

From: ROBERT W. HAACK
CHAIRMAN'S OFFICE
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HR 17333

NEW YORK STOCK EXCHANGE

ELEVEN WALL STREET

NEW YORK, N.Y. 10005

ROBERT W. HAACK
PRESIDENT

May 11, 1970

The Honorable Harley O. Staggers
Chairman
Committee on Interstate and
Foreign Commerce
2125 Rayburn House Office Building
Washington, D. C. 20515

Dear Mr. Chairman:

We have received H.R. 17333 which you introduced on April 29 and have comments with respect to three sections of the bill which we thought we might submit via this letter.

We are particularly concerned with Section 30 of the bill which purports to provide an antitrust exemption for the minimum commission imposed by the various exchanges including, of course, the New York Stock Exchange.

The New York Stock Exchange does not support Section 30 of the bill basically because the Federal Courts have held that an antitrust exemption presently exists. The Exchange submitted a letter of our counsel Milbank, Tweed, Hadley & McCloy to Mr. John Moss (See hearings on Mutual Fund Amendments, Serial No. 91-33, part 2, at page 934) which summarizes the law on this point. Since an antitrust exemption is presently available, Section 30 does not clarify the existing status of the law, but may, in our opinion, serve to confuse the situation.

In the opinion of our counsel, an antitrust exemption exists in those areas of Exchange activity which are subject to oversight by the Securities and Exchange Commission. If Section 30 became law, it would be arguable

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that the Congress, by singling out the commission rate area for a specific statutory exemption, had concluded that an exemption did not exist in any other area. This interpretation would be most unfortunate as it might severely hamper the existing self-regulatory activities of the major stock exchanges. This, in turn, would have an adverse impact on the investing public by lessening the protection currently available to investors by virtue of the regulation of the New York and other stock exchanges.

We have additional problems with the provision in Section 30 which seems to make the antitrust exemption available only if "said exchange provides reasonable access and commission rate differentials to bona fide non-members." I assume that it could be argued that anyone who does not hold a membership on an exchange is a "bona fide non-member." This interpretation, while seemingly illogical in that it would destroy the very basis for having a minimum commission, appears to be contrary to the intent of Section 30 but is nonetheless an arguable interpretation in view of the rather broad language of the Section.

As you know, the subject of exchange commission rates is under study by the Securities and Exchange Commission. In this connection, extensive public hearings have been held and voluminous written briefs have been filed. No final determinations have yet been announced by the Securities and Exchange Commission.

If it would be helpful, we could submit copies of the legal briefs which the Exchange has filed in connection with the SEC hearings.

For these reasons, we respectfully suggest that Section 30 not be included in the bill reported to the House by your Committee.

H.R. 17333, Section 9, amends Section 17(f) of the Investment Company Act of 1940 to make some changes in the existing provisions of the Act relating to the custody of portfolio securities of registered investment companies. The

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Exchange has developed a central system for handling transfers of securities (the Central Certificate Service or CCS) which has been of significant benefit in facilitating the transfer of securities and improving the paperwork situation in brokerage firms. We are presently in the process of expanding the operations of this system to include participation by banks and others. In this connection, it would be helpful if Section 17(f) of the 1940 Act were amended to permit custodians of registered investment companies to leave on deposit in CCS the portfolio securities of the investment companies. A suggested amendment to Section 9 of H.R. 17333 and an explanatory cover memorandum are enclosed. This amendment should be non-controversial and, if passed, could be of material benefit to the investing public by facilitating the transfers of securities within the Central Certificate System.

Section 29 of the bill requires, as a condition of employment, the taking of fingerprints of all personnel of registered broker-dealers, stock exchanges and stock clearing corporations affiliated with a registered stock exchange. The New York Stock Exchange favors such a requirement and supports Section 29. The requirement that "every set of fingerprints taken pursuant to this section shall be promptly submitted to the Commission" may impose a substantial administrative burden on the Commission and its staff. Accordingly, consideration might be given to requiring transmission of the fingerprints to the Attorney General rather than the Securities and Exchange Commission with authority in the Commission to exempt categories of personnel from the fingerprint requirement.

Whether this is done or not, however, the Exchange supports the fingerprinting requirement as set out in Section 29.

Most of the other provisions of H.R. 17333 do not directly relate to or affect the New York Stock Exchange and its membership; accordingly, we are taking no position on the other provisions of the bill.

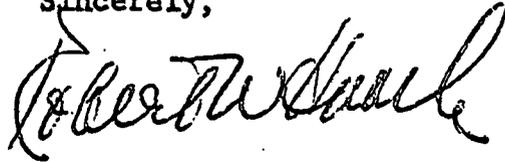
If we can supply additional information or answer any questions which might arise concerning our position on

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Sections 30, 29 and 9, please do not hesitate to contact me or John McConnell or Sam Lyons at our Washington office.

Sincerely,



Enclosures

Suggested Amendment to Section 17(f)
of the Investment Company Act of 1940

The Central Certificate Service (CCS) provided by the New York Stock Exchange's Clearing Corporation is proving the considerable value of the central depository concept. By the end of 1969 some 464 million shares of NYSE listed stocks were on deposit within the System standing to the credit of various member firms of the Exchange. A transfer of shares from the selling member firm to the buying firm is accomplished merely by bookkeeping entry; no physical delivery of stock certificates is required. During 1969 more than 1.064 billion shares, having a total value of some \$42.56 billion, were transferred between member firms in CCS by computerized bookkeeping entries.

While CCS is a significant benefit, it cannot as presently structured relieve the industry-wide problems involved in the physical delivery of stock certificates between seller, buyer and transfer agent. These problems can best be relieved by including within the central depository the nation's major institutions -- banks and insurance companies primarily -- and the shares of stock held by them. If this could be done, it would not be necessary for the broker buying shares for his bank customer to withdraw those shares from CCS in order to make delivery and

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receive payment. The shares could be transferred to the bank by computer, the money could be credited to the broker's account, and the shares could be left to the bank's credit within the System awaiting possible future sale.

As you may know, the banking and securities industries have joined forces to attack mutual problems involved in handling securities transactions. A joint organization, called the Banking and Securities Industry Committee (BASIC) has been formed for this purpose. Herman W. Bevis, retired Senior Partner of Price Waterhouse & Co. and Executive Director of BASIC, has cited as the first major objective of the new joint committee, the broadening of CCS and "development of the depository concept on inter-industry levels so that transactions between banks and brokers can be settled through the depository."

The goal of full institutional participation in a central depository system is undoubtedly several years away. Numerous changes in state and federal law will be necessary. However, there is one relatively simple change in federal law that could be made now and would make possible a long step forward. Section 17(f) of the Investment Company Act of 1940 could be amended to permit custodians of registered management companies to leave on deposit in CCS the securities owned by those investment companies. If the central depository included those securities, the benefits of CCS should be

materially increased. The attached amendment to Section 17(f) is designed to accomplish this purpose.

New York Stock Exchange
May 11, 1970

Text of Proposed Amendment to
Section 17(f) of the Investment
Company Act of 1940

(f) Every registered management company shall place and maintain its securities and similar investments in the custody of (1) a bank (including in the case of a registered investment company which is a collective fund maintained by a bank (if such a collective fund is otherwise permitted by law), the bank maintaining such fund) or banks having the qualifications prescribed in paragraph (1) of section 26(a) of this title for the trustees of unit investment trusts; or (2) a company which is a member of a national securities exchange as defined in the Securities Exchange Act of 1934, subject to such rules and regulations as the Commission may from time to time prescribe for the protection of investors; or (3) such registered company, but only in accordance with such rules and regulations or orders as the Commission may from time to time prescribe for the protection of investors. Any such custodian may, with the consent of the registered management company for which it acts as custodian, deposit all or any part of the securities of any such registered management company held by it as custodian in a system for the central handling of securities established by a national securities exchange or a national securities association registered with the Commission under the Securities Exchange Act of 1934, pursuant to which system all securities of any particular class or series of any

issuer deposited within the system are treated as fungible and may be transferred or pledged by bookkeeping entry without physical delivery of such securities. Rules, regulations, and orders of the Commission under this subsection, among other things, may make appropriate provision with respect to such matters as the earmarking, segregation, and hypothecation of such securities and investments, and may provide for or require periodic or other inspections by any or all of the following: Independent public accountants, employees and agents of the Commission, and such other persons as the Commission may designate. No such member which trades in securities for its own account may act as custodian except in accordance with rules and regulations prescribed by the Commission for the protection of investors. If a registered company maintains its securities and similar investments in the custody of a qualified bank or banks, the cash proceeds from the sale of such securities and similar investments and other cash assets of the company shall likewise be kept in the custody of such a bank or banks, or in accordance with such rules and regulations or orders as the Commission may from time to time prescribe for the protection of investors, except that such a registered company may maintain a checking account in a bank or banks having the qualifications prescribed in paragraph (1) of section 26(a) of this title for the trustees of unit investment trusts with the balance of such account or the aggregate balances of

such accounts at no time in excess of the amount of the fidelity bond, maintained pursuant to section 17(g) of this title, covering the officers or employees authorized to draw on such account or accounts.

STATEMENT OF DONALD L. CALVIN, VICE PRESIDENT,
NEW YORK STOCK EXCHANGE, BEFORE THE ANTITRUST
SUBCOMMITTEE OF THE COMMITTEE ON JUDICIARY OF
THE HOUSE OF REPRESENTATIVES

May 14, 1970

My name is Donald L. Calvin. I am a Vice President of the New York Stock Exchange. Mr. Phillip L. West, Vice President and Director of the Department of Stock List of the New York Stock Exchange is with me. We appear here today at your invitation to present the views of the Exchange on corporate takeovers as it relates to the conglomerate merger movement.

In our prepared remarks, we will attempt to present an overview of the activities of the New York Stock Exchange as they relate to corporate takeovers. During the course of this discussion, we will point to some problem areas which have arisen in the past couple of years in connection with techniques which were developed and used by companies seeking to diversify their activities through the acquisition of other companies.

The New York Stock Exchange's primary role in the financial community is to provide a marketplace where members and member organizations can conveniently execute transactions in securities listed on the Exchange.

STATEMENT OF DONALD L. CALVIN, VICE
PRESIDENT OF THE NEW YORK STOCK EXCHANGE,
BEFORE THE SUBCOMMITTEE OF THE COMMITTEE ON
CORPORATE GOVERNANCE OF THE HOUSE OF REPRESENTATIVES

DONALD L. CALVIN

NEW YORK STOCK EXCHANGE
11 WALL STREET
623-6000

VICE PRESIDENT

May 14, 1970

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The New York Stock Exchange's primary role in the financial community is to provide a marketplace where members and member organizations can conveniently execute transactions in securities listed on the Exchange.

The New York Stock Exchange is deeply interested in the affairs of companies whose securities are listed on the Exchange. The Exchange, among other things, carefully pre-examines each security issue before it is admitted to trading in light of listing standards developed over a period of many years. The Exchange takes into consideration many factors to determine the appropriateness for listing of a company's securities. Included in this consideration are a company's assets and earnings, its products, relative stability and position in the industry, the voting rights relating to the securities sought to be listed and, of course, the accounting policies which reflect the operating results and financial position of the company.

In the case of preferred stock or debt securities, the Exchange studies the total capital structure, interest and dividend coverage, and prior voting restrictions.

To aid in determining whether there is an adequate distribution and interest in a company's stock to attract sufficient investor interest to maintain a fair and orderly market, certain numerical standards have been adopted. These are attached to your copies of this statement.

By and large, the Exchange's relations with listed companies engaging in tender and takeover activities have centered on joint efforts to provide that such offers are

presented fairly and in accordance with good business practice. Listed companies have been extremely cooperative in complying with Exchange requirements. As a matter of policy, the Exchange does not comment on the merits of tender offers, or inject subjective opinions into the often-vigorous corporate disputes which have characterized some takeover situations. Basic Exchange policies with respect to takeovers have developed over a period of some fifteen or more years and are based on fundamental principles of equity and fairness for all shareholders.

A few years back, the takeover bid, which had been virtually unknown in this country, became the principal means for seeking corporate control. Along with this development came a host of new problems as the takeover bid technique became more commonplace and sophisticated in approach.

This development, I might add, has now abated substantially. While we do not have precise figures readily available, the number of major mergers and tender offers involving listed companies is substantially less thus far this year compared to periods in 1969 and 1968.

Exchange Regulation of Takeover Bids

For a number of years, the Exchange has insisted upon some basic requirements in connection with takeover bids.

These include the requirement that all shareholders have an equal opportunity to participate in the tender offer. If the offer is for a limited number of shares, it must be open for a minimum period of ten days and the shares deposited must be taken up on a pro rata basis.

Exchange regulation in this area has now been buttressed by the Corporate Takeover Act which was passed by the Congress in 1968. The Corporate Takeover Act, or the "Williams Bill" as it is commonly known, amended the Securities Exchange Act of 1934 to require the disclosure of pertinent facts concerning a tender offer. Disclosures must be made of: the purpose of the tender offer; the background and identity of the persons making the offer; the size of their holdings; the source of funds to be used to acquire the shares; any financing arrangements made for these funds and how these arrangements will be liquidated; and the plans of the offeror concerning the target company if he gains control.

In addition to the disclosure requirements, the Act provides that the offeror must accept the tendered shares on a pro rata basis during the first ten days of the offer if less than all of the shares outstanding are the subject of the offer. Persons who tender shares may withdraw them within seven days after the offer is announced. Further, rule-making authority is given to the Securities and Exchange Commission

to implement certain of the provisions of the Act.

In February, Senator Harrison Williams introduced S. 3431 to amend the Act to: 1) require persons acquiring 5%, rather than the present 10%, of a company's stock to comply with the Act; 2) eliminate the exemption for exchange offers registered under the Securities Act of 1933; 3) extend the provisions of the Act to insurance companies; and, 4) broaden the rule-making authority of the SEC in certain areas.

The Exchange testified in connection with the original Corporate Takeover Act and the amendments stating in the latter connection that the Act has worked well in our opinion in improving the disclosures made in connection with takeovers and has not impeded legitimate corporate takeovers as some people had feared would be the case.

During the heightened activity in the corporate takeover area, particularly with respect to the so-called conglomerates, the Exchange became concerned about the leverage situation in some offerings, the voting arrangements which developed as a defensive tactic and the issuance of long-term warrants in connection with an increasing number of takeovers.

Leverage Situation

In February 1969, the Exchange publicly announced its concern with the various types of securities being issued

in connection with some tender and exchange offers.

One of the concerns expressed at that time was that the leverage and senior capital ratios of the acquiring company might be so increased by the issuance of debt securities as to result in an imbalanced capital structure. This could be the case where the interest charges on a debt issue might not be adequately covered by the company's earnings. In some cases, the level of these interest charges were such that the acquiring company's earnings might not be sufficient to cover the interest charges on the debt being used for the acquisition. If this was permitted, the target or acquired company could be financing its own acquisition in that its earnings would be used to pay the interest on the debt.

The Exchange refused to list the bonds of two companies in 1969 after it appeared that the earnings before taxes would not be sufficient to cover the interest on the bonds being used to finance the acquisitions.

Voting Arrangements

The Exchange also became concerned by a number of so-called "defensive tactics" which developed in response to the growing number of takeover bids during this period. In December 1968 and February 1969, the Exchange sent letters to its listed companies advising that the adoption of certain

"defensive tactics" designed to ward off possible takeover bids would be reviewed closely by the Exchange in light of its long-standing policy on voting rights. While the Exchange has taken no final position on the matter, we have stated that the further development of corporate democracy is the only satisfactory foundation on which a viable base of broader public shareownership can be built. Consequently, attention has been called to the fact that at some time in the future the Exchange may adopt a policy that restrictive arrangements would constitute a listing problem.

Long-term Warrants

During this period, the practice also began developing of issuing long-term warrants which raised serious questions. Because of the number of warrants involved in some offers, existing shareholder equity would be diluted by a substantial amount. Further, the issuance of an exceedingly large number of warrants could ultimately relegate existing shareholders to a minority interest in the issuing company.

These problems have been largely solved by the adoption of a new Exchange policy with respect to warrants which became effective in March 1970.

To be eligible for listing on the Exchange, warrants to purchase listed stock must meet a series of detailed

requirements. Warrants must, example, have a life span of not less than 3 nor more than 10 years. The exercise price must not be substantially above the market price at the time of issuance. To protect against dilution of the interest of existing shareholders, the aggregate of shares purchasable upon exercise should not exceed 20% of the total common stock outstanding at the time of issuance, unless shareholder approval is obtained.

Summary

This brief overview of Exchange activity with respect to corporate takeovers, particularly as it relates to the conglomerate merger movement, deals primarily with situations which developed in 1968 and 1969. The pace of conglomerate mergers and takeovers has slackened considerably in recent months. Certainly the general state of the market and the economy has been an important factor in this decline in activity. The prevailing prices of the stocks of most companies placed in the conglomerate category are lower now, some substantially, thus reducing the ability to exchange such securities for shares in other companies.

In our opinion, the Corporate Takeover Act, and the disclosures required thereunder, have been a favorable development from the standpoint of the public shareholder. We have no legislative proposals to present to this Committee for

your consideration but we would be willing to attempt to answer any questions which you might have.

Attachment

EXHIBIT A

MINIMUM NUMERICAL STANDARDS

Number of stockholders	
Total.....	2,000
Holders of 100 shares or more.....	1,800
(The number of beneficial holders of stock held in the name of NYSE member organizations will be considered in addition to holders of record. NYSE will make any necessary check of such holdings.)	
Number of shares	
Total outstanding.....	1,000,000
Publicly held.....	800,000
Market value publicly-held shares.....	\$14,000,000
(While greater emphasis is placed on market value, an additional measure of size is \$14 million minimum net tangible assets)	
Demonstrated earning power before federal income taxes and under competitive conditions	
Latest fiscal year.....	\$2,500,000
Each of preceding two years.....	\$2,000,000