TESTIMONY OF THE HONORABLE RAY GARRETT, JR., CHAIRMAN SECURITIES AND EXCHANGE COMMISSION, BEFORE THE SENATE COMMITTEE ON COMMERCE, ON S. 3356, 93RD CONG., 2ND SESS.

MAY 16, 1974

It is a pleasure for me to appear before this Committee today, to present the views of the Securities and Exchange Commission on S. 3356.

This bill is substantially similar to legislation introduced in both the 91st and 92nd Congress, which this Commission strongly supported. It would, if enacted, have the effect of subjecting public offerings of securities by rail and motor carriers to the requirements of the federal securities laws, even though the issuance of such securities would remain under the regulatory jurisdiction of the Interstate Commerce Commission. It would also require rail and motor carriers with publicly-held securities to file annual and periodic reports under the Securities Exchange Act of 1934. Finally, it would remove the exemption from the Investment Company Act of 1940 now accorded to any company subject to the financial regulatory jurisdiction of the ICC.

At the present time, carriers regulated by the Interstate Commerce Commission are the only industrial or public utility issuers whose investors are not afforded the protections provided by the federal securities laws.

We support the enactment of this bill, although we express no opinion on those portions which relate to the computation of income tax liabilities of ICC-regulated carriers.

We are submitting to this Committee a detailed analysis of the relevant provisions of S. 3356, and I will not take up the Committee's time by repeating those comments

here. Instead, I would like to summarize for you some of the major reasons that we support this bill and then respond to any questions you may have.

As this Committee knows, the federal securities laws - - principally the Securities Act of 1933 and the Securities Exchange Act of 1934 - - established a comprehensive disclosure system for companies which seek to finance their operations, in whole or in part, by selling securities to the investing public or who have an outstanding substantial public interest in their securities. Over the last 40 years, that system has, in our view, worked quite well, and has made American investors far better informed than their counterparts in other countries.

The Acts grant certain exemptions from these requirements, mostly for financial companies such as banks, savings and loan associations and insurance companies, but the only exemption afforded to a public utility company or other industrial company is that provided in Section 3(a) (6) of the Securities Act with regard to securities issued by common or contract carriers subject to Section 20(a) of the Interstate Commerce Act. A similar exemption with respect to regular report filing requirements was afforded by Section 13(b) of the Securities Exchange Act.

The exemption from the Securities Act may have been patterned after certain existing state blue-sky laws, which exempted from their requirements the securities of public utility companies subject to financial regulation by a state or federal agency.

In 1933, the Interstate Commerce Commission was the major federal agency having such authority and railroads were the principal public utilities subject to that type of federal regulation. If such regulation was the statutory reason for the exemption, that rationale has been abandoned with respect to the other public utility companies that have

since become subject to financial regulation by federal bodies, such as electric and gas utilities and pipelines subject to such regulation by the Federal Power Commission and air carriers subject to such regulation by the Civil Aeronautics Board.

With respect to each of these other types of companies, it has become accepted that the regulatory considerations governing a determination as to whether or not it is appropriate for the regulated company to issue a particular security at a particular time do not duplicate or supercede the needs for investor protection supplied by the federal securities laws. Neither does the type of annual report required by these agencies - - governed as it is by the production of information relevant to their exercise of their regulatory responsibilities - - necessarily duplicate or supercede the type of information, on a continuing basis, that is desirable for public investors. The exempt status of railroad and motor carriers has, therefore, become an accidental anachronism which, we submit, has no sound foundation in modern policy.

At present, the Interstate Commerce Commission is developing rules, intended to be comparable to those administered by the Securities and Exchange Commission, to require adequate disclosures to investors. While we commend this effort, and think it desirable under the present statutory exemption, we think there are significant advantages that would inure to the benefits of public investors if S. 3356 were adopted, arising from the fact that our staff has developed a high degree of expertise in reviewing proposed disclosures, and the benefits flowing from the uniform application of identical standards by the same agency, and the statutory liabilities and penalties imposed by the Securities Act.

First, repeal of the existing exemption would bring into play certain administrative procedures which are now available to us in aid of our process of reviewing registration statements before they become effective, such as the investigatory powers conferred on us by Section 20(a) of the Securities Act, the injunctive powers of Section 20(b) of the Act - - pursuant to which we may ask a court to enjoin or restrain any person whenever it determines that such a person is engaged, or about to engage, in any act or practice which constitutes, or will constitute, a violation of the Act - - and the power conferred on the Commission under Section 8(b) of the Act, to issue a "stop order," to delay or suspend the effectiveness of a registration statement until all deficiencies are remedied.

Second, if compliance with the disclosure requirements of the Securities Act is not obtained, or when any of the provisions of the Act or the rules or regulations promulgated thereunder are willfully violated, the criminal penalty provisions of Section 24 of the Securities Act may be invoked.

Finally, and perhaps most importantly, the civil remedies provided by Section 11 and 12(1) of the Securities Act would be available to purchasers of such securities not sold in compliance with the Securities Act. These remedies are in addition to the civil antifraud remedies provided by Sections 12(2) and 17(a) of the Securities Act, and by Rule 10b-5 under the Securities Exchange Act, which presently are applicable to securities of carriers subject to the ICC's jurisdiction. The principal benefits inherent in bringing a civil action under Sections 11 and 12(1) of the Securities Act, for which there are no counterparts under the Interstate Commerce Act or general fraud rules, are, first, that affirmative responsibility for complete and truthful disclosure is placed on the

various classes of persons participating in the sale or distribution of the securities, and, second, as a general rule, that a defrauded investor need not establish his reliance on material misstatements or omissions in order to recover damages.

In addition, S. 3356 would amend Section 13(b) of the Securities Exchange Act of 1934, a section which authorizes us to prescribe the forms to be used by industrial companies of any significant size for reporting to us periodically the results of their operations, and to prescribe the accounting methods to be used in preparing those reports. At present, Section 13(b) does not extend at all to ICC-regulated carriers, and, with respect to accounting procedures, does not extend to companies subject to the jurisdiction of other federal agencies, such as the Federal Power Commission, the Federal Communications Commission, the Federal Home Loan Bank Board and the Civil Aeronautics Board. This amendment would place all such entities on an equal footing with other industrial and public utility issuers, and subject them to our reporting and accounting requirements.

Because of the important interrelationship between registration reporting under the Securities Act, and continuous periodic disclosures under the Securities Exchange Act, we believe the proposed amendment of Section 13(b) is a necessary concomitant of the proposed rescission of the Securities Act exemption contained in S. 3356. Together, both provisions will insure an adequate and continuing source of important corporate disclosures.

The bill also would repeal Section 3(c)(7) of the Investment Company Act of 1940. The Commission has, on a number of occasions in past years, called to the attention of Congress the fact that Section 3(c)(7) provides a means whereby a

corporation, which largely may be engaged in the business of investing, reinvesting, owning, holding and trading in securities, can avoid regulation under the 1940 Act simply by acquiring, with only a small fraction of its assets, a common carrier, provided the ICC subjects it to Section 20(a) of the Interstate Commerce Act or, to some minor extent, by directly engaging in the business of an interstate carrier. This avoidance is possible in a variety of ways. Here, again, if it was once thought that financial regulation under the Interstate Commerce Act was an adequate substitute for the investor protections afforded by the pervasive provisions of the Investment Company Act, there no longer appears to be a sound basis for this view.

S. 3356 would eliminate these anomalies by repealing Section 3(c)(7) of the 1940 Act so that those companies currently relying on that exclusion would be subject to registration and regulation under the 1940 Act if they otherwise fall within the Act's definition of an investment company as set forth in Section 3(a) of that Act.

In sum, we view S. 3356 as an important and desirable piece of legislation which has our full support. We believe it will enhance the protection of investors while preserving, intact, the ICC's substantive jurisdiction over rail and motor carriers. For these reasons, we look forward to its early adoption.