SECURITIES AND EXCHANGE COMMISSION
WASHINGTON

December 10, 1937

Honorable Joseph C. O'Mahoney
United States Senate
Washington, D. C.

My dear Senator O'Mahoney:

In response to the request which you made at the time of the hearing on H.R. 8046, I am happy to enclose a memorandum setting forth certain factual materials of interest in connection with the Federal Incorporation Bill.

In compiling these materials we have examined our records and exhibits concerning reorganizations, and have gone beyond these to search the registration statements of newly issued and distributed securities. I believe the memorandum affords an interesting sample of some of the less desirable corporate practices in current usage.

I hardly need add that I am happy to be of service to you in this matter.

Sincerely yours,

Martin Riger
Associate Attorney

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MERGERS, CONSOLIDATIONS, RECAPITALIZATIONS

I. Limitations on the Effectiveness of Voting Rights.

In December of 1932 The Equity Corporation was formed for the purpose of gaining control of investment trusts and investment trust companies and consolidating them "into one corporation or into a coordinated, controlled group". Incidents in the history of this company's expansion program bring into clear focus existing deficiencies in state laws, which permit action by dominant stockholders in corporations with small regard to the wishes of other investors in the enterprise. (Investment Trust Study Proceedings Questionnaire in the matter of Equity Corporation, et al).

In the year 1936 The Equity Corporation acquired or brought under its direst control by merger or consolidation net assets of 12 corporations amounting to almost $50,000,000. This was done under the laws of the states of Delaware and Maryland. The mergers all affected Delaware corporations and were all consummated under the Delaware law. Thus, Interstate Equities Corporation and Chain & General Equities Inc., were merged into Equity on March 25, 1935. And Reliance International Corporation and American, British & Continental Corporation were merged into Equity on September 6, 1935. In addition, eight corporations - seven incorporated in Maryland and one in Delaware - were consolidated to form American General Corporation, a subsidiary of Equity, on November 23, 1935.

The Delaware statutes authorize merger or consolidation by the vote of "stockholders of each such corporation representing two-thirds of the total number of shares of its capital stock, * * * each share entitling the holder thereof to one vote." As a result, the class of stock which has the most votes wields the greatest power, <u>regardless of the proportion of the corporation's assets that may be applicable to it</u>. In its most pernicious aspect such a provision may permit common-

stockholders, if sufficiently numerous, to bind the preferred stockholders of the corporation into a merger or consolidation on terms dictated by the interests of the common stockholders, even though all of the assets of the corporation are applicable to the preferred stock and none to the common.

The possibility just described is not a hypothetical one. In the case of three of the four corporations merged into Equity, the control of common stock alone, apart from its preferred stock holdings, gave Equity control of the vote necessary to effect the merger. And at the time of the mergers these common stocks had no asset values. This control of the common stock was also sufficient to give Equity control of the managements which determined the terms of the mergers. By these terms the preferred stockholders of the four corporations merged into Equity experienced severe losses in preference rights on liquidation. Before merger these stockholders were entitled to approximately $9,800,000 on liquidation. After merger into Equity their preference on liquidation amounted to about $6,200,000, a loss of over $3,600,000 in preference rights. In addition, preferred stockholders of two of these corporations suffered appreciable losses in the asset values of their securities.

The provisions of the Maryland law, as distinguished from that of Delaware, ostensibly guard against this abuse. The applicable statutory provisions require a two-thirds vote of each class of voting stock for the adoption of a merger or consolidation agreement, as distinguished from two-thirds of all the capital stock. The history of Equity Corporation's expansion, however, illustrates how this apparent safeguard may be effectively circumvented.

Thus, the consolidation of eight corporations into American General Corporation has been referred to above. Seven of these eight companies had been incorporated in Maryland, and of these, five had preferred stock outstanding. Equity controlled virtually all the common stocks

of these corporations. But control of the common alone, however overwhelming, would not enable Equity to force preferred stockholders of the Maryland corporations into the consolidation without their favorable vote as a separate class. Equity's holdings of the preferred stocks, on the other hand, were relatively small. In no instance did it control the two-thirds required for a favorable class vote. Its combined holdings of both preferred and common, however, were in excess of two-thirds of the total shares of both classes outstanding. Its predominant interest lay in the common stock, in direct conflict with the interests of preferred stockholders. Accordingly, it employed devices to deprive preferred stockholders of the protection of a class vote.

The corporate maneuver which effected this result was based on another provision of the Maryland corporation law. This stated that irrespective of statutory requirements for action by vote of the holders of two-thirds of each class of stock, "such action shall be effective and valid if taken or authorized by such vote of its stockholders or members as may be required for such action by its charter." The charters of the five Maryland corporations contained no provisions on the point. They did, however, contain general authority to adopt charter amendments by a majority vote of all the outstanding stock entitled to vote.

Apparently pursuant to this authority the respective charters were amended to authorize approval of a merger or consolidation agreement by a two-thirds vote of "the shares then issued and outstanding and entitled to vote." Equity's own holdings were sufficient to adopt these amendments, and were thereupon sufficient to vote the consolidation. It was significant that the favorable vote cast by the preferred stock of each company was far less than two-thirds of that class.

The consolidation drastically affected the rights of the preferred stockholders. Annual dividend preferences of stockholders were reduced in amounts varying from $.25 to $4.10 per

share. Dividend arrearages in the neighborhood of $4,000,000 were eliminated. Preferred stockholders suffered losses of approximately $200,000 in the net asset values of their securities. These and other drastic changes in the rights of preferred stockholders were accomplished, in effect, solely by the vote of the common stock. Furthermore, the consolidation agreement which determined the participation of preferred and common stockholders in the new entity was drafted by representatives of Equity, whose interest was predominantly in the common stock. In some of the instances this stock was wholly without asset value.

One further circumvention may be noted. The charters of the Maryland companies themselves required a two-thirds class vote, and in one case apparently a unanimous vote, of the preferred stock for approval of any particular charter amendment which would decrease the liquidating or dividend preferences, or the redemption prices, of the preferred stocks. The consolidation, however, had exactly these effects. As a result of the charter amendment described above, the consolidation had been effected without a vote of the preferred stockholders as a class. And the amendments likewise had been effected without such class vote. Thus, the procedure accomplished by two steps what could not be accomplished by one.

While there may be some question as to the validity of the various steps taken to effect the consolidation, it should be pointed out that counsel for Equity and the consolidated company steadfastly maintained that everything was done in strict compliance with the Maryland law. And at this date, more than two years after the consolidation was consummated, American General Corporation remains in existence.

II. JURISDICTION SHOPPING

A few registration statements disclose the practice of forming a new corporation under the laws of a different state in order that a particular plan of reorganization may be carried out. The quotation below is an excerpt from the prospectus of Worthington Pump and Machinery Corporation, (RS-2-3117), dealing with this question:

> "As hereinbefore stated the Corporation was organized (February 17, 1937, under the laws of the State of Delaware) to succeed Worthington Pump and Machinery Corporation, a Virginia corporation, which was incorporated under the laws of the Commonwealth of Virginia on April 20, 1916. All the property, business and good-will of the said Virginia corporation were transferred to the Corporation, and all its debts and liabilities assumed by the Corporation, on March 20, 1937. Such reincorporation was effected, pursuant to express authority in the charter of said predecessor Virginia corporation, in order to make possible the formulation of a feasible plan of recapitalization. As stockholders were informed at the time the vote was requested on the question whether to reincorporate, any effective plan of recapitalization of such predecessor Virginia corporation would have required, under the laws of the Commonwealth of Virginia, the approval of 90% in amount of each class of stock affected, and taking into consideration foreign stockholders, fiduciaries with limited powers, stock held in brokers' names, and those who could not be reached or would not respond, as a practical matter, such percentages were deemed unobtainable. The amendments to the charter of the Corporation required to affect any such plan may, however, be authorized with the approval by holders of 66-2/3% in amount of each class of its stock under the provisions of its Certificate of Incorporation and the laws of the State of Delaware.

Jurisdiction Shopping

This is likewise illustrated in the registration statement of Gaylord Container Corporation (RS-2-3325):

> "The corporations whose businesses were consolidated to form the Company enjoyed a contractual relationship, first in written form and subsequently on the basis of oral agreements, from July, 1927, to the time of consolidation, and Bogalusa Paper Company, Inc. (a Louisiana corporation) owned, prior to the consolidation, one-fourth of the issued and outstanding Common Stock and one-half of the issued and outstanding Preferred Stock of Robert Gaylord, Incorporated (a Missouri corporation). The consolidation is considered a natural outgrowth of this relationship. To effect the consolidation, a change in domicile of Robert Gaylord, Incorporated (a Missouri corporation), and certain changes in the organization of Bogalusa Paper Company, Inc. (a Pennsylvania corporation, formerly named Great Southern Lumber Company), and Bogalusa Paper Company, Inc. (a Louisiana corporation) were adopted on advice of counsel." -- prospectus, p. 1, 2.

SERVICES AND PROPERTY IN EXCHANGE FOR STOCK

The chief difficulty here centers in the company's issuing stock generally to affiliated or controlling interests, in consideration of the acquisition of tangible property, mining claims, patents, license agreements, rights, and the like, and the attendant necessity of a valuation. The ensuing valuation of the property acquired is subject to serious question, especially in view of the fact that it represents solely an arbitrary valuation by a board of directors whose purpose usually is that of issuing a predetermined number of shares to the vendor as fully paid in accordance with governing statutes.

For example, subsequent to stop order proceedings in the matter of the registration statement of American Cereal Food Corporation (RS-2-2242), the balance sheet was footnoted as follows:

> "While this sum is considered a fair price for the values received by the registrant, such valuation was arbitrarily fixed and considered with a view to issuing stock to the vendors of the intangibles in an amount sufficient to assure them control of the registrant."

The practice has been to set down a figure in the property account which represents cost to the company measured by the par value of the securities issued. The balance sheet caption, however, is required to be modified and described, or a footnote appended, to set forth the fact that the amount has been arbitrarily arrived at by the board of directors, representing the par of the securities issued, and that at the time such determination was made by the board, it consisted of so many directors who were also vendors (or a similar statement of affiliation adjusted to the circumstances).

In stop order proceedings in the matters of Snow Point Mining Co., Inc. (1 S.E.C. 311) and Franco Mining Corporation (1 S.E.C. 285), the Commission found, and in its opinions so stated, the shares issued, ostensibly for property of the value of the aggregate par of the securities

issued, actually were issued in accordance with the pre-determined arrangements of the promoters to assure themselves control of the corporation. In stop order proceedings in the matter of Brandy-Wine Brewing Company (1 S.E.C. 123), the Commission found and so stated in its opinion that stock ostensibly issued for property and services was actually issued as a gift to the promoter.

In the Brandy-Wine opinion the Commission said with respect to this point: "Statutory provisions in the state of incorporation making values fixed by directors conclusive for certain purposes, in the absence of fraud, cannot foreclose this Commission's inquiry as to the truthfulness of a statement that a corporation has received services of a certain value, reasonably determined, nor prevent such a statement from being tested for truth under the standards set by the Securities Act. Under those standards, if the valuation of services is so grossly and unreasonably excessive as to be outside the range of reasonable difference of opinion, this item of $71,000 in the balance sheet amounts a misstatement of a material fact. To put it in other words, if a large portion of this stock was in reality donated to a promoter, the statement that it was issued for services is false."

A variation of the principle of statement of assets at cost is represented by the Commission's opinion in the matter of the registration statement of Unity Old Corporation (1 S.E.C. 25). In that case, the Commission held that it was misleading and improper to include in the original cost of property the value of stocks issued for property and concurrently "donated back" as required by the purchase contract, even though the effect of such a transaction under the applicable state law was to render such shares "fully paid and non-assessable". It was further held in the same opinion that it was false and misleading to value stock at par in determining the

cost of property when all other sales of said stock were at varying prices, all considerably below par.

SURPLUS RESTRICTIONS

Many registration statements on file with the Commission disclose that contribution of capital by one class of holders may provide a source of dividend payments to holders of other classes of the corporation's securities, and that dividends may be paid from capital surplus even though the payment would reduce the net assets of the company below the aggregate amount payable to the holders of a senior stock upon liquidation.

The following are excerpts from the prospectus of Olympic Forest Products Company (RS-2-3316):

"According to the opinion of counsel of the Company, under the laws of the State of Nevada, the State of incorporation of the Company, there is no legal restriction upon the Company's payment of dividends out of surplus because of the fact that, as to the $2 Cumulative Preferred Stock, the liquidation value thereof ($37.50 per share plus all accrued and unpaid dividends) exceeds its par value ($25 per share) at which par value the capital liability with respect to the $2 Cumulative Preferred Stock will be recorded on the Company's Books, or because the amount paid in per share of $2 Cumulative Preferred Stock is or may be deemed to be in excess of the par value thereof."--pages 10, 21 and 30.

"According to the opinion of counsel of the Company under the laws of the State of Nevada, the State of incorporation of the Company, there is no legal restriction upon the Company's payment of dividends out of surplus because of the fact that the liquidation value of the $8 Preferred Stock ($100 per share plus accrued dividends) exceeds the capital liability at which the $8 Preferred Stock is recorded on the Company's books. Effective August 12, 1937, the capital liability with respect to the $8 Preferred Stock was reduced from $98 per share to $1 per share."--page 12.

"According to the opinion of counsel of the Company, under the laws of the State of Nevada, the State of incorporation of the Company, there is no legal restriction upon the Company's payment of dividends out of surplus because of the fact that the liquidation value of each share of the Preferred Stock ($100 per share plus accrued dividends) exceeds $98 per share, at which the capital liability with respect to the Preferred Stock is recorded on the Company's books as stated in the answer to Item 10A. Reference is made to following Note 8.--page 28 (Footnote No. 6 to the Balance Sheet).

In a separate communication to the Commission, opinion of counsel was furnished as to whether there would be any restriction of surplus to the extent that the par value of the $2.00 Preferred Stock is less than the stated liquidating value thereof.

Excerpts from the opinion of counsel (Messrs. Sullivan & Cromwell and Messrs. Todd, Holman and Sprague) follow:

"We understand that the capital liability with respect to the $8 Preferred Stock was, prior to the filing of a Certificate of Reduction of Capital in the office of the Secretary of State of Nevada and in the office of the Clerk of Washoe County, Nevada, on August 12, 1937, $98 per share, and that after the filing of the said Certificate of Reduction of Capital of the Company as aforesaid, the capital liability with respect to each share of the $8 Preferred Stock is $1 per share, and that such stock has a liquidating value of $100 per share, a redemption value of $107.50 per share, and an accumulation of dividends in arrears as of April 30, 1937, of $45.33 per share; the $2 Preferred Stock has a liquidating value and a redemption value of $37.50 plus accrued and unpaid dividends. We understand that to the extent that $100.50 (the aggregate par value of four (4) shares of $2 Cumulative Preferred Stock and one-half (1/2) share of Common Stock), exceeds the capital for each share of $8 Preferred Stock, that is, $1, the difference will be debited (1) to the extent of $97, to capital surplus (thereby, with respect to each share of $8 Preferred Stock so exchanged, extinguishing the credit to capital surplus arising from the reduction of capital, represented by the $8 Preferred Stock, from $98 per share to $1 per share upon the filing of said Certificate of Reduction of Capital), and (2) to the extent of $2.50, to earned surplus."

"We have also examined the Nevada Corporation Law of 1935, as amended, which provides in Sections 24, 25 and 26, that dividends may be paid to stockholders from a corporation's net earnings or from the surplus of its assets over its liabilities, including capital, as computed in accordance with the provisions of said Sections."

"On the basis of the foregoing, it is our opinion that under the laws of the State of Nevada, there is no legal restriction upon the Company's payment of dividends out of surplus because of the fact that the liquidation value of each share of the $2 Cumulative Preferred Stock exceeds its par value ($25 per share) at which par value the capital liability with respect to the $2 Cumulative Preferred Stock will be recorded on the Company's books, or because the amount paid in per share of $2 Cumulative Preferred Stock is or may be deemed to be in excess of the par value thereof, or because of the fact that the liquidation value of the $8 Preferred Stock exceeds the amount of capital ($1) represented by each of the outstanding shares of $8 Preferred Stock."

Substantially the same situation with respect to absence of restrictions upon surplus existed in Grays Harbor Pulp and Paper Company (RS 2-3314). Counsel expressed an opinion to substantially the same effect as the opinion expressed in Olympic Forest Products Company. Grays Harbor Pulp and Paper Company was organized under the laws of the State of Delaware.

The registration statement of Thermoid Company (Delaware) (RS 2-2713) showed a capital stock liability of $421,040 attributed to 42,104 shares of $10 Par $3 Cumulative Convertible Preferred Stock. Each share was entitled to $50 in liquidation. A footnote to the balance sheet stated that even though it might be legally possible under the laws of the State of Delaware for the Board of Directors to pay dividends on common stock out of capital surplus so as to reduce the capital and surplus below the liquidation value of $50 per share on the preferred stock, it was the present intention of the board not to declare or pay cash dividends on the common, such intention being subject to changes in Federal or State laws which might render such policy inadvisable.

Other registration statements which likewise raise questions as to the adequacy with which state laws provide adequate protection of a surplus perhaps equitably belonging to a given class of holders are:

(1) Hilton-Davis Chemical Company (RS 2-3406). In this case counsel for the company expressed the opinion that there was no legal restriction on surplus by reason of the fact that the amount to which the $1.50 Convertible Preferred Stock would be entitled in liquidation, $25 per share, exceeded the par value of $5 per share; the company stated its intention to limit the payment of dividends to the amount of surplus in excess of $20 per share of $1.50 Convertible Preferred Stock outstanding.

2. Wilson & Co., Inc. (RS 2-3090). The balance sheet dated October 31, 1936, filed with the registration statement showed that the capital account of the registrant totaled $41,125,655, consisting of $22,724,800 allocated to 324,783 shares of 6% Cumulative Preferred Stock without Par Value, and $18,400,855 allocated to 2,001,163 shares of No Par Common Stock. Counsel rendered the following opinion:

"We have considered the question as to whether or not, in connection with the payment of dividends on your outstanding common stock, there is any restriction upon the surplus of your Company arising from the fact that the capital of your Company allocated to its outstanding $6 Cumulative Preferred Stock is $22,724,800 and the liquidating value of such preferred stock is $32,478,300.

"We are of the opinion, in the light of the provisions of Section 34 of the Delaware General Corporation Law and the other sections of that law therein referred to and in the light of the pertinent provisions of your amended certificate of incorporation effective November 30, 1925, and the certificate of amendment of your Certificate of Incorporation filed and recorded February 23, 1935, that there is no such restriction upon the surplus of your Company prior to liquidation of your Company.

"In this connection it may be not irrelevant to point out that as appears from the balance sheet of your Company as at October 31, 1936, the total capital of your Company, namely $41,125,655, is $8,647,355 in excess of the liquidating value of your Company's outstanding $6 Cumulative Preferred Stock and that the $6 Cumulative Preferred Stock of your Company is entitled to priority to the extent of its liquidating value over your Company's common stock upon any liquidation, dissolution or winding up of your Company."

3. Reed Drug Company (Rs2-3421). The registration statement showed that the aggregate difference between the par or stated value of outstanding Class A stock par value $1.00 and the liquidating value thereof of $5 per share was $140,000. If the contemplated sale of 30,000 shares of Class A stock were effected, the proceeds thereof to be received by the corporation would constitute paid-in surplus in the sum of $97,500, and in the event of the effectuation of such sale the liquidating value of all Class A stock that would then be outstanding would at the rate of $5 per share aggregate $325,000, which would exceed by $80,822.92, or by approximately $1.25 per share, the value of the net tangible assets of the corporation that would then exist in the sum of $244,177.08. Counsel for the company expressed the opinion that there was no restriction or prohibition in the laws of Delaware against the payment of dividends either on common stock outstanding or Class A stock from the presently existing paid-in surplus, or from the surplus that would be derived from the sale of 30,000 shares of Class A stock.

In a few cases, counsel have rendered opinions to the effect that a restriction against surplus might under certain circumstances exist. In the registration statement of American Corporation (RS 2-2623) an opinion was rendered that the portion of the paid-in surplus equal to the difference between the aggregate par value and the aggregate liquidation value of preferred stock was not available as a source of payment of dividends on common stock. The paid-in surplus in this case was contributed by preferred holders and represented the difference between par value and sales price.

The registration statements referred to below disclose a grave disproportion between the capital contributions of a given class of holders of securities and the participation of such class in earnings and management.

The registration statement of First State Trust Company (organized under the laws of the State of Delaware) (RS 2-3292) disclosed a capital structure of 200,000 shares of Class A Common Stock Par Value $1, and 10,000 shares of Class B Common Stock No Par Value. The Class B Common Stock was the sole voting stock of the corporation. The Class A Common Stock was preferred as to assets in event of dissolution or liquidation of the corporation to the extent of $3 per share. After such payment to the Class A, any remaining assets were distributed two-thirds to the Class A Common Stock and one-third to the Class B Common Stock. The Class A Common Stock was entitled to receive dividends at the rate of ten cents per annum, prior to any payment of dividends on the Class B Common. Thereafter, any net earnings available for distribution were divided two-thirds to the Class A Common Stock and one-third to the Class B Common Stock. The Class A Common Stock was offered to the public at $2.25 per share, or an aggregate of $450,000. The lack of balance in the participations of the two classes on the basis of relative contributions is apparent. The paid-in surplus resulting from the contribution of the

Class A in excess of the par value of such stock was deemed to be non-restricted and available for payment of dividends on either class of stock in accordance with charter provisions.

Cane Industries Corporation (RS 2-1832) proposed to make a public offering of 100,000 unissued Class A shares and invest the proceeds in securities of companies engaged in the manufacture, sale and distribution of sugar cane products and by-products. The authorized capital stock of the company consisted of 100,000 shares of Class A $4 Cumulative Stock stated value $100 per share and 100,000 shares of Class B stock stated value $.02 per share. Cumulative voting for each issue was provided for, however, with the Class A Stock to elect a majority of the board. Class A Stock was to be offered to the public for cash at $100 per share. The Class B Stock, all outstanding, was held by Redcrest Corporation, which was controlled by Mrs. Harvey Greenspan. Mr. Harvey Greenspan was director, chief financial and accounting officer, secretary, treasurer, and member of the executive committee. Earnings of the company were employed first in payment of the $4 dividend on the Class A Stock. After such payment the Class A and Class B Stock shared equally in any dividends. Thus the declaration of $600,000 in dividends would involve the payment of $500,000 to Class A and $100,000 to Class B, or a rate of 5 percent on the $10,000,000 investment in the Class A Stock and 5,000 percent on the $2,000 investment in Class B Stock.

The capital structure of Robot-Hand Corporation (RS 2-2044) consisted of three classes of authorized stock: 500,000 shares of $5 Par 7% Cumulative Convertible Preferred; 1,500,000 shares of $1 Par Class A Common; 1,500,000 shares of $.01 Class B Common. As of March 13, 1936, there were 30,400 shares of Preferred and all of the Class B Common outstanding, with an aggregate capital liability of $167,000. Such shares were issued to Mr. Osuch (promoter) in consideration of the transfer of patents and patent applications.

Preferred Stock was entitled in liquidation to $5.50 per share while the remaining assets were distributable pro rata to common stockholders without regard to class. The Company proposed to offer to the public 250,000 units consisting of one share of 7% Cumulative Convertible Preferred and one share of Class A Common at $7.50 per unit. Excluding the 30,400 shares of Preferred issued to the promoter, the subscriber to one of the 250,000 units at $7.50 a unit would be entitled in the event of immediate liquidation to $5.50 for the share of Preferred and $.07 for the share of Common, and holders of Class B would receive $.07 a share. The underwriter, Frank J. Osuch and Company, was to receive $1.50 as commissions on the sale of each unit.

On the basis of the stock outstanding at the time of filing the registration statement, the dilution suffered by the subscriber for cash is even more pronounced. If the initial block of 41,657 units proposed to be offered were fully subscribed, and the company did nothing at all for a full year, the distribution of the proceeds of the issue, in the event of liquidation, would be:

41,667 units at $7.50 per unit	$312,500		
Less $1.50 to underwriters	62,500		
Net to Company		$250,000	
Less 10 months salaries		40,000	
Equity of 72,067 shares Preferred (or $2.91 per share of the $5.50 to which entitled)			$210,000

In the event the entire pubile offering of 250,000 units were subscribed, the status at the end of one year, without any operations, in the event of liquidation, would be:

Equity of 250,000 shares Preferred at $5.21	$1,302,000
Frank Osuch (Salary, equity, commissions)	541,000
Other “promoters” (Salary, equity)	32,000
	$1,875,000

Percent returnable to subscribers – 69.

On the other hand, in the event that the company engages in profitable operations, the holders of Preferred may wish to convert each share of Preferred into two shares of Class A. In this extreme case, the Class A and Class B shares equally in liquidation, and should that later occur, the allocation of $1,875,000 originally paid in would be as follows:

	Class A	Class B	Salary	Total
"Public"	$473,862	-	-	$473,862
Frank Osuch	37,907	$815,044	$10,000	862,953
Other Officers	505	132,680	30,000	163,185
Frank Osuch Co.	-	-	-	375,000
				$1,875,000

Percent returnable to subscribers – 25.3.

Other registration statements which reveal a disparity between the amount of contributions and the degree of control acquired are:

1. H. R. Holtzman Corporation (RS 2-1919). Fifty thousand shares of $5 Par Class A stock have no voting power, the entire voting power resting in 50,000 shares of $1 par Class B stock.

2. Easy Washing Machine Corporation (RS 1-2220). Fifty seven thousand, two hundred forty shares of No Par Class A Stock (held by the parent) possess voting power, while 461,094 shares of No Par Class B Stock do not. The respective capital liabilities at December 31, 1934 are given as $570,611.61 and $1,885,915.56.

3. Norni Signal Manufacturing Corporation (RS 2-1564). The authorized capital structure consists of 100,000 shares of Participating Preference Stock (entitled to elect a minority of the board), 36,000 shares of Non-Voting Class A Stock, and 2,000 shares of Class AA Stock (entitled to elect a majority of the board), all of which stock is without par value.

4. Bankers Union Life Company (RS 2-60). Both A and B stock of this company have voting rights, but the 25,000 shares of $10 Par A Stock possess only one-fifth vote per share, while the 5,000 shares of No Par $1 Stated Value B Stock possess five votes per share.

5. United Investors Realty Corporation (RS 2-3137). The authorized stock consists of 50,000 shares of No Par Preferred, 250,000 shares of $1 Par Class A Common, and 1,000 shares of $1 Par Class B Common. The voting control is held by the Class B Stock, title to which is vested under a voting trust agreement in the company's four directors.

OFFICERS AND DIRECTORS

I. Compensation

A corporation may enter into a contract for services of an officer at a stated consideration, or upon a bonus arrangement, generally based upon a percentage of earnings, or it may provide for the optioning of shares of stock to the officer at prices which result in his receiving additional remuneration. These arrangements may be of a character which provides for compensation of any two of the three, or of all three.

The registration statement of The Liquid Carbonic Corporation (RS 2-3247) illustrates the stated salary contract type. In this case, the contract existing between the corporation and W.K. McIntosh, Chairman of the Board, provides for the performance of duties assigned him by the directors in consideration of $25,000 per year, without further participation to any bonus or other profit sharing plan of the company.

The Packer Corporation (RS 2-2645) by contract dated February 6, 1928, expiring January 31, 1938, employs Harry A. Packer as General Manager, in return for 7 1/2 percent of its net profits each year; and Tampax, Incorporated (RS 2-2498) employs W. Ellery Mann as General Manager for 10 percent of the net earnings. The Tampax contract originally also provided for a drawing account of $20,000 a year, irrespective of net profits, but was subsequently modified to provide that all drawings be deducted from the annual 10 percent. It appears that Mr. Mann had a somewhat similar contract with Zonite Products Corporation (RS 1-261).

The amended certificate of incorporation of Bethlehem Steel Corporation (Delaware) (RS 2-3346) provides for the establishment of a Special Incentive Compensation Fund as an "incentive to increased efficient and profitable management."

> *There shall be paid into said Fund for each fiscal year of the Corporation an amount equal to five percent of the consolidated net income of the Corporation and its subsidiary companies for each such year, after deducting all fixed charges and depreciation (including obsolescence) and depletion, and the amount, if any, to be paid into said Fund for such year, and after deducting an amount equal to the dividends accrued for such year upon the preferred stock or preferred stocks of the Corporation and of its subsidiary companies.
>
> The persons who shall be eligible to receive special compensation out of said Fund shall be (1) the executive officers of the Corporation, (2) the heads of departments having general control of matters affecting the Corporation and its subsidiary companies as a whole, and (3) the other persons, if any, who shall be directors of the Corporation and in its employ or in the employ of one or more of its subsidiary companies.
>
> Whenever any cash dividend shall be paid upon the Common Stock, then to the extent that the amounts that shall theretofore have been paid into said Fund out of earnings after December 31, 1935, and that the aggregate amount which shall then remain in said Fund shall be sufficient therefor, there shall be paid to the executives of the Corporation an amount equal to one-fifteenth (1/15th) of the aggregate amount of said cash dividend."

Bonus arrangements based on percentages of earnings, where the basic salary apparently is not contracted for, are also presented by numerous companies. Such arrangements are found in the registration statements of Philip Morris & Co. Ltd., Incorporated (RS 2-2317), Alaska-Juneau Gold Mining Company (RS 1-492), Brown-Forman Distillery Company (RS 1-123), General Time Instruments Corporation (RS 2-2019), Chicago Mail Order Company (RS 1-412); Collins & Aikman Corporation (RS 1-205), Continental Motors Corporation (RS 1-619), Fitingon Schild Co., Inc. (RS 1-454). In the last named company, Philip Fouke, (President), Donald Gibbins and S. J. Pingree (Vice-President) receive 25%, 17% and 17%, respectively, of annual net profits of Fouke Furniture Company after deducting 50% of net profits taken by another subsidiary. Provision is further made that 59% of any losses sustained are to be borne by these three officers out of subsequent payments.

Contracts with officers whereby they were or are entitled to subscribe for shares of stock are common. These contracts are disclosed in the registration statements of Republic Steel

Corporation (RS 2-1858), Hawaiian Pineapple Company, Limited (RS 2-3462), Skelly Oil Company (RS 2-1862), The Black and Decker Manufacturing Company (RS 2-2157), Bridgeport Brass Company (RS 2-2155), Pittsburgh Steel Company (RS 2-2944), The Dayton Rubber Manufacturing Company (RS 2-2359), Bell Aircraft Corporation (RS 2-2342), R. H. Macy & Co., Inc. (RS 2-3305), Dominion Stores, Limited (RS 1-450), Globe Steel Tubes Co. (RS 2-3221).

The contract, however, more frequently takes the form providing for a stated salary and a percentage of the net income, or for a stated salary and options designated amounts of stock. Illustrative of the former type is the agreement between Allied Stores Corporation and B. Earl Puckett providing for a salary of $30,000 and additional compensation of two per cent of the consolidated net profits up to the amount of profits equal to dividend requirements on the preferred stock and three per cent of net profit above such requirements. Allied Stores Corporation (RS 2-2362) agreement of February 1, 1936, extending for two years.

In the registration statement of F D. Jacobs Co. (RS 2-1959), the company agrees to pay Clare S. Jacobs and Rex C. Jacobs each $20,000 a year and five per cent of the net profits.

Similarly Electric Household Utilities Corporation employs Edward N. Hurley, Jr. (President and Director) as General Manager at $30,000 a year plus a share of annual net profits in excess of ___ per cent of the average capital and surplus accounts. Electric Household Utilities Corporation (RS 1-1695) agreement of October 30, 1933, for five years commencing January 1, 1933. The percentage is graduated: 4% to $250,000, 5% thence to $1,000,000, and 8% of the excess over $1,000,000.

Salary and bonus arrangements are also revealed in United Aircraft Corporation (RS 2-1939), Compressed Industrial Gases, Incorporated (RS 2-2433).

The Pacific _in Corporation (RS 1-231) was party to contract with Oscar B. Perry as Consulting Engineer, providing for a salary of $23,000 and the right to purchase:

> 2% participation in any metal properties acquired by the company by direct purchase of property or the purchase of 50% of the stock of the company owning the property,
>
> 2% further participation if the properties were examined by Perry within one year of the date of acquisition or making of option to acquire,
>
> 2% participation in any underwriting by the company of metal mining propositions.

Such contract was unassignable, inoperative if Perry were sick, relieved Perry from going to countries dangerous to health, and freed him from the obligation of remaining in Alaska, Yukon Territory, or South America, longer than six consecutive months.

American Smelting and Refining Company (RS 2-2615) has a similar contract with R. A. Guess, Vice President.

The Electric Auto-Lite Company (RS 2-2791) entered into contracts under date of August 21, 1934, with G. G. Miniger (Chairman), R. G. Martin (President), and B. R. Kelly (Vice President), providing for their employment respectively as Supervisory Manager, Manager, and Assistant Manager, at salaries of $60,000, $40,000 and $40,000, and granting to each options expiring July 1, 1937, to 5,000 shares of common stock at $25 per share. Such options were exercised.

Likewise Industrial Rayon Corporation (RS 1-436) employed Hiram S. Hivitz (President) and Hayden S. Kline (Vice-President).

at salaries of $75,000 and $24,000 with options to purchase 75,000 and 9,000 shares of stock at $30 per share for three years ending April 30, 1937, to perform such services as designated by the Board or Executive Committee or the by-laws in connection with any office held during the life of the contract.

The type of arrangement covering salary, bonus, and options may be noted by the contract between Remington Rand Inc. (RS 2-1869) and James H. Rand, Jr., calling for his services at a salary of $85,000 a year plus 2 ½ percent of net profits above $2,000,000 a year (before deducting Federal income taxes) plus $20,000 a year for extraordinary expenses above ordinary travel expenses. In addition he was granted warrants calling for 100,000 shares of common stock at $10 a share. In 1936, Mr. Rand was granted additional warrants exercisable for 100,000 shares of common stock at the same price. Remington Rand, Inc., (RS-2-2480). Salary, Bonus and option arrangements are also presented in registration statements of Bridgeport Brass Company (RS 2-2964), Sidney Blumenthal & Co., Inc. (RS 1-1240), Varnishes & Paints, Inc. (Truscon Laboratories) (RS 2-1904).

The registration statement and prospectus of Loew's Incorporated (RS 2-1892) set forth a rather detailed summary of what is stated may be regarded as material management or general supervisory contracts made with certain officers and directors of the company. An original contract entered into in 1924 and subsequently modified from time to time provided for the employment of Louis B. Mayer, Irving Thalberg and J. Robert Rubin individually and as co-partners to supervise, manage and generally control the manufacture of all pictures produced by Metro-Goldwyn Pictures Corporation. Compensation payable under the contract is (1) weekly salaries of $2,500, $4,000, and $1,000 respectively and (2) a percentage payable to the partnership of 20 percent of the first $2,500,000 combined net profits and 15 percent of any

excess, remaining after deduction of an amount equal to dividends on preferred stock of the company and its subsidiaries and $2 per share on outstanding common stock of the company. In addition the three persons in 1932 were granted non-assignable options to purchase 50,000, 100,000, and 50,000 shares of common stock, respectively, exercisable as to 27.78 percent of each option at $30 per share between December 31, 1934 and March 1, 1935, as to 27.78 percent at $35 per share between December 31, 1936, and March 1, 1937, and 44.44 percent at $40 per share between December 31, 1938 and March 1, 1939. Shares not purchased during either of the first two periods specified may be purchased up to the end of the second period at $35 per share, and thereafter at $40 per share prior to March 1, 1939.

Similar arrangements exist for the employment of David Bernstein, Vice President, to supervise the finances of the company at a weekly salary of $2,000, certain allowance for expenses, and 1 ½ percent of the combined annual profits, and granting an option upon 50,000 shares exercisable upon the same terms indicated above. Since 1926 the Board of Directors from year to year has authorized payment to Nicholas M. Schenck, President, a percentage compensation based on 2 ½ percent of the combined annual profits in addition to a weekly salary and a certain allowance for expenses other than traveling expenses. (Loew's Incorporated (RS 2-1892), as amended). Since 1932, Mayer, Thalberg and Rubin voluntarily accepted a reduction in weekly salaries to $3,250, $3,250, and $1,000 respectively. For the fiscal year ended August 31, 1935 the sum of $1,013,058 was paid the partnership as the percentage compensation referred to, while total remuneration received by Bernstein was $182,711.88 and by Schenck was $265,176.80.

II. Interest in Contracts

The persons constituting the management generally are not precluded from entering into contracts on behalf of the corporation with themselves or with corporations in which they are also interested. Articles of Incorporation frequently have a provision covering this point, usually requiring that the interest of a director in the transaction be disclosed to other directors, though not necessarily prohibiting the interested director from voting. For example, the following in the Articles of Incorporation, November 29, 1932 (Delaware) of Dejay Stores, Inc. (RS 2-2302)

> "Thirteenth: In the absence of fraud, no contract or other transaction between the Corporation and any other corporation or any individual or firm shall be in any way affected or invalidated by the fact that any of the directors of the Corporation is interested in such other corporation or firm or personally interested in such contract or transaction; provided that such interest shall be fully disclosed or otherwise known to the Board of Directors at the meeting of said Board at which such contract or transaction is authorized or confirmed; and provided, further, that at such meeting there is present a quorum of directors not so interested and that such contract or transaction shall be approved by a majority of such quorum. Any director of the Corporation may vote upon any contract or other transaction between this Corporation and any subsidiary or affiliated corporation without regard to the fact that he is also a director of such subsidiary or affiliated corporation."

Likewise the interested director of Addressograph-Multigraph Corporation (RS 1-685) is barred from voting. On the other hand, he is not by R. H. Macy & Co., Inc. (RS 2-3305), Koppers Gas and Coke Company (RS 1-555), The Diamond Match Company (RS 1-378).

The proposed prospectus of Tampax, Incorporated, was amended to include reference to the provisions of its Articles of Incorporation concerning transactions by its directors who might have an interest adverse to that of Tampax, Incorporated:

> "The corporation may enter into contracts or transact business with one or more of its directors, or with any firm in which one or more of its directors are partners, or with any corporation or association in which any one of its directors is a stockholder, director or officer, and such contract or transaction shall not be invalidated or in any wise affected by the fact that such director or directors have or may have interests therein which are or might be adverse to the interests of this corporation, even though the vote of the director or directors having such adverse interest shall have been necessary to obligate this

corporation upon such contract or transaction; and no director or directors having such adverse interest shall be liable to this corporation or to any stockholders or creditor thereof, or to any other person, for any loss incurred by it under or by reason of any such contract or transaction, nor shall any such director or directors by accountable for any gains or profits realized thereon; always provided, however, that such contract or transaction shall at the time at which it was entered into have been a reasonable one to have been entered into and shall have been upon terms that at that time were fair. "-- Tampax Incorporated, (RS 2-2498), Article Tenth, paragraph 4, Articles of Incorporation.

ANNUAL MEETINGS

The place selected for the annual meeting, the required notice of such meeting and the provisions for constitution of a quorum apparently are frequently determined by a desire on the part of the management to abridge the exercise of whatever participation in management the security holders may, in terms, have under the charter.

Thus, some question may be raised as to the possible degree of participation in management policies by the stockholders of Bankers Income Shares, Limited (RS 2-2090), where the charter provides that at annual meetings action may be taken by show of hands of stockholders present, of whom two constitute a quorum, and notice of the annual meeting, which may be held any place, need be given only to residents of Newfoundland and by posting 24 hours prior to the date of meeting in the office of the company in Newfoundland.

LICENSING OF CORPORATIONS BILL --- S. 3072

Introduced by Senators O'Mahoney and Borah

To regulate interstate and foreign commerce by prescribing the conditions under which corporations may engage or may be formed to engage in such commerce, to provide for and define additional powers and duties of the Federal Trade Commission, to assist the several States in improving labor conditions and enlarging purchasing power for goods sold in such commerce and for other purposes.

(1 printed copy received 2/24/38 -- at our request)