July 12, 1968

Honorable Harrison A. Williams, Jr.,
Committee on Banking and Currency,
United States Senate,
Senate Office Building,
Washington, D.C.

My dear Mr. Williams:

I write in support of S. 3707 presently pending before your committee. A similar letter is being written to Congressman Wright Patman in support of the companion bill H.R. 13884 presently pending before the House Committee on Banking and Currency.

The principle that corporations ought not to exercise or control exercise of the voting rights of its own capital stock is classic in American common law. Sixty-five years ago, The Prudential Insurance Company of America (now The Prudential Life) worked out a plan. The stockholders of that company sold a controlling block of Prudential to the Fidelity Trust Company, a New Jersey bank. Stockholders of The Fidelity Trust Company simultaneously arranged sale of a controlling block of Fidelity shares to the Prudential. The result was that the directors of Prudential could always elect the management of Fidelity while Fidelity could always elect the management of the Prudential -- an impenetrable circular situation. A Prudential stockholder brought action in a New Jersey court to enjoin the scheme. Vice Chancellor Stevenson enjoined the arrangement. He said this was a “self-perpetuating syndicate for the perpetual control of the Prudential Insurance Company” to the advantage of the existing

directors. He pointed out that when a corporation directly or indirectly causes its own stock to be voted in a corporate election, its directors defend a personal interest -- namely, their own jobs -- rather than the interests of the corporation and its stockholders. (Robotham v. Prudential Insurance Co., 64 N.J.Eq.673, 53 Atlantic 583. 1903)

This principle, more than sixty years old, applies to the subject matter of S. 3707.

Banks frequently do come into control of their own capital stock, sometimes in substantial blocks. Commonly this occurs when banks have trust powers and become executors or trustees under wills. When they also are trustees for pension funds, they may acquire such stock for investment. As executors or trustees, they can vote this stock, commonly by executing appropriate proxies. It is unthinkable that the trust department of a bank would refuse to execute proxies other than in favor of the existing bank management. One need not charge bad faith, fraud or other misconduct. The trust officer of the bank would vote the stock in favor of the bank management as matter of course.

This, I suggest, violates the elementary principle that the bank management should be accountable to its stockholder-owners, and not to itself. It is almost if not entirely universal law that a corporation may not vote the stock held in its treasury. By the same logic it should not be permitted to vote its own stock when it is not owner but trustee, or when by some other device (possibly through control of another corporation) it is in a position to dictate how its own stock should be voted. More recently another aspect of the subject has commanded attention. Typical of it is the policy just announced by The First National City Bank of New York. It made public a decision of its management to form a “one bank holding company” by requesting stockholders of the bank to exchange their holdings of the bank’s stock for stock in the proposed holding company. The latter will not be subject to banking restrictions, may enter any industry, may

acquire existing corporations as subsidiaries, and generally enlarge the scope of operations. Since the holding company stock will be listed on the stock exchange, its management can use authorized but unissued stock to purchase subsidiaries. The First National City Bank itself is, of course, subject to the voting limitations (including cumulative voting) applying to national banks. The holding company would not be so restricted, and the holding company device if used by State banks could permit a non-banking subsidiary of the holding company to acquire any stock of the bank not previously exchanged for stock of the holding company. Eventually it could eliminate any independent representation on the board of the bank. Though the bank holding company device is not new, it has disturbing possibilities.

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The provision requiring cumulative voting I also favor. The case is clearer where banks are involved than where business corporations are concerned. In business corporations there are times when a harmonious management is probably best for all purposes, and election of dissidents -- a possibility inherent in cumulative voting -- may not be useful. These situations, however, apply to smaller corporations. Compulsory cumulative voting in all corporations is the rule in a number of States and has certainly caused no damage.

Banks, however, stand in a different relation to the community than do non-banking corporations. They are not only insured by the F.D.I.C.; they commonly have rediscount and Federal Reserve privileges. In ultimate analysis, they are really sub-instruments of the Federal Reserve System by and through which money and credit are made available for the legitimate business, commerce and credit needs of the country. The responsibility of the management of a bank runs to the whole community it serves and should be subjected to continual scrutiny and review by its owners as well as by the relevant Federal and State agencies charged with bank

supervision. This powerfully suggests that bank managements be as widely representative of their ownership as possible.

I believe passage of this legislation would be salutary at this time. Following a long period of prosperity, financial manipulation tends to increase. This is the case at present as banks increasingly convert themselves into bases for holding companies, control not one but a series of banking and allied enterprises, and increasingly stretch the reach of their managements into cognate or even extraneous fields. At least twice in this century, the results have been unfortunate -- one remembers the report of the Pujo Committee more than half a century ago, and of the Pecora investigation not quite forty years ago.

The effect of S. 3707 would be to prevent situations like that condemned by old Vice Chancellor Stevenson in the Prudential Insurance Co. case Directors of a bank "by reason of their self-interest" probably are (as Vice Chancellor Stevenson said) and in any case should be disqualified from exercising or controlling exercise of the voting rights of their corporation's stock held by or coming under the control of their corporation.

As individual stockholders, of course, they can and should vote their own shares. They should be disqualified from voting shares in respect of which the bank as trustee or by any other means has come into a position permitting it to cast or control the votes of its own capital stock.

I hope therefore that S. 3707 and its companion bill H.R. 13884 will be favorably acted upon by your committee and by the Congress.

Respectfully yours,

Adolf A. Berle