see to it that there was some way found by which other persons competed with that affiliate for that business?

Mr. Stanley: I think you can have competition, as I said before, without requiring competitive bidding. I do not see why if you have competition for the selection of business, different offers from different people or proposals which the management can decide to take or leave, I do not see why is not competition.

Chairman Frank: How is the Commission going to be able to, if you will indulge me for a moment that the statute means at least under Section 12 dealing with portfolio securities, - that we will see to it that there is a maintenance of competitive conditions, particularly where there are affiliates, - how is the Commission going to see to it where there is an affiliate that there is competition?

Mr. Stanley: I am afraid that this is perhaps a matter somewhat for lawyers more than for laymen, and I want to come

back ---

Chairman Frank: (Interrrupting) Perhaps so. Perhaps it is not fair to ask you.

Mr. Stanley: I am sure that I completely answered Judge Healy's question, but it seems to me that after all the main thing is that the business is done on fair terms, and I think you can ascertain that to your satisfaction that it is done at arm's-length, which is really nothing more than is being done without fear or favor and with two people who are independently negotiating and bargaining so that each is acting for his own best interest.

Commissioner Healy: I think where you have admittedly arm's-length bargaining you may have a somewhat different problem. The difficult case, it seems to me at least, in maintaining that sort of condition, is where there is an affiliation.

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Mr. Stanley: But does the law say that any affiliation automatically makes arm's length impossible?

Commissioner Healy: No, I don't think it does. I think the statute raises a very strong presumption against the existence of arm's length bargaining where there is affiliation.

Mr. Stanley: I feel I am a little bit out of my depth in discussing a legal interpretation.

Commissioner Healy: I did not raise the legal point; I refrained from doing that. Let us just forget the law.

Mr. Stanley: All right.

Commissioner Healy: If you are not prepared to do it now you can do it when you please, but I would be very much interested to know what your recommendations are as to how we ought to handle the situation where there is an affiliation between the underwriter and the issuer.

Mr. Stanley: I think, Judge Healy, that I had better get the law rather than from a layman's point of view and then come down.

Commissioner Healy: I did not ask for a legal opinion, Mr. Stanley.

Mr. Stanley: But I don't know my facts well enough to know what the procedure is.

Commissioner Healy: We made an effort to deal with that situation and did not seem to evoke universal satisfaction, and I think our old rule, 12-f worked much better in some respects

than it was given credit for.

Mr. Stanley: I am afraid I do not follow, but it does not make any difference.

Chairman Frank: Before I forget it, I would like to bring up a point. You said in this memorandum that you are offering, you made some comments on the manner of the hearing of the T.N.E.C. I do not care to go into that, but just to clarify the situation here, I take it that you do not find any objection to the manner of this hearing or your opportunity to discuss the question?

Mr. Stanley: I am completely pleased and satisfied.

I think we were talking about the distribution of securities, and I was saying that we had no preferential contracts today and never have had any. We have no agreements with other bankers today and never have had any, and as I have said before, we agreed that there should be competition in this field and believe that there is, and that there should be numerous straw firms in the field and not, as Mr. Chamberlain suggested might be the case, only one.

As I have said, we have done quite a large volume of business, and the reasons why we have, I think are very simple. Our firm is composed of individuals who have had years of experience in the bond business. They know and have dealt with the officials of many important companies for years, and when those and other companies wanted to issue securities, they knew us or

knew about us and had enough confidence in us to ask us to do the business, and it is just as simple as that. It was their free right to decide, and I think their responsibility to decide how they should do the business and with whom.

Before summing up, I would like to say and I think I have said it in a way but maybe not as concisely as I might, and it is just a matter of opinion and I think perhaps you do not agree, but I am inclined to agree with Mr. Ecker that the chances are that the bigger amounts of securities will go to the insurance companies by private bidding than they do today.

I would like to sum up by reviewing who the people are who are urging that the Commission adopt this new competitive rule, and I would like to read a few short paragraphs about this from our memorandum.

"(1) Those who are so bent on doing what they seem to think will result in further 'decentralization' of the industry that they can tolerate no opposing argument. This same group believes that members of commissions such as yours should be relieved of the responsibilities inherent in their jobs by being furnished with a device that will mechanically determine price and spread.

"(2) A small but vocal minority of security dealers who, in their own desire to obtain more business (which is a perfectly understandable motive) are claiming that they should have a right to do business with people who apparently do not

want to do business with them, provided they make the highest bid at the auction block.

"On the other side we find:

"(1) The overwhelming majority of issuing companies throughout the United States. Borrowing corporations could always, of course, have required competitive bidding if at any time they so desired. It is no accident that for generations corporate enterprise has preferred to select its own bankers. It would seem that in the world of private enterprise business managers should have the right and responsibility of deciding whether their companies are best served by such relations, or by the casual contacts that would result from enforced competitive bidding."

I won't attempt to go into the point that was discussed at some length at the investigation to cover the liability questions under the Act, but I can conceive, Mr. Chairman, that if six or eight groups of people were competing for an issue, that the time that the management would consume in trying to advise with those people on what they would need to know would be a terrible thing to handle. Perhaps it could be done, but it would be an awful waste of time. If one fellow could compete, then everybody would. In good times, you might have everybody and in bad times nobody.

The second group consists of the great majority of investors and investing institutions who favor negotiation.

The third group that favors it -- to read from my own memorandum -- are with a few exceptions referred to already, all of those engaged in the business of underwriting and distributing securities and who have practical knowledge of what they are talking about.

"We appreciate that your staff will discount the testimony of this group on the theory that it is affected by self interest. Investment bankers obviously have a great interest in the question. They do not want to see further damage done to an industry which must continue to play an important part in the life of this country unless our present economy is to<sup>be</sup> remodeled on European patterns. We are sure that your Commission will recognize their sincerity when they lay before you their considered views, publicly expressed after years of experience and study, to the effect that the procedure which your staff recommends will be contrary to the interests of issuers and investors, will not work to the satisfaction of any one concerned, and will not accomplish the results which its proponents appear to anticipate."

That is all, sir. Are there any questions you would like to ask me?



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Commissioner Eicher: Mr. Stanley, do you give any serious emphasis to the supposed value in the way of potential support that an underwriter can give in stormy weather to the issuer or investor?

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Mr. Stanley: That depend a great deal on conditions. Sometimes they can and sometimes they cannot. They cannot do it to the extent that they could have in the good days, because they have not got the capital of the people who used to be in the underwriting business had, namely, the banks. But I would like to add another point where I think they can be of benefit to the issuer, which has been referred to, but I do not think this particular point has been definitely stated. I am quite aware of the tremendously valuable protection that the Commission can give investors in the preparation of utility securities, but I still say that the advice and help--and it is a matter of opinion only and I cannot prove it to you-- I can state facts that have happened--that the cooperation of a fellow who works and negotiates with the borrower and who puts his reputation and his cash back of the deal contributes something beyond what you contribute--something additional.

Chairman Frank: Thank you very much.

Mr. Weiner: Apart from the question as to whether they should or should not be competitive bidding for equipments, is it your judgment that the experience with them would be fairly illustrative and <sup>as to</sup> something that ought to be taken into account,

or are the two situations dissimilar altogether?

Mr. Stanley: You mean in the small number of people who participate?

Mr. Weiner: I mean in whatever the results of that may be, is it a fair analogy? In other words, would the Commission be justified in treating the result of competitive bidding with respect to investment trusts as a consideration in the present subject, or should that be left out of account as not being similar and being a trustworthy guide?

Mr. Stanley: You are not talking about these indenture matters? Who buys them and how?

Mr. Weiner: The overall pattern. Whether the consequences whatever they may be should be taken into consideration.

Mr. Stanley: I don't know; it is hard to answer. They are done by competition. They are usually of short maturity--a single maturity which is often and under certain conditions a different kind of a market than a long-term bond, but I should think some of it applies to what might happen to utility bonds and some of it does not, because in the equipment issues you do not have your 30-day period and you do not have your prohibition of solicitation. A dealer can go to an institution and get an order before he buys. I am not quite clear what you are talking of or driving at. I am not sure whether that is an answer.

Mr. Weiner: I am simply trying to get your judgment whether

the equipment issues have been mentioned here so frequently as to whether or not the experience with respect to them would be a thing that you would rely on in trying to anticipate the consequences of the adoption of a rule of this type, or whether you thought the situation was so dissimilar that whatever one's judgment might be, that the experience with the equipment trust, that it would be unsafe to anticipate any similar results with respect to corporates.

Mr. Stanley: Maybe this answers it. One of the reasons why I think that the insurance companies under competitive bidding would get <sup>a</sup> great big lot of bonds is that they could use the same methods that are now being used in buying equipment securities on order from banks and institutions, even though they are different from 30-year bonds.

Mr. Weiner: Then you would anticipate that the experience with equipment trusts is a fairly reliable analogy.

Mr. Stanley: "Experience" is such a comprehensive word-- I don't know. If you are comparing the handling of a short-term with a 30-year term, they are quite different things. I don't think you can condense it to compare the results.

Mr. Weiner: That is, some of the results that have taken place with respect to the equipment trusts are likely to be duplicated and others are not likely to be as far as corporates are concerned?

Mr. Stanley: Yes, I would think so if I understand you.

Mr. Weiner: You mentioned one or two of the results, I believe, that were likely to work out the same way, and others that would not. Would you care to summarize that?

Mr. Stanley: Would you put the question the other way? Would you lead me and tell me what results you have in mind?

Mr. Weiner: I was going to ask, for example, whether the kind of participation and the interest of the managing underwriter, whether that be concentrated or not, whether that would be indicative of what the result of competitive bidding requirement might be.

Mr. Stanley: We are not in the equipment trust business.

Mr. Weiner: I appreciate that.

Mr. Hall: May I reply to that?

Mr. Weiner: Yes.

Mr. Hall: I would think that with regard to the underwriting and the spread, I would think that competitive bidding on public utility issues would be similar to what has taken place since the competitive bidding was made compulsory for equipment trust certificates.

Mr. Stanley: In good times, but not necessarily in bad times.

Mr. Hall: I think that you would have concentration in the managing of new public utility issues under compulsory bidding, as you would have in both the municipal field and the equipment trusts. I think, however, that the standardization of the

securities of the equipment trusts makes it very difficult to give a direct comparison as related to many types of bonds that you would have in the public utilities field.

I think that the same result might be comparable as regards smaller issues, but would not apply with respect to the larger issues of the public utilities. I don't know whether that answers your question?

Mr. Weiner: That was the sort of thing I wanted to get at, because we have had so many references to it that I thought some orderly comparison as to the consequences might serve as a guide.

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Chairman Frank: Any further questions?

Mr. Stanley: There is just one thing I would like to say. Mr. Hall's use of the word "standardization" brings this thought to my mind, that in talking about the competitive bidding for utility securities, very little reference has been made to the junior securities or equity securities and the difficulty of doing complicated deals might take many months of negotiation even with the help of the Commission and its staff,--as I said a moment ago in a little different connection, I do not see how three or four or half a dozen people can negotiate with a company at the same time to the extent that they would bid and to know what they were doing under a difficult deal.

Chairman Frank: Any further questions?

Mr. Weiner: I would like to ask Mr. Stanley one or two

questions. You have some figures on the concentration of management of equipment trust issues?

Mr. Stanley: No, I gave them on municipals. Some one else gave them on equipment; I gave them on municipals.

Mr. Weiner: I don't know how familiar you are with the equipment trust field generally, but would you say there was more concentration in the management of those issues since the competitive bidding requirement came into effect?

Mr. Stanley: I don't know.

Mr. Weiner: Could you answer that, Mr. Stuart?

Mr. Stuart: I think there is less concentration now than there was before competitive bidding, because before competitive bidding most of the equipments were handled by two or three firms.

Mr. Stanley: Aren't they now?

Mr. Stuart: My statistics show that 40 per cent of all railroad equipments purchased in the last five and a half years or so have gone to one house.

Mr. Weiner: Have you figures as to what it was before the competitive bidding situation went into effect?

Mr. Stewart: No.

Mr. Weiner: It is my recollection that Commissioner Eastman said that they were all practically handled by two firms.

Mr. Stewart: I am sorry that I have not the figures.

Mr. Stanley: If Commissioner Eastman said it, there is

no question about it.

Chairman Frank: Are there any further questions?

(No response.)

Chairman Frank: Mr. Stuart, I wonder whether you care to clarify this evidence. When you were speaking, you did not address yourself directly to the question whether there is competition in your opinion for the issues. Is there, in your opinion?

Mr. Stuart: Now?

Chairman Frank: Yes.

Mr. Stuart: Not what I call real competition.

Chairman Frank: Will you explain yourself?

Mr. Stuart: For example, within a few days we thought to get an opportunity to bid on \$50,000,000 of Illinois Bell Telephone bonds, which is an Illinois institution, and I thought should be placed in Illinois. It could have been handled in Illinois just as well as in New York. I sought that from the president of the company and I was unable to accomplish anything. I went to the Illinois Commerce Commission and sought the same opportunity and they refused to give it to me, and they said because of the shortness of the time and also because they were waiting to see what the S&E.C. did about competitive Bidding. Competition does not exist as it would exist under such a ruling, no.

Mr. Dean: The very fact that Mr. Stuart went there

established the fact that there was at least competition to that extent.

Chairman Frank: Mr. Dean, may I ask you a question? Mr. Rogers suggested this noon that I ask you this question. Perhaps you cannot supply the answer, but we were speaking of the comparatively small amount of railroad issues that had been privately placed since 1933. What percentage of the total of railroad securities issued since 1933 did that consist of?

Mr. Stewart: I think I would have to get the figures from New York.



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## STATEMENT OF WICKLIFFE SHREVE

Lehman Bros.

New York, New York

Mr. Shreve: I have a few short remarks that are not repetitious.

The position of the firm of Lehman Brothers on the question of compulsory competitive bidding has already been presented to the Commission in a letter of January 20 from John M. Hancock, and I would like to ask that this become a part of the record. Mr. Hancock regrets that he cannot come here to read it himself.

(The same is as follows:)

LEHMAN BROTHERS

ONE WILLIAM STREET

NEW YORK

January 20th, 1941

Securities and Exchange Commission

Washington, D. C.

Attention: Mr. Francis B. Brassor

Secretary

Gentlemen:

This is in acknowledgment of the receipt of the Commission's letter of December 20, 1940 and in reply thereto.

As the Commission doubtless knows, this firm has specialized in industrial financing and has had only a minor part in utility financing so at least its views are not influenced

by a desire to protect its present position in that field of financing.

The report is an excellent reference list of the reasons favoring and opposing competitive bidding so there seems no purpose to be served by a restatement of our reasons for not favoring the proposed rule. Our departure from the conclusions in the report arise from our experience in the investment banking field which leads us to give different weights to the arguments than are assigned by the authors of the report.

We purposely do not concern ourselves with any questions relating to the purpose of the legislation or the difficulties of the S.E.C. in carrying out its responsibilities as it sees them. Our interest lies only in considering whether the proposed change would result in public good.

As the Commission knows, this firm has submitted bids under competitive conditions in a few situations. With one exception in another field (Cincinnati Union Terminal) the issues were utility mortgage bonds of the highest grade for companies well known to us and therefore requiring only very limited investigation; also the securities depended primarily on money rates and in no respect have our competitive bids covered the whole range of utility securities, and we have declined to bid on issues of a lower grade. We emphasize also that the legal work on these high grade issues had been done by law firms in whom we and our counsel have utter con-

fidence.

We do not believe we can afford the salaries and expense of the staff required to be prepared to bid on general utility issues, nor are we willing to assume the liabilities imposed upon us by the Securities Act in addition to the responsibility we assume voluntarily on every issue we undertake unless we have every opportunity to investigate a company and its records, to interview its officers and to work with them in the preparation of the registration statement in a helpful spirit of cooperation and confidence, each in the other party. We doubt this spirit can exist under wide-open competitive bidding.

Those of us who have labored over such problems know the difficulties of preparing a registration statement and prospectus under present conditions when two banking firms are partners in an underwriting venture. We can appreciate the added complexity created by the need of reconciling the conflicting views of several competing underwriters, as well as the waste of time on the part of the utility management.

In general, we cannot afford to do the kind of work necessary and desirable for a satisfactory result to an underwriting if our only protection against loss lies in our belief that we will be the high bidder. Due to time limitations our habitual investigation of the important but intangible factors in the field of opinion and entirely beyond the facts covered by a registration statement could not ordinarily be

carried out under competitive bidding conditions, in our opinion.

We believe the managements of utility companies and the bankers they choose are generally deserving of public confidence as to the terms surrounding security issues, particularly now when all their acts are publicly examined in the flood lights of publicity and their own self interest demands that they exercise their best judgment.

Surely it is significant that in its present preparedness program, its largest buying effort in its history, this country recognizes there is no inherent virtue in competitive bidding. When men are willing and competent to determine the values of goods to be paid for by public funds, and Congress is willing to entrust such authority to government officials, there is no reason to magnify the difficulty of discharging the responsibility placed upon the S.E.C. in this case.

We believe that the best results can be secured only if the banker has earned the confidence of the issuer's management and is able to proceed with every emphasis on the professional aspects of his work.

The proposed rule appears to be reaching for a formula that will avoid having to make a difficult judgment. The administrative difficulty of deciding on the part of the S.E.C. as to the fairness of the terms of a security issue is referred to frequently in the report and this reason is apparently

regarded as alone sufficient to justify the proposed rule.

It would seem far wiser for the Commission to secure a staff competent to advise it in that field, or failing that, to have hearings with expert testimony so as to establish a good record, and a foundation for a sound administrative decision.

"Competitive bidding" is not a self defining term and its adoption will call for more regulations and more administrative proceedings. The net result in many cases will only be to relieve the S.E.C. from a responsibility it now feels and turn the whole responsibility back to management or leave the responsibility unfixed.

We do not find anything in the law itself setting up a social theory that it is harmful to have "concentration" in the underwriting field, and we recall that only a few years ago the Commission was concerned over the lack of underwriting capital. We believe that this second danger is far the greater one - so far as the country's good is concerned - and that this second danger will be increased by the proposed rule. It would seem in order first to establish rather than merely assert that "concentration" is one of the evils Congress had in mind.

With reference to the last paragraph at the foot of page 11 of the report, this firm has never "claimed proprietary rights" in the financing of the companies referred to, and so far as it is aware, there has never been even a shred of

testimony to the effect that such "proprietary rights" existed. It is beyond our understanding how such an inaccurate statement should be included in an official report.

Finally we submit that with world affairs as involved as they now are, with disturbed economic conditions, this is probably the worst time to undertake such an experiment.

Yours very truly,

(Signed) John M. Hancock.

Mr. Shreve: There is little that need be added to that letter except perhaps to stress the fact that Lehman Brothers has specialized in industrial financing and its opposition to the proposed rule is thus in no way influenced by a desire to protect its present position in the field of public utility financing.

It might be reasoned that since we have managed groups that were the successful bidders at mandatory competitive sale of two utility issues in New England, the firm's chances of securing additional high-grade public utility financing would probably be increased by the adoption of the proposed rule. But when this appeal to self interest is set against our opinion of the far-reaching detriment to the public good that would result from universal competitive bidding on all kinds and classes of utility securities, the overwhelming weight of evidence and experience leads us clearly to oppose any such procedure.

As was pointed out in Mr. Hancock's letter, our bidding under competitive bidding has been confined to the highest grade issues of well-known companies requiring very limited investigation and for whom the legal work had been done by law firms of unquestioned ability. The importance of this element of the problem should not be minimized.

There is another aspect of the problem not covered in Mr. Hancock's letter but which has been raised here. This is the position of the small dealer in universal competitive bidding. It so happens that our actual experience and the evidence of our actual records may prove helpful in considering this question. While the Commission quite properly is not concerned with underwriting the investment banking business, it does appear that the maintenance in the small communities of the country of a sound and efficient organization of investment bankers and dealers is inseparably involved with the broad questions of public good in so far as they are affected by any threat to established channels for flow of capital into industry, and if I understand correctly, Mr. Frank, your general statements made yesterday, you appreciate this and are considering it.

It is our impression that the Commission's staff holds that the small dealer participates in the distribution of issues bought in competitive bidding to generally the same extent as he does in negotiated issues, although on a somewhat different

basis. Only last week we furnished the Commission's staff with some evidence on this point. It is customary that all the individual members of a group which has purchased an issue at public bidding be permitted to make sales to other dealers less the full selling concession. There is active competition among group members for such sales in the municipal field. The contention is that the sum total of dealers who buy from all of the members in a purchase group will closely approximate the same number that would otherwise be invited into a formal selling group organized by the syndicate managers alone.

Our experience in the distribution of issues bought at competitive bidding does not support this thesis. In the case of the \$20,300,000 issue of New England Power Company 3-3/4s, eleven of the thirteen account members made sales to other dealers less the selling concession of 1/3%. 149 dealers bought a total of \$5,543,000 or about 27 per cent of the issue. In the case of the \$10,000,000 issue of the Connecticut River Power 3-1/4s all 10 members of the account made sales to other dealers less the selling concession of 3/8 per cent. 138 dealers bought \$4,001,000 of bonds or about 40 per cent of the total issue. In the case of \$12,000,000 of Cincinnati Union Terminal 3 3/8s, which were bought at public bidding, only five of the eleven account members made sales to other dealers less the selling concession of 1/8 per cent. 54 dealers bought



\$1,456,000 of bonds or only about 12 per cent of the issue.

It should be noted that in each of these instances the dealers participating were considerably smaller in number than would have been the case in comparable sized issues distributed through a formal selling group. Perhaps more important is the fact that the geographic distribution and the percentage of each issue sold through dealers was also less than would have been the case with a formal selling group organized in connection with a negotiated issue.

Total compensation paid the 149 other dealers for distributing the Connecticut River bonds was \$27,700. Total compensation paid the 138 other dealers for distributing the New England Power Company bonds was \$15,000. Total compensation paid the 50 other dealers for distributing the Cincinnati Union Terminal issue was \$1,800. About the time we offered the two utility issues, we distributed \$10,000,000 of a high-grade industrial 4 per cent issue which presented no unusual selling problems. Nevertheless, in order to achieve wide distribution, we used 320 selling group dealers of whom 246 were located outside of New York City to distribute approximately 59 per cent of the total issue and we paid this group a total compensation amounting to \$80,550.

Thus, on an issue half the size of the Connecticut River Power offering, total compensation to selling group members was almost three times what it was for the issue bought at competitive

bidding and the number of dealers who participated was somewhat over twice the number who participated in the Connecticut River distribution. The industrial issue was the same size as the New England Power offering yet the total compensation paid selling group distributors was over five times and the number also over twice what it was in the case of the issue bought at competitive bidding. In the case of the Cincinnati Union Terminal issue, the participation by 54 dealers in distributing profits of \$1,800 may for all practical purposes be characterized as virtually no participation, considering the \$12,000,000 size of the issue.

Without in any way involving ourselves in a controversy over what constitutes adequate compensation for selling group distribution, we simply submit this evidence for whatever value the Commission may find in it. Certainly in the case of issues bought at competitive bidding and distributed by us, it may be fairly said that participations by smaller dealers, both in number and total compensation was considerably below what it was in negotiated issues currently being offered at about the same time.

Again the Commission cannot reasonably be expected to concern itself with investment banking profits as such, but if our experience so far is any indication, there may very well be a genuine threat to many small dealers in the extension of competitive bidding. Perhaps here are involved broad questions

of public interest with which the Commission most properly should concern itself.

Mr. Connely: In your Cincinnati Union Terminal, if I remember your figures are that you had about \$12,000,000 of bonds?

Mr. Shreve: Yes.

Mr. Connely: How many underwriters did you have?

Mr. Shreve: Eleven.

Mr. Connely: Or about a million plus per underwriter?

Mr. Shreve: Yes.

Mr. Connely: What would you have had if you had negotiated that deal in an original underwriting purchase?

Mr. Shreve: Twenty to twenty-five probably.

Mr. Connely: Does that run similarly on those other competitive deals?

Mr. Shreve: We had \$10,000,000 in the New England Power issue, and we had \$20,000,000 in the Connecticut River Power issue, and there were 13.

Mr. Connely: I think it has been adequately shown around here for the last four or five years that a \$20,000,000 deal that an underwriter may have that (balance of statement in order book).

Mr. Shreve: I think Jay Whipple had an observation on that that time is of the essence there. Sequence is of the essence. And availability upon negotiation of the price is important. The closer you are to New York--I think that all of ours were in New York, except two or three Boston houses.

Mr. Dean: Could I ask Mr. Stuart just one question?  
Do you recall testifying before the T.N.E.C.?

Mr. Stuart: Yes.

Mr. Dean. Senator King askee you a question: "You had competition, I suppose, and still you underwrote a great many of the bonds, didn't you?" And you replied, "Yes, sir", and Senator King then asked you, "You had no competition from the banking houses in New York, did you, the investment company houses in New York?" And you replied, "Well, if there is any <sup>that</sup> business/we have got in Chicago that New York investment houses have not tried to get since the passage of the Securities Act, then I don't know what it is."

Mr. Stuart: I recall it perfectly.

cyl 11

Mr. Dean: Does that statement agree with what you testified today?

Mr. Stewart: I believe so.

Mr. Daley: I have an analysis which I was going to present in connection with the small dealers which will bear on what Mr. Shreve just testified to. May I do it at this time?

Chairman Frank: I would like to take this occasion to say something that Judge Healy suggested I should. Those of you that are lawyers and have appeared before the Commission will recognize and those who are not will not, and that is why I want to make this statement that the fact that we asked vigorously questions of certain witnesses sometimes has a Socratic purpose and does not necessarily indicate our conclusions. I trust therefore that you will recognize that anything we have said does not indicate that we have not an open mind. Mr. Dean will know what I am talking about, I am sure.

Mr. Dean: Yes, sir.

(Laughter.)

#### STATEMENT OF W. R. DALEY

of Otis & Company.

Mr. Daley: In reading the figures which Mr. Shreve just gave, one may get the impression that a very large amount in dollars is received by the selling group members of the privately negotiated issue. I would like for the record to take up a \$50,000,000 issue and try to analyze just where this spread in an

issue of this size goes. If it is the conventional two points, there would be \$1,000,000 gross spread in the business. With 1/4 for the management, \$125,000 would go to the management, and \$175,000. Assuming that the underwriters get one point, \$500,000 goes to the underwriters, and assuming that the underwriters take 60 per cent of the issue, which I think is a fair assumption, an additional \$225,000 goes to the underwriters for their direct selling, making a total of \$850,000 before you get to the 600 dealers who would be in that selling group. That leaves \$150,000 or approximately 15 per cent of the total spread which will go to the 600 underwriters, or an average of about \$250 each.

Commissioner Eicher: You mean 600 dealers?

Mr. Daley: Yes.

Mr. Eaton: Aren't you \$50,000 off in your management?

Mr. Daley: I misread it, yes. In competitive bidding, it seems to me that there is still room for the dealer to get his 3/4, and if it is spread narrower so that we can compete with the actual threat we have of the banks and the insurance companies.

I would like to comment at this time on the small dealer, as I think he is approaching the problem from the wrong point of view. I do not think that the dealer is a kept man; I think that he has a function in this business, and he is in the business not because the large underwriter likes him but because he is essential

to the distribution of securities. I see no reason why he will be any less essential, by and large, in the distribution of securities which have sold under competitive bidding. I do not think it is fair to compare his compensation with competitive bidding in municipals or in short term equipment trusts, because in those cases, in the case of the municipals, for example, I think his part of the compensation would be smaller because of the higher grade character of the security.

In the case of the equipment trusts, which are short term, his spread is always very small if he gets in at all on any of the short term issues.

Let us take some of the issues which have been competitively sold, for example, and a dealer got  $3/4$  of the C. & O. issue. He got 1 point in the Terminal Association of St. Louis; he got  $1/2$  a point in the Boston Edison case; he got 75 cents in the Pennsylvania Telephone preferred stock issue, which was a \$50 par or the equivalent of \$1.50 on a \$100 par value.

In a negotiated issue, he got  $5/8$  in the Illinois Bell Telephone Company. I do not think that the spreads are so far away, and I think they are somewhat equalized when you consider that in these cases of competitively bid issues, there was not the technical selling group for which he had a penalty if his securities happened to come in the market. It was free to all. You did not have to be a member of any particular club to get in; it was free to all dealers, and first come first served, and



the spread was his after he bought the securities.

I think it is well known that the small dealer that gets on the large syndicate lists feels that it is an accomplishment to get on the list, and he is very apt not to turn back bonds even though he can not sell them when they are allotted to him, and I think that is of some expense to him, and that is something that partly offsets the fact that he might get some less spread under the system whereby there is a general offering to dealers in which case his spread is on whatever he takes down.

Mr. Stanley: Just for the sake of the record, because I am sure the Commission is aware of it, I think that the presentation of the Division between different classes of work done does not tell the whole story, because these different people perform different functions and are paid in a different way. A man who does one thing -- sometimes we have guaranteed performance of the entire group as a part of our job. The underwriter takes the responsibility. The dealer sells without the commitment which the underwriter has taken.

Mr. Dean: Will Mr. Daley amplify what he meant when he spoke of the small dealer getting what he takes down?

Mr. Daley: I meant that he purchases the securities and then he resales them even though they come back on the market and he suffers no penalty.

Mr. Dean: But he is not restricted at the price at which he resells?

Mr. Daley: That is correct.

Mr. Dean: But under the Securities Act, he is?

Mr. Daley: That is correct. And he would be under these issues.

Mr. Dean: And under the utility issues, the Commission would have to pass upon the reasonableness of the spread?

Mr. Daley: The offering price is set and he can not depart from that.

Mr. Dean: In the municipals, that is not correct?

Mr. Daley: That is correct.

Mr. Dean: And in most dealers in municipal issues, they resell those issues at any price they can get?

Mr. Daley: I don't believe that is correct.

Mr. Dean: Isn't that correct in municipal issues, Mr. Stewart?

Mr. Stuart: What is that?

Mr. Dean: Are the dealers restricted in the price at which they can resell municipal issues?

Mr. Stuart: During the life of the syndicate.

Mr. Dean: Don't they take them down and mark them up?

Mr. Stuart: During the life of the syndicate, the dealer takes bonds at a certain price -- a municipal syndicate -- and he has to maintain that price when he sells the securities.

Mr. Dean: But he can sell at a higher price?

Mr. Stuart: Oh yes, in deed. Of course, a dealer would

not sell at a higher price until the syndicate was closed. He could not sell it at a higher price when someone else was selling at a lower price.

Mr. Dean: Isn't that a fairly common practice --

Mr. Stuart: (Interrupting) On a rising market, yes.

Mr. Dean: So that a dealer in municipal issues can withdraw them on a rising market and sell them at a higher price, which is not true of these other issues?

Mr. Stuart: Yes, sir.

Mr. Connely: I would like to ask Mr. Stuart. In the Boston Edison field, anybody that wanted to buy them could get them. In your group of which I think you are a member, were you contemplating a regular selling group?

Mr. Stuart: We had a great many members in our group, but if we bought the bonds we intended to have<sup>s</sup>/dealer's price.

Mr. Connely: Was it first come first served, or was it a formal selling group?

Mr. Stuart: I think we contemplated making a general offering of 1/2 per cent off or something like that.

Mr. Fournier: In the event of competitive bidding becoming effective in utility securities, is it your belief, Mr. Stuart, that as a general matter the syndicates would successfully bid for an issue of anything from \$10,000,000 up, and wouldn't you form a selling group as a matter of ordinary practice?

Mr. Stuart: I think it would work out that you would have

certain number of originals who would buy the issue, and they would offer it to a selling group just the same as you would in a private deal. That is the way it has worked out with us in a number of issues that we have bought competitively.

Mr. Stanley: With the same concession or a bigger one?

Mr. Stuart: I could not answer that.

Mr. Dean: I think there ought to be a distinction between the use of the selling group as used in the trade, and generally.

Mr. Fournier: I used the word in the sense that it is used in a private negotiation.

Mr. Dean: That was not the case in the case of the Boston Edison.

Mr. Fournier: I understand that, and that is the reason I asked the question.

Mr. Dean: In your municipal issues, do you offer the dealers firm bonds?

Mr. Stuart: Do you mean an allotment?

Mr. Dean: Yes.

Mr. Stuart: No.

Mr. Fournier: I asked him what would happen in the event of competitive bidding of utilities of \$10,000,000 and up.

Mr. Dean: If you had bought Boston Edison, would you have allotted firm bonds to selling security members?

Mr. Stuart: I thought of it. I think we would have offered them to all dealers on our list and first come first

km served, 1/2 off.

Mr. Dean: The same method that the First of Boston used on the Boston Edison?

Mr. Stuart: Yes.

Mr. Fournier: In that case, may I ask you, Mr. Stuart, why you believe if competitive bidding were a general practice that for larger issues it might be customary to form selling groups in the sense that it is now a custom with respect to privately negotiated issues?

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Mr. Stuart: As I understand you, in the larger issues you have two or three bids, on issues of \$10,000,000 and up. Then on the smaller issues, I should think that you would have eight or ten bids.

Mr. Fournier: With respect to the method of distribution by the purchasing syndicates, would it be your expectation that on sizeable issues that the purchasing group would organize a distinct selling group?

Mr. Stuart: Yes, it would be.

Mr. Dean: You see, there is a real distinction as far as the dealer is concerned as to whether or not he is going to get firm bonds or whether or not he is going to be permitted to buy bonds and subscribe for those bonds and be allotted those bonds on a first-come-first-served basis, and in the municipal field <sup>the</sup> it is first-come-first-served basis, and on the Boston Edison it was a first-come and first-served, and on most of the issues that have been bought on the competitive basis it has been first-come and first-served, and most dealers object to that very strenuously on negotiated issues, and dealers far prefer to have firm bonds allotted to them. If any dealer here disagrees with that statement, I would like to have him say so.

Mr. Spencer: May I ask whether the offering to the 276 dealers on the Boston Edison were firm bonds or whether the 276 dealers were offered an opportunity to sell them?

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Mr. Ford: We handled that about five years ago.

We handled that in the same manner that we handled the present deal. We sent out a letter which was called a dealer's account letter which was sent out to ---

Mr. Spencer: (Interrupting) 276.

Mr. Ford: Well, those 276 dealers were told that if they would come to our office, and the bonds were still there, they might take them down from us, and they were not offered firm bonds as is a common practice with negotiated issues where you have a selling group. We are trying to establish that distinction.

Chairman Frank: Now, will you proceed?

STATEMENT OF BENJAMIN J. BUTTENWEISER

of Kuhn, Loeb & Company, New York.

Mr. Buttenweiser: My firm was not one of the recipients of your letter and accompanying memorandum, and that accounts for the fact that we were not represented here yesterday. I am sure it was not due to any lack of interest in the subject matter under discussion.

Inasmuch as our firm was referred to yesterday, and inasmuch as the Chairman was gracious enough to suggest that we have a representative here today to answer the points that have been raised, I am here as that representative. I explain that because it will account for the informality of my presentation, due to the fact that I only saw the record when I arrived

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here at noon time by plane.

Mr. Eaton, if I correctly quote him, was gracious enough to say that one of the most enlightening discussions on this subject of compulsory competitive bidding is found in Kuhn Loeb & Company's brief presented to the Interstate Commerce Commission about 15 years ago when they --meaning the Interstate Commerce Commission-- were considering this same subject, namely, compulsory competitive bidding.

He further went on to say that they---meaning Kuhn, Loeb & Company---took the ground that the proper issue involved in that discussion was the highest possible terms and price to the issuer. That was what they were seeking to sustain, and they held this, - they said that if prices are to be supported and if issues are to go out at a high price, we must have banking houses, who are of great influence and great prestige, behind them, otherwise you will not be able to secure a full price for the security when it is offered, and furthermore unless you have that kind of a sponsorship, the market on the issue will not be sustained and supported in bad times.

Further he said, - and I am skipping a bit - "but the experience of the banking world has demonstrated that practically every position taken by Kuhn Loeb and back at that time by J. P. Morgan & Company in connection with railroad financing, practically every argument on which they based their case has



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been completely demolished in the sixteen or seventeen years that have elapsed since that time."

Now, the pamphlet to which he referred was one which was presented by our firm to the Interstate Commerce Commission in October, 1922, and I reviewed it on the plane coming down this morning, and naturally we have given much thought to this whole question of compulsory competitive bidding, and it seems to me that the views we presented at that time are equally applicable and equally cogent and equally timely at this moment, and I think before expressing any such opinion it is but fair to indicate what we really did say in that memorandum.

Naturally, I will not take your time by reading all or any very substantial part of it, but just the parts that are particularly pertinent and particularly applicable to what is before you now. I will be glad to leave one for your record.

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Quoting from that memorandum: "To market railroad securities"—and I might say that wherever we say "railroad securities", it is equally applicable to any type of securities: "to market securities on a large scale requires a combination of skill, experience, capital, reputation and connections that, from the nature of the case, can be possessed by only a limited number of concerns at any one time, because only the test of time will produce most of these necessary qualities.

"That skill, experience and reputation it is the business of the banker to make available to his clients, together with his financial potency and relationships.

"A banker of long experience with a record of success, conservatism and integrity, develops a power to place securities that is of great value to his clients, cumulatively so the longer the relationship is maintained.

"The question of the best and most serviceable method of selling securities must be determined not from the wholly exceptional and fortuitous circumstances which have prevailed during the last year"—and I might interpolate that the year 1923 as it developed by October of that year when this memorandum was submitted were very similar to the market situation as we have found it during 1940 and thus far in 1941; in other words, it was a period of relatively low interest rates and of consequent relatively high bond prices.

Continuing:

"In the marketing of securities, as in other businesses, there are occasional periods of excessive activity, usually of comparatively short duration, occasional periods of acute depression and longer periods of normal activity.

"It happens that this year has been a period of unparallel activity in the marketing of securities of domestic issues, simultaneously with, and partly caused by, growing reluctance to invest in issues of European countries. There has been a vast and almost insatiable demand for new domestic securities, particularly bonds, an almost uninterrupted decrease in interest rates and a corresponding increase in the market value of securities.

"The result has been that bankers and syndicates have been much more than usually successful in marketing the domestic security issues which they have purchased and that as a rule new security issues have advanced in the market and reached prices in excess of the issue price. The upward trend of security values is illustrated by the fact that in the last ten months the average market price of ten standard railroad bond issues taken at random has increased about thirteen points.

"It has been a time when it was possible to indulge in improvident bidding or 'spite-bidding,' without being deterred by the swift penalty of non-success in marketing, which follows such practices under normal circumstances.

"Under these conditions, it is easy for critics who consider

only recent experience, and whose knowledge does not carry them back to the pre-war years (which, after all, furnish the best standards for judging the future), to jump at the conclusion that the railroads have not been receiving the best possible prices for the securities they have marketed and that higher prices would have been realized if the sale of railroad securities had been opened up for competition."

Then further along in that document it says:

"It is to the best interest of a borrower that its securities should be absorbed by the investing public and that their value should be maintained under normal conditions. It is more important to the industry that a favorable reputation, the good will of the investing public and the broad steady demand for its securities should be preserved than that in every instance the very top notch price should be obtained to which through taking advantage of fortuitous circumstances, the purchasing banker might be driven".

Now, I say that on review that we find very little in this document that does not apply with equal force or equal conviction to the present situation, in fact, if it is not transgressing the bounds of modesty, we think that this document was in many ways prophetic in its applicability to today's discussion, and while we have not compared any complete analysis of the memorandum as submitted by your Public Utilities Division, we have read it, and we have likewise read the brief

submitted by the Investment Bankers' Association, and I want to say that we endorse the views expressed therein.

Here are one or two further observations which with your indulgence I would like to make. It does not seem quite a coincidence that the subject of compulsory competitive bidding comes to the fore always at times of low interest rates and high bond prices. We have been thinking about that for a very long while. And the reason for that is quite simple. If you will pardon the analogy, compulsory competitive bidding, as I see it, is somewhat like the method of loaning a man an umbrella with the express understanding that he return it at the time that it starts to rain. That analogy can be borne out and sustained by actual instances.

You have heard much on the subject of compulsory competitive bidding. You have heard many opinions expressed, but let me just cite to you a few instances where compulsory competitive bidding has been forsaken even though, as I understand it, the law provided for compulsory competitive bidding.

I refer to the case of the City of New York which in December, 1931, addressed personally and confidentially a letter to the then senior partner of our firm, Mr. Felix M. Warburg, and at the bottom added that a similar letter had been sent to J. P. Morgan & Company, the National City Bank, Chase National Bank, Guaranty Trust Company, the Bank of Manhattan Trust Company, the Bankers Trust Company and the First National Bank.

It is not fair for me to characterize the standing of our own firm, but I think it is fair to say that the other banks and the other firms mentioned stand at the very forefront of the banking community in New York City. And I am at liberty, I think, to read this correspondence, because the element of confidence no longer applies, this having happened in 1931.

Despite the fact that, as I understand it, the New York State law provided for compulsory competitive bidding for municipal securities, the City of New York wrote the following letter over the signature of the then Controller:

"The position occupied by New York City bonds in the present market is a matter of grave concern to city officials, especially despite all rumors to the contrary the financial of Greater New York is beyond question.

"May we appeal to you as a civic duty to form one of a group of New York bankers to consider this and any other relevant questions relating to the financial condition of New York City, and when conclusions are reached to confer with the Mayor and other responsible city officials to the end that such measures as are deemed advisable may be taken to correct the present situation.

"If the Department of Finance, New York City, can furnish any assistance or information that would be helpful, our facilities are at your service".

And that was signed by G. W. Berry, Comptroller of the  
City of New York.

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What confronted the City then was the urgent need for a large amount of funds, and despite what the comptroller has said then, the City of New York's finances were not in any too good shape. As I recall, there was a substantial amount of delinquency in the payment of taxes.

Without boring you too much with the details, suffice to say that as the result of this, there were formed a group which bought from the City by direct negotiation and not through compulsory competitive bidding \$100,000,000 of short term corporate stock, and in conjunction with the banks provided a revolving fund of \$151,000,000. I will submit for the record the answer of our firm which said that we would be delighted, naturally, to cooperate and undertake this as a matter of civic duty, and if I may, I would like to read the final reply of the comptroller of the work that had been accomplished by that group. The comptroller repeated his letter of December 23, 1931, and said:

"The response was most gratifying. Within a few days I had received letters of acceptance from each of the institutions, a working committee had been formed, and the City's financial requirements were undergoing a thorough examination.

"The members of your committee did not spare themselves at any time, holding conferences with City officials, accountants, et cetera, daily, evenings and Sundays, in their efforts to expedite the work in hand. As the result of this prompt



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and practical cooperation, the City has been relieved of the temporary embarrassment occasioned by the world-wide financial strain and has been placed in the position to meet all obligations and maintain the high credit standing that always has been its portion.

"The City of New York stands deeply indebted to the members of your group for their advice and assistance. As its chief fiscal officer I wish to acknowledge my own indebtedness to you".

And that was signed by Mr. Berry, the comptroller of the City of New York.

I did not read that, obviously, as any advertising praise of the firms involved, but merely as an illustration of the fact that in times of serious circumstances, compulsory competitive bidding cannot and does not function.

Chairman Frank: You are aware, are you not, that the proposed rule expressly provides that upon adequate showing the rule should be made inapplicable?

Mr. Battenweiser: I am well aware of that, and, Mr. Commissioner ---

Chairman Frank: So that if you assume such circumstances as those you have indicated, the rule will have plenty of rubber in it to get at it.

Mr. Battenweiser: I am well aware of that. This is not a unique situation. It may be more impressive in the size of the

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figures.

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Chairman Frank: What you are saying is that there are times when such a device as compulsory competitive bidding may be undesirable or impracticable. The rule which itself so states and recognizes and which contains the provision by which that rule may be rendered inapplicable in those circumstances would seem to meet what you have indicated as a necessity.

Mr. Bottenweiser: What I am alluding to and what I am leading up to is that this compulsory competitive bidding is one of those strange factors or methods which is bad for the borrower in bad times, that is in periods of high interest rates and low bond prices, and conversely is bad for the lender in times of low interest rates and high bond prices.

Chairman Frank: Have you also in mind what has been said several times, perhaps while you were not here, that at least to some of us the question of compulsory competitive bidding, at least in the present condition of the market, is of only minor importance relative to price. What we are more concerned with, some of us at any rate, is that the utility involved should have the best possible advice with respect to the character of the securities it should issue, to-wit, as to whether they should be bonds or stocks or whether it should be a mortgage, or if stock, what kind of stock. It is that matter that seems, at least to me, a matter of more importance than the matter of

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price.

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Mr. Battenweiser: I quite agree with you and I am delighted that you made that point. It paves the way for me to make my next point, but inasmuch as you have cited that part of the rule with which I was familiar, that it can be waived in certain instances, let me point out to you, if I may, that the very waiving of that rule would be detrimental to the credit, as I see it, of those corporations for which you waived it.

For instance, it was harmful to the credit of the City of New York that it has to resort to the waiving of the competitive bidding rule so far as its securities were concerned, just the same as it had a deleterious effect on the credit of Chicago and Boston and Cleveland and San Francisco and Los Angeles and the State of New Jersey and the State of California and various others that I can cite--- and I have them here --- that they advertised securities for competitive bidding and received none.

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So, too, if you waive the rule with regard to utility "A" or holding company "A" or corporation "A" but not as to others, it will be noted to the investing public that the credit of that company or the circumstances surrounding the issue are such that it necessitated waiving the rule, and that I believe will be very harmful to its credit.

Mr. Weiner: May I ask you a question?

Mr. Battenweiser: Yes.

Mr. Weiner: Is it correct to say that the City of New York at that time had good credit?

Mr. Battenweiser: Of course it had credit. The fact is that it had better credit than the public realized, and the sponsorship of a strong group established in the minds of the investing public a fair appraisal of that credit.

Chairman Frank: That is the opposite of your recent assertion.

Mr. Battenweiser: What is that?

Chairman Frank: Your assertion is that the credit was injured by the relaxation of the rule. Apparently it was bettered?

Mr. Battenweiser: Certainly it was. I will tell you the precise prices at which New York City bonds were selling at that time. They sold down to alarming levels.

Chairman Frank: And they sold at a better price after the relaxation of competitive bidding?

Mr. Battenweiser: No, sir, they got to that level because it

was heard that they were no longer susceptible of getting competitive bids, and they had to go to heroic methods to establish it. There was a good deal of civic virtue involved in forming that group.

Mr. Weiner: There were also many other pressures on the bankers besides the banking credit of the city?

Mr. Battenweiser: I don't know of any other pressures.

Mr. Weiner: I think that could be established.

Commissioner Healy: In addition to buying the bonds or corporate stock, did the group that you referred to go into the market and make purchases and support the prices of outstanding issues?

Mr. Battenweiser: I don't think so, Judge Healy. I am not clear on that, but my best recollection is that we did not. As a matter of fact, my recollection is strengthened by the fact that when we had \$251,000,000, we felt that we had ample. As a matter of fact, there was considerable difficulty in forming that group.

I could cite another case. We had greater difficulty in forming a group for \$100,000,000 for the City of New York which they owed in gold in London in 1914.

That brings me to the next point because Commissioner Frank raised it, and I think there has been considerable confusion in the minds of many, and I think it has been illustrated here this afternoon. I think we are confusing bidding and competition.

When you asked the question earlier this afternoon as to whether competition existed, the reply seemed to focus around bidding.

I submit that competition does exist. It exists potentially, and all of the borrowers know it and from what little I heard this afternoon and what I have been told was testified to earlier in the day, there is potential competition, and there is no such thing as the favorite banker referred to in your Division's report on page 44, unless the outstanding lawyer in a community or the outstanding doctor in a community or the outstanding architect in a community is the favorite architect or doctor or lawyer. In other words, if you are going to establish the thesis that being entrusted with a large amount of the business or practice in a community establishes one as the favorite, I say there is no such thing as a banker who gets things through favoritism. He may get business through his reputation for knowing his business, for knowing how to give the advice that is so important a part of the investment banking business or for knowing the timely moment at which to offer securities or being resourceful as to meeting the corporate financial problems of a borrower -- then I say yes, that establishes reputation, but I do not believe that reputation and favoritism are synonymous.

Chairman Frank: Is it the practice of your house to endeavor to get the business of an issuer that is doing business with another issuer of prominence when you consider, to use Mr.

Stanley's phraseology, that that other underwriter is doing a good job?

Mr. Battenweiser: Mr. Frank, Mr. Commissioner, I can only tell you that our motto is "Barkis is willin'".

Chairman Frank: That is one thing. You may be receptive, but I mean that the coal merchant does not say, "Barkis is willin'". He goes out and bids. I am not saying that it is desirable; I am just trying to get the fact. Is there competition you and Morgan Stanley and Dillon Read for the business of issuers --

Mr. Battenweiser: (Interrupting) Yes.

Chairman Frank: (Continuing) And there is in other fields? In other words, if Morgan Stanley has an issuer that has done business with them, and you think they have done it satisfactorily, do you aggressively go after that business?

Mr. Battenweiser: No, because we have not got a Chinaman's chance of getting that business so long as the banker is rendering a satisfactory service to that borrower.

Chairman Frank: Do you find that out by experiment, or do you know that to be true?

Mr. Battenweiser: We know that by the test of time.

Chairman Frank: Have you tried it?

Mr. Battenweiser: Yes sir, and I will tell you how. That borrower knows that we are available. As Mr. Stanley said a moment ago, our doors are wide open and we are very appreciative of anyone who wants to come in.

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Moreover, this is not merely hypothetical on our part.

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We have been the recipient of calls from other corporations who had bankers of very good standing, and I may say and possibly there may be a little more pathos in my voice when I say that we have had certain firms that have left us -- the Youngstown Sheet & Tube Company -- at that time a security affiliate of the Bankers Trust Company was---- that was in 1927 --- I am a little uncertain, I am relying on my memory now for the date, but it made some impression at the time. They had a \$75,000,000 issue which they were negotiating with the Bankers Company, or it may have been called the Bankers Trust Company, and without listing any great veil of secrecy, I do not think that they were quite satisfied with the terms that were suggested to them both as to the set-up and as to the price by the Bankers Trust Company, and they came to us and we were delighted.

The Bethlehem Steel Corporation more recently was dealing with one of our other friends and neighbors and competitors, Messrs. E. B. Smith & Company, and for reasons sufficient for the Bethlehem Steel Corporation, they came to us instead. That was during the time that they were negotiating with E. B. Smith & Company.

And I cite those two cases first because they are fairly large and fairly important, and also because they represented no change in the management whatsoever in those corporations at the time that those corporations took the walk, so to speak.



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I might on the other hand say that the Republic Iron & Steel Company, which is a very important steel corporation as you know and for which we made many issues, has seen fit for reasons good and sufficient to it to leave our firm for certain reasons which I think are probably valid, and is now, as I understand it, -- Mr. Pollard I think can check it -- is now negotiating with Dillon Read & Company and a group associated with them for a very sizeable issue.

I can cite many more examples, but I do not think it will make it any more forceful.

Chairman Frank: This is a question of receptivity that I was discussing. I am discussing the question of your going out and where you have really gone out to take business away from another concern.

Mr. Battenweiser: The reason we do not do that is very simple; we do not think that is the best way to get business.

Chairman Frank: Have you ever tried it?

Mr. Battenweiser: No, but we have seen others try it and we profit from the experience of others. (applause)

Mr. Fournier: In connection with this Republic Steel offering that you spoke of that Dillon Read negotiating for and which was formerly your account --

Mr. Battenweiser: (Interrupting) Do you mind my correcting a word there which has technical implications? It was no account of ours.

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Mr. Fournier: I will accept the correction.

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Mr. Battenweiser: They were clients of ours.

Mr. Fournier: Tell me whether or not you anticipate being offered a participation by Dillon Read in that syndicate?

Mr. Battenweiser: I can answer that very simply. We will probably be offered a participation and we will probably not accept it, and the reason is that, - the factors and reasons which motivated Republic Steel Corporation to cease being a client of ours - for the time being - (laughter), and this is said in utter seriousness - the reason I say "for the time being" is if they come back we will be delighted. The reason they gave us we have not the slightest right to doubt that they were perfectly sincere in it and it would be equally conclusive on us with regard to being an underwriter, and that is the reason we will not be an underwriter.

Mr. Fournier: Have you any reason why you do not care to state those reasons?

Mr. Battenweiser: I think in fairness --

Chairman Frank: (Interrupting) If you don't wish to, you need not.

Mr. Battenweiser: I think those reasons might better come from the corporation, because I think you will recognize as a lawyer, Mr. Frank, that there is a professional relationship between a lawyer and a client, and there is an analogous relationship between a banker and a client which precludes my disclosing

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it.

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Chairman Frank: At any rate, we won't press you.

Mr. Battenweiser: I alluded to the value of the continuing relationship, and the memorandum that we filed in 1922 with the Interstate Commerce Commission alluded to the continuing relationship, and I say again that I do not believe it can be any coincidence that the validity of that relationship is recognized in every other country. After all, the British and the French and the Swedes and the Japs and all the other countries were no neophytes in finance, and as far as I am aware competitive bidding does not exist in any other country. There must be reasons for that. They must rely on the advice and on the sponsorship and on the continuing experience, and they must place great faith in it.

I might add that our own Government seemed to believe in the continuing relationships, and when the Federal Land Banks were in the market, there was one continuing account which handled the financing for the twelve Land Banks and their consolidated financing, and I do not believe there was any change in that relationship from the inception of the Land Banks until the most recent issue that they made.

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If you want to I can dwell further on this question of competition as against bidding. We submit that bidding, the so-called auction block method or any other method of bidding is just one of the elements in competition, and frankly, not the most important by any means. Corporations which have paid the highest price may very often be obtaining a pyrrhic victory. I think you gentlemen recognize that, and I think certain instances in recent history have shown that.

So that, if I may, I should like to summarize our views of 1933, and I do not want you to think that we are old fashioned. We recognize this is a mutable world, but some of the views we expressed then apply today.

Chairman Frank: I believe you have changed some of them.

Mr. Battenweiser: We have changed no little, and I think it is only fair that you have had a hand in it.

Chairman Frank: Did we persuade you?

Mr. Battenweiser: You are always persuasive.

Railroads and other corporations should be left free under the responsibility of their board of directors and subject to such authority over the issue of their securities as is now exercised by the Interstate Commerce Commission. You will appreciate that this was a memorandum which was addressed on the subject of railroad securities, and that accounts for the mention of the Interstate Commerce Commission, but your Commission would apply equally in the case in hand now,--"to deal with whatever

banking houses they deem it to the best interest to employ. They should neither be bound by contract nor control to deal with any one banking house exclusively, nor forced by statute or regulation to take the chances involved in competitive negotiations or bidding among bankers or of direct dealing with the public".

There is just one last word and then I will be delighted to answer any further questions you may have.

On this entire question of whether or not we seek business, I want to make it quite clear that we seek business as actively as we can, and by what we consider the most practical useful method and the best method we have is the successful method that we may have with corporations that entrust their financing to us and seek our financial advice, and I suggest that while banking is not in the strict sense a profession, it has many of the attributes of a profession. Just the same as lawyers do not advertise and doctors do not advertise, nevertheless through their acts they are known and through their record they become increasingly important lawyers who seem to get a larger share of the legal business or the medical business or whatever it may be in the community.

Let me carry that analogy just one step further, because I think it has particular applicability to the question at hand now. There is no law which forces a man to engage a lawyer when he goes into a lawsuit or which forces a man to engage

an architect when he builds a house, or which forces him to engage a doctor when he does not feel well. But I submit to you gentlemen that as a practical matter is just is not smart business to go into court and act as your own lawyer, it is not very wise to build a house or a building and act as your own architect, and it is often almost suicidal not to engage a doctor, and therefore I say that it is sound business for your borrower and it is equally sound from the standpoint of the lender, namely, the investing public, that the experience and the resourcefulness and the financial resources and the placing power and all of the other attributes that go to make a sound successful banker be used in a financing operation.

If there are any questions, I should be delighted to answer them.

Mr. Dean: May I ask you just one or two questions?

Mr. Battenweiser: Certainly.

Mr. Dean: On page 25 of the Public Utilities Division Report there appears this sentence, "But whether or not, under the present non-competitive practice, the issuer tends to lose some of its independence, the various possible resultant conflicts of interest between issuer and underwriter make it both inadvisable and undesirable for an issuer to depend on its underwriter's advice and guidance".

Do you agree with that?

Mr. Battenweiser: I disagree with that completely. The

issuer does not have any lack of independence on the present basis. The issuers are free to go anywhere they want. I am glad that was called to my attention, because I omitted to state one thing. My firm has never had a so-called preference or financing contract or agreement with any borrower except in the following instances, as I recall:

First--we had a contract for a little while which I might add we did not seek but which the borrower sought that we would continue to handle the financing of a certain motion picture company which we backed in its infancy, and it wanted to be certain that it could rely on us for continued banking advice and for handling its finances. You might very well say that we were not bound by it, that we did not have to take all the securities. That is true, but there was a very strong moral commitment on our part that we would be the purveyors of credit to that corporation. That was, as I recall, in 1918.

In certain isolated cases, we had not a preference, for instance, but an arrangement whereby a certain foreign borrower would not borrow in the American market except through our firm for a certain length of time, and that is very analogous, I think, to the instance that Mr. Stanley cited of the Belgian Government. Our contract was not with the Belgian Government. I hesitate to mention who it was, but it was the Mortgage Bank of Chile, and the reason that we had that contract was as Mr. Stanley indicated; we did not want the American market flooded

with too recurrent borrowings by that borrower. I am sorry to say that we did not enforce that contract more closely.



Mr. Fournier: Before you leave the answer in response to Mr. Dean's question, I would just like to ask you this question,- are you taking the position that there are no potential conflicts of interest between an issuer and an underwriter?

Mr. Battenweiser: I see no possible conflict between an issuer and an underwriter so long as the issuer is, as I understand they now are, barring some contracts of which I have no knowledge but which I heard of recently, so long as an issuer is not bound to any underwriter or group of underwriters,- I see no conflicts of interest.

I will tell you why. It is not merely an opinion. I can show you the way out. If there is any conflict that the issuer recognizes, it is well within his power to cure it by simply going to other underwriters. Does that answer your question?

Mr. Fournier: Yes.

Mr. Dean: Suppose you were retained to advise an issuer with respect to a capital setup and a proposed offering and they said to you at the time, "We don't know whether you are going to be the bankers here or not, and we may throw this open to competitive bidding." Would your advice be any different to them than it would be as though you were negotiating with them in your usual manner now?

Mr. Battenweiser: On that we would be perfectly objective. We would sell them our advice, but we are not going to risk our best advice as a generous gesture to them. In other words,

if borrowers are going to take the view or if the customer should develop that they will seek financial advice as they seek legal advice, I think that we would be in the market to furnish it, and quite frankly and once again I do not want to transgress the bounds of modesty, but if they think we have sound financial advice, our rates will be accordingly, just the same as when you engage a really good doctor or a really good lawyer you pay his fees. That does not mean that we would say that for \$25,000 we will have this type of advice and for \$50,000 we will have a better type of advice, and for \$100,000 the very best.

(Laughter.)

Mr. Dean: On page 25 the report was referring to the capital setup and on page 31 they are talking about the preparation of registration statement and there appears the following: "It is submitted, however, that such preliminary work should be performed by independent experts retained for the purpose." It was suggested here this afternoon by Mr. Weiner, if I understood him correctly, that he could see no objection to an investment banking firm being retained as an independent expert to advise on the setup and the preparation of the registration statement and the indenture, and then that that same firm should be permitted to bid in competitive bidding. I was wondering if you would care to comment upon the significance of those statements?

Mr. Buttenweiser: I can not speak for Mr. Weiner, of course, but I would believe that in the long run, (a) it would be more

expensive for the corporation and (b) they might very well get some pretty confused ideas, because if they go shopping for advice that way on a competitive basis, it will be just about the same as if I had a fairly severe illness, and I sent for Dr. A and asked him what he would prescribe, and I sent for Dr. B and asked him what he would prescribe, and for Dr. C and asked him what he would prescribe, and I would still have to find someone to tell me which prescription to follow.

Chairman Frank: I have done that.

Mr. Bottenweiser: It is surprising that you are still alive. I want to congratulate you on your constitution.

(Laughter.)

Mr. Weiner: It seems fairly apparent to me that Mr. Bottenweiser misunderstood your question.

Chairman Frank: The question is a simple one. Assume that there should be a system of compulsory competitive bidding and assume that it would be desirable for the issuer to get expert advice and the issuer came to you to get such expert advice and paid you an appropriate fee, and the question is should you in those circumstances be allowed when the matter went to competitive bidding, to be one of those persons who would bid?

Mr. Bottenweiser: Mr. Commissioner, I can see no reason why we should be estopped from bidding, but I will say this, that I think that by that type of transitory advice you lose one of the very important elements of a continuing banking

relationship, namely that there is value in dealing with one banker for your advice, the same as there is value in dealing with one lawyer. The one banker is naturally more conversant with your problem, and it would take another banker much longer to orient himself to your problems, and therefore he might not have as comprehensive a view as a banking firm who has dealt with those problems for 20 or 30 years.

Chairman Frank: There is nothing implicit in the fact that having given expert advice, that he should not be allowed to bid when the matter went to competitive bidding?

Mr. Battenweiser: What is it that you deduce from that suggestion?

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Chairman Frank: Because of no circumstances the banker would be giving advice with no assurance that he would be the successful bidder.

Mr. Battenweiser: I do not see why that would temper his advice any. I was asked a moment ago whether we would give sound advice, and I say yes, if we were engaged, and we would do the very best work we could. I do not see why we would give one type of advice because we were assured of being the sponsor of that issue and another type of advice because we are in doubt as to whether we will be. Our advice would be predicated on the situation of the corporation and the business problems thus presented, that is, as we see them at the time. In other words, there are many aspects of this problem. There is the question of the set-up of the new issue, there is the question of the timing, there is the question of suggesting what type of security is to be issued; there are a multitude of issues involved, and the final fixing of the price is important, too, and as I see it, one of the less important of the problems, and as I see it, it represents confused thinking to think that the banker actually sets the prices. He does not; the market sets the price. One does not have to be a great genius to realize that come what may, and you have a certain type of security, the seasoned investors--and they are increasing--and the various rating services evaluate that security and they evaluate that price with comparable securities. There may come a time when you have a unique

security, and that is the time when you certainly want continued banking sponsorship, because many a time the real value of a security is not properly appreciated by the investing public, but as a sponsorship of reliable bankers--you gentlemen may discount this and think that I am pleading pro homo, but I am saying it to you with all of the sincerity I can--the sponsorship of a reputable banking firm, people who have records and are selfish in wanting to maintain that record is of value in the placing of that security and in the pricing of that security, and the reason I say "selfish" is, quite frankly, that people will buy securities sponsored by our firm or by any other firm just so long as they think that we know our business, and part of our business is to be able to evaluate securities in their proper intrinsic sense.

Mr. Weiner: Am I correct in my understanding that your firm has had such an interest for a great many years in railroad securities?

Mr. Buttenweiser: No, no more than in a great many other fields.

Mr. Weiner: But you have done a great deal of railroad business?

Mr. Fournier: More than in the utility field?

Mr. Buttenweiser: I think we have probably done a greater percentage of railroad issues than we have of the utilities, yes.

Mr. Weiner: And during all of those years during which you

did that business, your firm generally had a continuous relationship with the particular railroads affectee?

Mr. Bottenweiser: That would be implicit in my previous reply.

Mr. Weiner: The St. Paul Railroad would be an example of that?

Mr. Bottenweiser: Yes.

Mr. Weiner: Would you say that taken by and large over the period of years that the railroads of this country have gotten sound financial advice from their traditional investment bankers?

Mr. Bottenweiser: I say that got as sound advice as anybody could, but I also say that on the one hand the advice was given within the vise—I might rather say within the strait jacket of the laws set down by Congress, namely, that for a long time the earning power of the railroads was appreciably curtailed by certain aspects of the Transportation Act so that they were caught between the dilemma of rising costs and an impossibility of increasing their income, and I think you will agree that it is rather difficult to give sound advice or it is rather difficult to give what I think might better characterize as advice that will work out successfully in the face of diminishing income of railroads.

I want to add further that banking advice was not always followed, and I can show you instances where bankers made very earnest recommendations to the managements of railroads and of the

other corporations--but it is railroads that we are discussing at the moment--and that advice was not followed. I think it is unfortunate from the standpoint of the security holders of those railroads and the public in general that such advice was not followed.

Mr. Weiner: But did you sell the securities when your advice was that they should not be sold?

Mr. Battenweiser: In some cases we did and in other cases we did not. I might add that every one of those securities was passed on by the Interstate Commerce Commission, but what I am alluding to is the fact that in some cases we suggested that the financing be done through equity securities. There are very few railroads in recent history that have been in the position to issue equity securities and the reason for it is --



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Chairman Frank: (Interrupting) They could have in the roaring 20's.

Mr. Bittenweiser: Not even in the roaring 20's.

Chairman Frank: Some could.

Mr. Bittenweiser: And some did.

Chairman Frank: And some that could, did not?

Mr. Bittenweiser: Those were the fewer. There are some, yes.

Chairman Frank: And some that could that did not may well regret it today?

Mr. Bittenweiser: That is true and I rather imagine that they do, but the point I am endeavoring to make is this, that a great many of those companies, as you well know, Mr. Commissioner, had par value stock and they could not sell it below par, and the earnings of those railroads were through the working of the Transportation Act, especially right after they came out of the government control and afterwards, right after that, and their earnings were restricted to 5-3/4 per cent I think it was, and as a result they did not have earnings sufficient to warrant the sale of equity securities, because, quite frankly, equity securities have to be made quite attractive or else the public will not buy them, so the advice of the bankers might be ever so sound, but if they did not have the earnings, they could not issue the equity type of securities, which we would/rather have seen them issue, and I think that accounts for the fact that

there is a disproportionately large amount of debt on a great many of our American railroads as against the regretably small percentage of equity.

Mr. Fournier: Is it not true that in the event that railroad stock had been issued in the normal practice, they would have been offered as rights to existing common stockholders so that the underwriter would have simply had a minor underwriting position as contrasted with the position which the underwriter had in the very large bond issues that were being issued at the very time, which as you admitted, many of these railroads which now regret it, might have issued more common stock?

Mr. Battenweiser: Might I say that that is completely wrong, and the reason I say that is this, - the shares that were offered to the shareholders under their preemptive rights were almost invariably underwritten, and that was very sound financing, and the percentage of participation by the underwriters in an underwriting was at least -- in many cases much larger than on a new underwriting, in an offering to shareholders than an issuance of bonds and the spread was larger. If you want me to cite the gory details, I will tell you about a few offerings that were offered to the shareholders and the shareholders did not take the securities and the bankers had to take them.

I mentioned Bethlehem Steel. Most of us remember an

offering of \$48,000,000 Bethlehem Steel 3½'s convertible bonds which were offered to the shareholders of the Bethlehem Steel Corporation and the shareholders knew more about it than the bankers, because the shareholders did not take them and the bankers had to take \$46,000,000 of them.

Mr. Fournier: Do you mean to say that the underwriting remuneration to bankers would be as great in the issuance of equity securities where the stock in question is selling say at 110, and the offering is, let us say at 10 or 15 points away, as there would be in underwriting an issue of bonds ---

Mr. Battenweiser: (Interrupting) It might be in this pamphlet, if you will bear with me for just a moment, apropos of that.

Mr. Stanley: You mean that there was a margin of 10 points and that that is adequate, you are just wrong. Take the case of the Eastman Kodak Company. The price of the stock was 127½. It got to 168 and it went down to 131 -- almost 30 points. Fortunately, the stockholders did take it, but the margin of 10 points is not entirely adequate. How can you forecast 30 or 60 days in a thing like that?

Mr. Fournier: I think I can cite instances where such rights were offered --

Mr. Battenweiser: (Interrupting) I thought it was in this pamphlet, but I do not find it. One or two corporations in the best of railroad markets sought to offer their securities

to their shareholders without any underwriting, thinking that what you referred to as margin or differential was sufficient to insure the success.

Mr. Fournier: In what period was that? And what were the prices of those bonds?

Mr. Battenweiser: I will give you that in one second.

Chairman Frank: It must have been prior to 1922?

Mr. Battenweiser: Yes, I think it was in 1914 or 1915 or somewhere through there. I will have it for you in just a moment.

Commissioner Healy: It has been my observation that there are very few souls saved after 6.30.

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Mr. Battenweiser: If I can just crave your indulgence for one moment. I will submit that for the record right after we adjourn, or if you want to continue after dinner? Whichever you prefer?

Chairman Frank: Judging from my own state of fatigue and that of my colleagues which they have indicated by their physiognomies, I would suggest that we adjourn tonight and reconvene in the morning at 10 o'clock. And I think it will be possible, do you not, Mr. Stewart, for us to finish by 12:30 tomorrow or 1 o'clock?

Mr. Stewart: I would not venture to make any such engagement, because I do not know how long these things will take. I had not thought that Mr. Battenweiser ---

Chairman Frank: (Interrupting) Would be so entertaining.

Mr. Stewart: It has been very interesting, and he has taken the better part of an hour and a half, and I had not expected that he would take anywhere near that long. If that should happen tomorrow, you will understand what the situation will be.

Chairman Frank: I think we will have to try to get through by 1 o'clock tomorrow.

Mr. Battenweiser: Am I to go on again tomorrow?

Chairman Frank: I think perhaps that you would like to be here.

Mr. Battenweiser: Very well.

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(Whereupon, at 6:25 p.m., a recess is taken until 10  
o'clock, a.m., Wednesday, January 29, 1941.)

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