

hearing officer stated that the record would support a finding that the repurchase of 42% of Associated's shares by the underwriter and his associates, shortly after the offering was purportedly completed, was part of an undisclosed method of distribution. That conclusion appears to have support in the record. However, this is not the violation that was charged. The charge was that no bona fide public offering was intended, not that the public offering was to be made in a manner undisclosed in the offering circular.

The extent and nature of the repurchases were most suspicious. Hence it would be possible to infer that nominal purchasers were used to create the appearance of a public offering and that the nominal purchases were followed by a re-acquisition of the shares by the underwriter and his associates. But the hearing officer found no such scheme. The findings that he did make, that there was neither an agreement to repurchase shares nor any market domination by the underwriter, were unchallenged. Moreover, the record supports those findings.

There is no direct evidence of any repurchase scheme. Indeed, the issue of the underwriter's intention was left almost wholly unexplored. But such scant evidence as there was tends, if anything, to cut against any pre-arranged repurchase scheme. Hence we conclude that the administrative law judge's finding that the underwriter did not intend to make a bona fide public offering of the 100,000 shares of Associated is unsupported by the record.

The administrative law judge's statement about the existence of an undisclosed "method of distribution" raises a serious question as to the adequacy of the disclosures in Associated's offering circular. But the parties were never given any notice of this alleged defect in the offering circular. Nor did they have an adequate opportunity to answer that charge. To suspend the exemption permanently at this time on the basis of that finding would therefore be unfair.²

Accordingly, IT IS ORDERED that the order of December 3, 1971, temporarily suspending the exemption herein be, and it hereby is, vacated.

By the Commission (Chairman GARRETT and Commissioners LOOMIS, EVANS, SOMMER and POLLACK).

² Moreover, no such suspension is needed to protect investors. The underwriter's broker-dealer registration has already been revoked. Separate administrative proceedings subsequently instituted against the underwriter alleged violations of registration and anti-fraud provisions in connection with the purchase and sale of Associated stock, and violations of credit extension, net capital, reporting and recordkeeping provisions. For the purpose of settling those proceedings and without admitting or denying the allegations, the underwriter consented to findings of violations as alleged, to revocation of his broker-dealer registration, and to a bar from the securities industry with a provision that after one year he might apply to re-enter such business in a non-supervisory and non-proprietary capacity. *Samuel Weisberger, d/b/a First New York Equities Co.*, Securities Exchange Act Release No. 10504 (November 15 1973), 3 SEC Docket 46. The findings and order in that proceeding expressly noted that they were of no effect with respect to this proceeding.

IN THE MATTER OF
CHRISTIANA SECURITIES COMPANY

E. I. DU PONT DE NEMOURS AND COMPANY

File No. 3-3928. Promulgated December 13, 1974

Investment Company Act of 1940

MERGER OF A REGISTERED INVESTMENT COMPANY INTO ITS AFFILIATE

Mergers Generally—Applicable Standards—Disparity in Benefits—
Historical Factors

Where registered closed-end investment company and affiliated operating company made joint application under Investment Company Act for exemption from statutory prohibition so as to permit proposed merger of investment company into affiliated company, *held*, the terms of the proposed merger, including exchange ratio based on underlying net asset value of investment company rather than aggregate market price of its own shares, are reasonable and fair and do not involve overreaching, and are consistent with the Act's general purposes. Exemption *granted*.

Where registered closed-end investment company formed in 1915, a quarter of a century prior to the enactment of the Investment Company Act, for the sole purpose of controlling an industrial company, whose securities were its only asset of any consequence, wished to merge into such industrial company and where, because of tax factors and other reasons, benefits to investment company were greater than those to industrial company, *held*, imbalance of benefit does not render transaction inherently unfair; some transactions are more important to one side than to the other.

Where functionless investment company sought to merge into its affiliated portfolio company, *held*, public policy against the perpetuation of unnecessary entities makes it inappropriate for the Commission to insist on terms likely to result in investment company's continued existence.

Intrinsic Investment Values versus Market Prices

Intrinsic investment values, *held*, controlling in assessing fairness of proposed merger of closed-end investment company into portfolio company. Contention that hypothetical adverse market impact of merger of closed-end investment company into its affiliated portfolio company should be given great weight in assessing fairness of merger proposal, *rejected*, just result could be attained on basis of investment company's net asset value without conjectural assessment of market impact.

Restraints on the Power of Alienation

Proposal by objecting stockholders for restraints on the alienability of marketable securities to be issued pursuant to proposed merger on ground that unre-

stricted sales of such securities would lower the market price of the objector's shares, *rejected*, as unnecessary under the circumstances.

Taxation

Where registered investment company's managers' decision to merge it into its affiliated portfolio company was motivated by tax factors which led them to prefer a merger that would require the Commission's approval under the Act to a liquidation that would give investment company's shareholders the net asset value of their holdings but impose substantial and uncertain tax liabilities on them, *held*, Act's "reasonable and fair" standard does not entitle portfolio company's shareholders to the benefits of the taxes that the United States would otherwise have collected.

Dissolution of Registered Investment Company

Merger of registered investment company into its affiliated portfolio company that would eliminate duplicative operating expenses and taxation, *held*, consistent with Investment Company Act's purposes. Finding of consistency with investment company's purposes under Section 17(b)(2) of the Act, *not required*, where company's existence is to be terminated.

PRACTICE AND PROCEDURE

Asserted Inadequacy of the Record
Request for Remand
Pre-Trial Discovery
Depositions
Due Process
Rules of Practice

Objecting security holders' request for remand to supplement assertedly inadequate record, *denied*, because matters into which they wished to inquire irrelevant under governing legal principles. Hearing officer's denial of requests for depositions, *affirmed*, where Commission's rules make no provision for such depositions.

Due process does not require depositions.

APPEARANCES:

Kenneth W. Gemmill, Matthew J. Broderick, Stephen R. Miller and Richard S. Seltzer, of Dechert, Price & Rhoads, for Christiana Securities Company.

Daniel M. Gribbon, Cyril V. Smith, Jr. and Peter B. Archie, of Covington & Burling, for E. I. du Pont de Nemours and Company.

Gerald Osheroff, for the Division of Investment Management Regulation of the Commission.

Lewis C. Murtaugh, of Murtaugh, King, Neiman & Grais, *pro se*.
Richard J. Collins, Jr., of Rassieur, Long, Yawitz & Schneider, *pro se*.

Ernest N. May, pro se.

Daniel W. Maher, pro se.

FINDINGS AND OPINION OF THE COMMISSION

I

This case involves one of the World's great industrial complexes. It is here under the Investment Company Act of 1940. Its origins, however, go back to 1915.

At that time T. Coleman du Pont¹ was the largest single stockholder of E. I. du Pont de Nemours and Company ("Du Pont").² He wished to dispose of that interest. To keep Coleman's large block of stock within the family thus assuring its continued control of the enterprise, Coleman's cousin Pierre joined with others to form a holding company.³ That was Christiana Securities Company.⁴ It began life with the substantial amount of Du Pont stock acquired from Coleman plus other blocks of that security contributed by Pierre and by other family members in exchange for Christiana shares.⁵ Thus Christiana was organized by members of the du Pont family for the service of their own interests. Through Christiana, the family's dominant faction made sure that its massive holdings in Du Pont would be voted as a block.⁶ Christiana was a control device. Historians friendly to Pierre and to the family point out that:

"[I]t was as chairman of the Christiana Securities Company that his power was most explicitly defined. His immediate family held over 60% of Christiana common stock, and Christiana in turn held over 30% of the Du Pont common stock outstanding (through Delaware Realty⁷ and personal holdings the share held by Pierre's family in Du Pont was even higher). Since the Du Pont Company still owned close to 35% of the voting stock of General Motors, the family had practical control of that corporation."⁸

II

The du Pont family is large. And since the family rewarded outstanding managerial performance with Christiana stock, there were

¹ The du Pont family spells its name with a lowercase "d."

² In this opinion the company's name is hereinafter spelled with an uppercase "D."

³ With one exception, all of the people involved were members of the du Pont family. And the outsider was a man closely linked to the family.

⁴ Christiana was at first called Du Pont Securities Company. It took its present name in 1918.

⁵ The historical treatment is based on CHANDLER & SALSURY, PIERRE S. DU PONT AND THE MAKING OF THE MODERN CORPORATION 322-358 (1971). For other accounts see JAMES, ALFRED I. DU PONT: THE FAMILY REBEL (1941) (critical of Pierre and his associates and castigating them as "the secret six"); DONALDSON, CAVEAT VENDITOR (privately printed 1964) presenting the situation from Coleman's viewpoint.

⁶ The historical writings cited in the preceding footnote show that a family feud between Pierre and his cousin Alfred had much to do with Christiana's origins.

⁷ See *Delaware Realty and Investment Company*, 40 S.E.C. 469 (1961) (Footnote added).

⁸ CHANDLER & SALSURY, PIERRE S. DU PONT AND THE MAKING OF THE MODERN CORPORATION 564-565 (1971). On page 565 the authors note that "During the 1920s Pierre and his brothers were obsessively concerned about assuring control."

some non-du Pont stockholders in Christiana from the very beginning.⁹ So by 1940, when the Investment Company Act went into effect, Christiana had far more than a handful of stockholders.

Christiana registered under the Act. It had to do so for two reasons:

(A) Christiana had more than the 100 security holders whose presence, with other facts, brings the Act into play.¹⁰

(B) Christiana maintained, and still maintains, that it did not and does not run Du Pont. It insists that it is not Du Pont's parent. It concedes that it "has the potential to exercise a controlling influence over Du Pont," but it has consistently contended that this potential lies dormant and unexercised and that there is no actual control relationship. This, its own version of the facts, made, and makes, Christiana an investment company of the closed-end, non-diversified type rather than an industrial holding company.¹¹

III

Today Christiana is still what it was at its birth in 1915, a receptacle for a huge block of Du Pont common stock. It holds 28.3% of the issue. This massive commitment accounts for something like 98% of Christiana's total assets.¹²

Christiana's stock is still highly concentrated. While it has over 11 million common shares outstanding, 95.5% of them are held by a mere 338 people. Christiana remains in overwhelming measure a du Pont family affair, 75% of its outstanding shares being held by family members.

This does not mean that Christiana is just a collective name for the descendants of the original stockholders. It is a publicly held company with about 8,000 stockholders. There is an over-the-counter market in the issue, and for reasons hereinafter explained, Christiana shares have over the years had a certain appeal to a few of the many people who wanted to invest in Du Pont. It was—and for that matter, still is—cheaper to buy into Du Pont indirectly by buying Christiana than it was to acquire the underlying Du Pont shares themselves. Someone with \$10,000 that he wanted to invest in Du Pont common could do so in one of two ways. The first was to buy \$10,000 worth of Du Pont on the New York Stock Exchange. The second was to buy \$10,000

⁹ Chandler & Salsbury, *Pierre S. Du Pont and the making of the modern corporation* 581 (1971).

¹⁰ Section 3(c)(1).

¹¹ For fuller discussion see this Commission's 1966 report on the PUBLIC POLICY IMPLICATIONS OF INVESTMENT COMPANY GROWTH, House Report No. 2337, 89th Cong., 2d Sess. 40, n. 54.

¹² It also holds a small block of Du Pont preferred. The non-Du Pont assets consist of the two daily newspapers in Wilmington, Delaware, and 3.5% of the stock of the Wilmington Trust Company. *Qua* trustee for various du Ponts and du Pont relatives, the Trust Company holds more than half of Christiana's common stock.

worth of Christiana in the over-the-counter market. Since Christiana, like most other closed-end investment company issues, has long tended to sell at a substantial discount from net asset or liquidation value, the Christiana buyer got what could be regarded as a real bargain. His \$10,000 purchased an interest in Du Pont that might have cost him \$12,000, \$13,000 or \$14,000 had he acquired it in the direct Du Pont form rather than in the indirect Christiana form. One did not have to be a du Pont in order to see the point. The record suggests that some of the 338 large holders previously referred to may be wholly unconnected with the founding family. Although members of the du Pont family still hold about 75% of Christiana, the other 25% belongs to public investors.

IV

Those who control Christiana (and who presumptively at least are for present purposes deemed to control Du Pont as well¹³) think that Christiana has outlived its usefulness. Du Pont, they say, is no longer a family firm. Hence the family no longer needs Christiana. It has no contemporary function.

And Christiana is expensive. It costs something to run. Much more important than administrative costs are the taxes that have to be paid because of Christiana's existence. For practical purposes, Christiana's income consists entirely of the dividends it collects from Du Pont. Yet Federal income tax has to be paid on those dividends before they can be distributed to Christiana's stockholders. Were there no Christiana and were the present Christiana stockholders to own their Du Pont shares directly, there would be no such tax.

Accordingly, Christiana's management urges that Christiana merge into its portfolio company, Du Pont. Du Pont's management agrees.¹⁴ The salient features of the joint Christiana-Du Pont proposal are these:¹⁵

(1) Christiana's assets and liabilities will become those of Du Pont.¹⁶

(2) Accordingly, Du Pont will reacquire the 13,417,120 shares of its own common now in Christiana's portfolio.¹⁷ Those shares will be retired.

¹³ Under Section 2(a)(9) of the Act an interest of more than 25% in voting securities is presumed to constitute control. We also note that Christiana and Du Pont have five common directors.

¹⁴ In addition to the five common directors referred to in the preceding footnote, another seven of Du Pont's 26 directors own Christiana common stock.

¹⁵ The application before us states that the 12 Du Pont directors who are also directors or stockholders of Christiana did not participate in the consideration of the merger proposal.

¹⁶ Du Pont intends to dispose of the newspaper interests and the bank stock (see n. 12 on p. 652, *supra*) to be acquired from Christiana.

¹⁷ Christiana's 16,256 shares of Du Pont's \$4.50 preferred (0.96% of the outstanding shares of that class) will also be reacquired by Du Pont.

(3) Each Christiana common share will become 1.123 shares of Du Pont.¹⁸

The merger is designed to be tax-free to Christiana and its stockholders. Accordingly, it is conditioned on a ruling to that effect by the Internal Revenue Service.

V.

Like other corporate mergers, this one cannot be consummated unless the law of the state of incorporation (in this case Delaware for both companies) is followed. Hence the stockholders of both companies must approve. Were this an ordinary amalgamation between industrial or mercantile firms, the merits of the matter would be none of our concern. Our responsibility would be solely that of seeing to it that the two companies' stockholders were told enough about the proposal to enable them to reach an informed judgment. The decision would be theirs, not ours.

But Christiana is an investment company, and the Congress that passed the Investment Company Act deemed transactions of this character to be fraught with potential for overreaching and unfairness.¹⁹ Accordingly, it prohibited them,²⁰ subject to our power to lift the prohibition²¹ "if evidence establishes that . . . the terms of the

¹⁸ In time the present Christiana holders may also receive some additional Du Pont stock. This would stem from a contingent, unliquidated tax refund claim that Christiana now has against the United States. Du Pont will acquire that claim. If it collects on it within five years from the effective date of the merger, it will distribute additional shares of its common whose then current market value will equal the proceeds of the claim. Should the tax refund claim remain unsettled and adjudicated within the aforementioned five-year period, the number of additional shares issued will be based on the then fair value of the claim.

The plan makes provision for the holders of Christiana's 106,500 7% callable preferred. Those shares are callable at \$120. Accordingly, the plan calls for their conversion into shares of Du Pont with a then market value of \$120, based on the average closing price of Du Pont common stock on the New York Stock Exchange for the ten trading days immediately preceding the effective date of the merger, plus cash equal to the accrued dividend. Du Pont states that its present intention is to offer dissenting Christiana preferred holders who follow Delaware's statutory appraisal procedures \$120 in cash (plus the accrued dividend) for each share.

¹⁹ Section 1(b)(2) of the Act states that "the national public interest and the interest of investors are adversely affected . . . when investment companies are . . . managed . . . in the interest of directors, officers, . . . or other affiliated persons thereof . . . , in the interest of special classes of their security holders, or in the interest of other investment companies or persons engaged in other lines of business, rather than in the interest of all classes of such companies' security holders." Of special significance here is Section 1(b)(2)'s reference to investment companies' affiliated persons, Christiana and Du Pont are "affiliated persons" of each other. That is so because Christiana owns more (far more) than 5% of Du Pont's voting securities. See Sections 2(a)(3)(A) and 2(a)(3)(B).

²⁰ Section 17(a)(1) of the Act makes it "unlawful for any affiliated person [of] . . . a registered investment company . . . knowingly to sell any security or other property to such registered company." The proposed combination would take the form of a statutory merger. But this would constitute a "sale" by Christiana of its assets to Du Pont within the meaning of Section 17(a)(1). *E. I. du Pont de Nemours & Company*, 34 S.E.C. 531 (1953), overruling *Phoenix Securities Corporation*, 9 S.E.C. 241 (1941).

²¹ Section 17(b) provides that "notwithstanding subsection (a), any person may file with the Commission an application for an order exempting a proposed transaction . . . The Commission shall [emphasis added] grant such application and issue such order of exemption if . . ."

proposed transaction including the consideration to be paid or received, are reasonable and fair and do not involve overreaching on the part of *any* person²² concerned."²³

Does this transaction meet that test? That is the central question before us.²⁴ A negative answer will end the matter. Should our answer be in the affirmative, the managers of both companies will be at liberty to proceed to seek the approval of their stockholders.

VI.

At first blush it is hard to see a real problem here. In economic reality Christiana stock already is Du Pont stock—under another name. Substantially, all that we are dealing with is an exchange of equivalents.

Christiana owns 13,417,120 shares of Du Pont common. But there are only 11,710,103 Christiana common shares outstanding. It follows that a Christiana common share is in economic substance 1.15 shares of Du Pont common. Make a few simple adjustments for the relatively inconsequential preferred stocks of the two companies and for the newspaper interests and the bank stock that Du Pont will get from Christiana,²⁵ and the whole thing is over.

That in essence is the view of the two companies involved. Our Division of Investment Management Regulation agrees. But three Du Pont stockholders disagree.²⁶

²² Because of its special impact here the word "*any*" has been italicized. Its presence means that we must find this transaction fair to the stockholders of both companies. See *Bowser, Inc.*, 43 S.E.C. 277 (1967).

As we said in *Fifth Avenue Coach Lines, Inc.*, 43 S.E.C. 635, 639 (1967): "[T]hat Section 17(a) by its terms makes it unlawful for the affiliate, rather than the investment company, to engage in specified types of transactions, does not . . . indicate a Congressional concern for the shareholders of the investment company to the exclusion of the other stockholders affected. While it is true that the protection of fund shareholders was a primary consideration which led to the passage of the Act, we find nothing in the legislative history which persuades us that Congress intended the broad language of Section 17(b) to be read in the restrictive manner which applicants suggest, nor have we ever done so. We cannot believe the Congress intended, after requiring an agency of the Government to examine a transaction such as this, to put that agency in the position of effectively authorizing the transaction when there are circumstances raising questions as to possible overreaching of a person concerned which has public investors."

²³ Section 17(b)(1).

²⁴ But it is not the only question presented. Under Section 17(b)(2) we must also find the proposed transaction consistent with Christiana's policy. And Section 17(b)(3) precludes approval unless we find the merger consistent with the Act's general purposes. Its primary general purpose, of course, is the protection of investors. Finally, the parties invoke Section 17(d) and our Rule 17d-1 thereunder, which taken together prohibit joint enterprises and joint arrangements between investment companies and persons affiliated with them, unless we approve the specified transaction involved.

²⁵ See n. 12 on p. 652, *supra*.

²⁶ These stockholders, Lewis C. Murtaugh, Richard J. Collins, Jr. and Daniel W. Maher, participated in the hearings before the administrative law judge. An initial decision having been waived, the case came to us after the record was closed. Briefs were filed, and we heard oral argument. Our findings are based on an independent review of the record.

VII

The objecting Du Pont stockholders consider the view just outlined misleadingly simplistic. They contend that this transaction will:

- (A) Confer great benefits on Christiana's stockholders;
- (B) Give Du Pont's stockholders nothing worth mentioning but actually injure them; and
- (C) Serve no real business purpose for Du Pont.

VIII

The objectors are clearly right when they say that the merger will be a very good thing indeed for Christiana's stockholders. Their benefits will stem from:

- (A) The federal tax structure; and
- (B) Stock market phenomena.

We begin with the tax factors. There are two of them. One is the federal corporate income tax that Christiana now pays.²⁷ The United States Treasury takes 7.2 cents out of every dollar of dividend income that Christiana gets before such dividend income is disbursed to the Christiana stockholders.²⁸ So the merger will increase each Christiana stockholder's individual pre-tax income by 7.2% over what he would receive if Du Pont dividends continued to be passed through Christiana.²⁹ Of course, this 7.2% accretion will be taxable income in the individual stockholder's hands. A particular Christiana stockholder's net tax benefit will therefore depend on the tax bracket in which he happens to find himself. To the extent that Christiana stock is held by people in high tax brackets, the actual increment to the Christiana stockholders' net after taxes will be significantly less than 7.2%.³⁰ The second tax factor relates to the tax cost of alternative methods of achieving the end that the applicants wish to reach. Christiana could be killed off without any need for our prior (or for

²⁷ Many closed-end investment companies do not pay federal corporate income taxes. They, like most of the open-end companies, avail themselves of the special treatment that Subchapter M of the Internal Revenue Code gives to so-called regulated investment companies, i.e., companies regulated by this Commission under the Investment Company Act. Such companies are free from all corporate income taxes so long as they distribute all of their income to their stockholders. But this special tax benefit is available only to "diversified" investment companies. Christiana, of course, is as undiversified as an investment company can possibly be. Hence its federal income tax status is no different from that of any other corporation. Sections 851-855 of the Internal Revenue Code.

²⁸ The applicable normal corporate income tax is 48%. Section 11 of the Internal Revenue Code. But all corporations (whether investment companies or not) are entitled to deduct from their income 85% of any dividends that they receive. Section 243 of the Code. Thus the maximum effective federal corporate income tax on dividend income is 48% to 15% or 7.2%.

²⁹ Christiana pays out substantially all of its after-tax income in dividends.

³⁰ Additional savings will stem from the elimination of Christiana's operating expenses. The application states, however, that those expenses are "relatively minor."

that matter subsequent) approval. Nothing in the Act or anywhere else in the law inhibits a registered investment company from liquidating. But a liquidation might be much more expensive for Christiana's stockholders than this tax-free plan.³¹ Liquidation would certainly be a great deal more conjectural.³²

In view of what has just been said about the special 7.2% tax burden on Christiana's stockholders, it would be unsurprising to find Christiana's shares selling at a discount of about that magnitude from net asset value.³³ Actually, however, the discount has been much higher than that. When the merger negotiations were first announced it was 23%. During the preceding two years it had been as high as 25% and was never below 20%.

The mere announcement of the planned merger led to an appreciable narrowing of the discount. Its consummation will, of course, extinguish the discount forever. Thus the merger will substantially enhance the market value of the Christiana stockholders' property.

What is the offsetting benefit to Du Pont's stockholders? Applicants point to the fact that Christiana's stockholders will get only 97.5% of its adjusted net asset value. This looks like a 2.5% discount from net asset value. But the actual dilution to be suffered by the Christiana stockholders will be only 1.8%. That is so because Christiana is so substantial a Du Pont stockholder. Since Christiana has a 28.3% interest in Du Pont, 28.3% of the 2.5% discount will go right back into the Christiana holders' pockets. Accordingly, objectors dismiss the discount as derisory, a mere "pacifier."

The objectors' claim of positive harm to themselves and the other similarly situated Du Pont stockholders rests entirely on market factors.³⁴ They point out that from a stock market point of view Christiana's massive block of Du Pont is sterilized. Christiana has never sold

³¹ Christiana's tax picture is said to be clouded by reason of the distributions of General Motors common stock resulting from the antitrust divestiture decree entered against Du Pont. *United States v. E. I. du Pont de Nemours & Co.*, 366 U.S. 316 (1961). We are told that this is so because:

"(a) the fair market value of the General Motors stock received by Christiana pursuant to the antitrust divestiture decree . . . is the subject of a tax refund suit by Christiana against the United States Government and is thus presently indeterminable;

"(b) the effect of pro rata distributions by Christiana of General Motors stock to its own stockholders is uncertain under the tax laws; and

"(c) the effect of distributions by Christiana of General Motors and Hercules Powder Company stock . . . is uncertain."

³² Christiana's brief states that its "stockholders would in effect be voting tax litigation for themselves were they to sanction a liquidation."

³³ Implicit in this statement is the somewhat unrealistic assumption of a market for Du Pont common that is entirely income-oriented.

³⁴ Some Du Pont stockholders are also Christiana stockholders. Objectors do not weep for them. Their concern is with the people whose interest in Du Pont stems entirely from their ownership of its stock. Since there are over 225,000 Du Pont holders as against a mere 8,000 Christiana holders, it is obvious that most Du Pont stockholders belong to the class whose interests the objectors champion.

any of its Du Pont. Nor, so long as it remains in being, is Christiana ever likely to do so.

The enormous capital gains taxes that would have to be paid are enough in themselves to inhibit Christiana from selling any of its Du Pont holdings. Those taxes would arise at two levels. First, at the corporate level there would be a very heavy tax on Christiana itself. The basis of its Du Pont shares is but a tiny fraction of those shares' present value. And should Christiana follow its past practice of distributing all of its income to its stockholders, a second onerous tax would fall on the individuals who own Christiana.

Most of Christiana's stock has a very low basis in the hands of those who now hold it. That is so because:

(A) The holders either paid much less for it than it is now worth or acquired it from donors who bought it for far less than the present value; and

(B) The basis of their Christiana shares has already been materially reduced by reason of their receipt of substantial quantities of General Motors stock, pursuant to the Du Pont divestiture distribution.³⁵

The objectors say that the merger will work a radical change in this state of affairs. They note that the corporate capital gains tax inhibition will vanish. After Christiana is dead and gone, no one will worry about the capital gains taxes that it would have had to pay had it remained alive. True, the holders of about 70% of Christiana's stock state that they have no present intention of selling the Du Pont shares to be received in exchange for their Christiana holdings. But the objectors point out that:

(A) No binding commitments to refrain from selling have been given.³⁶

(B) The plan's carefully crafted provisions for Securities Act registration statements at the selling stockholders' expense (twice a year on a non-firm commitment basis and once a year on the basis of a firm commitment underwriting for at least \$25 million) show that some important holders have given some thought to some selling at some time.

(C) Public investors unrelated to Christiana's control group own about 25% of the company's stock. Hence the merger will give them about 3/4 million shares of Du Pont common. They will be as free as other noncontrolling Du Pont stockholders to sell those shares when-

³⁵ See n. 31 on p. 657, *supra*. Some 3 million Christiana shares (roughly 25% of the issue) have a zero basis.

³⁶ Indeed, the Wilmington Trust Company, record owner of more than half of Christiana's outstanding shares (see n. 12 on p. 652, *supra*) states that its fiduciary responsibilities may require it to do some selling from time to time.

ever and wherever they choose without registering them under the Securities Act.

Objectors argue that the merger will have an adverse impact on them even if nobody actually sells. They ask us to focus on potential available supply. Such supply will, they say, be increased by over 13 million shares. The market's knowledge of this is bound to depress the price. Ergo, Christiana should be required to compensate the Du Pont stockholders for the "vast and virtually uncontrolled increase in the supply of marketable stock" flowing from the merger.

As for Du Pont, objectors argue that it has been doing well all these years and will continue to do well with or without Christiana; that applicants have failed to show that Christiana is an incubus to Du Pont; and that though the proposal does a great deal for the du Pont family, it does nothing of consequence for Du Pont. True, after the merger's consummation Du Pont will have about 188,500 fewer common shares outstanding than it now does. But presently outstanding shares of that issue number 47,445,810. So the number of shares outstanding will be diminished by a mere four-tenths of one percent.

One objector argues for a substantial increase in the contemplated 2.5% or 1.8% (depending on whether one looks at gross or at net impact) discount from Christiana's net asset value.³⁷ The other two also urge an increase in the discount. But they go on to attack the whole affair root and branch. They consider it an outrageous assault on the rights of the Du Pont stockholders and on the law of supply and demand. What they deem essential are conditions to "protect the price of Du Pont shares." They therefore implore us to impose restraints on the alienability of the new Du Pont common shares to be issued pursuant to the merger.

IX

Applicants consider the objectors' contentions frivolous and absurd. So does our Division of Investment Management Regulation.³⁸ We

³⁷ See p. 657, *supra*.

³⁸ Though in accord with the applicants on every substantive point presented, the Division has certain qualms about the performance of the financial experts who testified on their behalf with respect to the value of Christiana's Du Pont holdings. It asks us to say some harsh words about those experts and to make a pronouncement about the role of an independent expert in a proceeding of this character. We agree with the Division that financial experts should be diligent, conscientious, and painstaking. On the record before us, we think it inappropriate to go beyond that truism. The importance of expert testimony varies from case to case. In some situations such testimony is crucial. When a closely held firm or a business of an esoteric character must be appraised, much turns on what the experts say. *LaSalle Street Capital Corporation*, 44 S.E.C. 655 (1971) is illustrative. That case presented a question about the value of a major league baseball franchise. Such questions are, as was said at page 662 of the *LaSalle Street* opinion, "not susceptible to precise determination." The instant case, on the other hand, involves marketable securities. The questions presented are in our view essentially legal. Hence they cannot be resolved by reference to the opinions of financial experts, however conscientious and

take a different view. To us the questions presented are substantial and troublesome. This is not an easy case. But after careful consideration of the issues raised, we find ourselves constrained to resolve them against the objectors and to grant the application before us.

That there is an imbalance of benefit is plain. This merger cannot possibly do as much for Du Pont as it will for Christiana. The very slight reduction in the amount of Du Pont's outstanding common and the resulting increase in earnings per Du Pont common share is incommensurate with the tax and the market value benefits inuring to the Christiana stockholders.

Applicants ask us to look at other benefits that will, they say, be reaped by Du Pont and its stockholders. We have done that. And we find their magnitude far from striking.

Apart from the small reduction in the number of Du Pont shares outstanding and the resulting small increases in book value and in earnings per Du Pont common share, it is said that Du Pont will benefit from:

(A) The "dispersal" of Christiana's large block of Du Pont common; and

(B) Its escape from the Investment Company Act, which precludes it from entering into transactions with Christiana without our approval.

The "dispersal" argument is somewhat puzzling. Applicants insist over and over again that it is most unlikely that any substantial number of Du Pont shares will come to market by reason of the proposed transaction. In that regard applicants point quite cogently to the large individual capital gains taxes that selling Christiana holders will have to pay and to the long-run character of the du Pont family's investment commitment to the company that bears its name. What then is likely to be dispersed?

It would seem that the dispersal will be formal, not substantive. Today some people own a great deal of Du Pont indirectly through Christiana. Tomorrow those very same people will still own a great deal of Du Pont. But they will own it directly rather than indirectly. What will that change do for Du Pont?

Du Pont's answer to these questions look to the long run. Its brief concedes that its "management was aware of no immediate prospect of

however eminent. We do not go so far as to say that expert testimony is of no weight here. Some of it we have found interesting and even instructive. But in view of the nature of the issues raised, we think its weight limited. We note, for example, that some of the experts seem to have spent a great deal of time studying our decisions under Section 17 of the Act and pondering the implications of the opinions in those cases. That sort of thing is normally the function of a lawyer, not of an expert witness. The Division has, we think, failed to give due heed to the special nature of this concrete case. Observations about experts in our past opinions have been mechanically transposed to contexts quite different from those in which they were uttered.

any adverse consequences from the Christiana holdings." The brief goes on to argue, however, "that over the long term such a possibility might arise."

The precise nature of these possible long-term adverse consequences is obscure. The argument rests on the possibility of a future clash between the people then in control of Christiana and the people then managing Du Pont. It assumes that in this hypothetical situation the Du Pont managers will be the "good guys" and the Christiana control group the "bad guys." The argument seems far-fetched and rests on premises we consider unacceptable. Christiana's extinction may well make it somewhat easier for Du Pont's managers to maintain themselves in office. We, however, cannot presume that this will necessarily be in the Du Pont stockholders' interest.³⁹ And in any event the Investment Company Act was not designed to foster the retention of control by managerial groups. Nothing in it warrants a holding that such control is to be preferred to control by important stockholders.⁴⁰

No showing has been made that the Investment Company Act imposes any really onerous burdens on Du Pont. No doubt the applications that the company is required to file by reason of its affiliation with Christiana are something of a nuisance.⁴¹ But no contention has been made that the Act has interfered or is likely to interfere with the company's business. Hence we find it difficult to view Du Pont's exit from the Act's net as a significant benefit.

But the Act's requirement that the transaction be reasonable, fair, and free from overreaching, does not mean that the benefits to the parties must be nicely balanced. Such a reading would be wholly impractical and would frustrate legitimate arrangements. Some transactions are more important to one side than to the other. This one is of that type. And that does not make it inherently unfair under Section 17(b). Nor does the fact that Christiana has much more at stake than Du Pont mean that the consideration moving from Christiana to Du Pont must be large enough to inflict really substantial detriment on the former.

The benefit to Du Pont is far from awesome. But it is sufficient to meet the statutory standard. Christiana is a legal device. Those who

³⁹ As a former Chairman of this Commission recently observed: "The raider may . . . be a better manager than the raidee". Cary, *A Proposed Federal Corporate Minimum Standards Act*, 29 BUS. LAW, 1101, 1105 (1974).

⁴⁰ Certain Delaware decisions seem to hold otherwise. They are beside the point. Our concern here is not with the niceties of local corporation law, but with broad Federal investor-protection standards formulated in large measure because of the inadequacies of local corporation law. See Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663 (1974).

⁴¹ Our files show that there have been approximately 50 applications since the Investment Company Act went into effect back in 1940.

invented it did so to serve their own purposes.⁴² And they had every right to do that. Now the inventors' heirs and successors in interest conclude that the device is obsolete. That is their privilege. Nothing in the Act compels them to pay a high price for exercising it.⁴³ Only if

⁴² The parties did not go into Christiana's history on the record. But we thought it appropriate to take administrative notice of some fairly well-known facts of economic history. And we did so at the outset of this opinion. We cannot forget that Christiana as an investment company is of a very special kind and that the situation with which we are confronted was created long, long before anyone dreamed of any such statute as the Investment Company Act. Compare *Hawaiian Electric Company, Inc.*, 44 S.E.C. 189 192-3 (1970), where our view of the Public Utility Holding Company Act's impact on the matters there before us was much influenced by Hawaii's unique history.

The Public Utility Holding Company Act to which we have just referred has a certain bearing here. As applicants note, Section 11(b)(2) of that statute mandate the elimination of unnecessary holding companies in the industries affected. Were that Act applicable to Christiana, it would have vanished long ago. Nobody suggests that it serves any real purpose in the world of today. Of course, Du Pont is neither an electric company nor a gas company. So we have no power to destroy Christiana on our own motion. But we think the policy against the multiplication of superfluous corporate entities articulated in the Holding Company Act sound and salutary. When as here questions about wholly unnecessary entities come before us in non-utility contexts, it is quite inappropriate for us to insist on their perpetuation or to impose terms likely to lead the parties to conclude that it would be cheaper and better to keep them alive.

⁴³ But they must pay a fair price. And in assessing the fairness of the proposed price one is struck by the fact that the Securities Act restricts the marketability of Christiana's massive block of Du Pont. Objectors do not demur to the proposal on this ground. Nor does our staff. We, however, have considered the question *sua sponte*. We have done so because (1) as the Commission pointed out some years ago, "the valuation of restricted securities at the market quotations for unrestricted securities of the same class would, except for most unusual situations, be improper." ("*Restricted Securities*," Investment Company Act Release No. 5847, Accounting Series Release No. 113 (October 21, 1969)); and (2) in the normal case a discount of only 2.5% from net asset value would be much too small to reflect the diminution in value resulting from the restrictive feature. After such consideration, we find this one of those "most unusual situations" referred to in the above-cited release in which it is proper to value restricted securities at the price assigned by the market to unrestricted securities of the same class.

The typical investment company-restricted security situation involves the acquisition of a block of restricted securities for investment at a price below that at which unrestricted securities of the same class are selling, with the discount (usually a substantial one) being attributable to the restrictions imposed by the Securities Act on persons who take securities in so-called private placements. None of these factors is present here. Christiana's 13,417,120 shares of Du Pont were not acquired for investment in the ordinary sense of that term. Those shares are a historic control block assembled almost two decades before anyone thought of any such statute as the Securities Act. And although the price Christiana paid for its Du Pont holdings was nominal when viewed in relation to their present value, it received no discounts at the time of purchase. What has just been said is more than historical digression. It has contemporary relevance. A block of securities restricted under the Securities Act because it is large enough to confer control cannot be equated mechanically for all purposes with smaller non-controlling blocks restricted only because they were acquired in transactions claimed to have been exempt from the Securities Act's registration and prospectus-delivery requirements by reason of the special provision in Section 4(2) of that statute for "transactions . . . not involving any public offering." Our policy with respect to the valuation of restricted stock by investment companies rests on two principal considerations. First, the impropriety of an investment company recording essentially fictitious profits by buying restricted stock at a discount and then marking it up to the market; and secondly, the fact that stock which cannot be publicly sold without registration normally is worth less than stock which is free for trading. Neither consideration is applicable here. Christiana did not acquire Du Pont stock at a discount by reason of the status of that stock under the Securities Act, and Christiana never intended to, and never has, traded in and out of Du Pont stock. If Christiana had ever made the clearly momentous decision to attempt to sell its Du Pont stock, registration under the Securities Act would have been the least of its problems.

Also pertinent in this regard is the fact that much (probably most) of the Du Pont

their decision to dismantle Christiana inflicts cognizable harm on Du Pont and on its stockholders unrecompensed by the proposed discount, can we insist on terms harsher for them than those now before us.⁴⁴

Another aspect of this case illustrates that principle. The Christiana stockholders could have caused Christiana to be liquidated. They would then have become the direct owners of the Du Pont shares now held by Christiana. Had they done so, the situation would have been essentially the same as that contemplated by this merger.

But a liquidation, unlike this merger, would have adverse tax consequences for Christiana's stockholders. And in view of the problems attributable to the General Motors divestiture, the extent of their potential tax liability is shrouded in uncertainty.⁴⁵ The proposed merger is thus designed to avoid the serious tax problems that Christiana's liquidation would engender for its stockholders. Aside from those tax problems, however, the economic impact of this merger on Du Pont and its stockholders is no more onerous than the impact that would be produced were the Christiana stockholders to exercise their prerogative to liquidate Christiana. More specifically, the possible market effects resulting from the Christiana stockholders acquiring direct ownership of the Du Pont shares would be the same. It may be that in the course of bargaining between wholly unrelated parties, Du Pont could have exacted a handsome price for permitting consum-

stock to be received by the Christiana stockholders will itself be restricted under the Securities Act. To discount the value of those persons' present indirect holdings in Du Pont on the ground that those holdings are restricted under the Securities Act and then to give them new direct Du Pont shares that would be similarly restricted, would involve a double subtraction that we deem impermissible.

⁴⁴ It might seem that the discount should at the very least equal the 7.2% income tax benefit to be realized by the Christiana stockholders. However, their actual benefit will in most cases be less than 7.2%. See p. 656, *supra*. This consideration, however, we put to one side. The heart of the matter is that the tax benefits to be reaped by the Christiana people will inflict no corresponding detriment on Du Pont or on its stockholders. The burden will fall wholly on the United States. And neither the Du Pont family nor the other Christiana holders are under any duty to maximize their tax liabilities. As the Court of Appeals for the Second Circuit said when it spoke through Judge Learned Hand in *Helvering v. Gregory*, 69 F. 2d 809, 810 (C.A. 2, 1934): "Anyone may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes." Also in point are Judge Hand's subsequent observations when he dissented in *Commissioner v. Newman*, 159 F. 2d 848 (C.A. 2, 1947), *cert. denied* 331 U.S. 859 (1947): "[T]here is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands; taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant." 159 F. 2d at 850-851. Nor do we see how Section 17(b)'s "reasonable and fair" standard can be deemed to require Christiana's stockholders to turn every nickel of their tax savings over to Du Pont. The tax savings are of some weight. But it does not follow that the Du Pont stockholders are to be subrogated to the rights that the United States now enjoys under the status quo.

⁴⁵ See n. 31 on p. 657, *supra*.

mation of the transaction in a form that relieves the Christiana stockholders of their tax problems. But Du Pont's failure to do that does not render the transaction unreasonable or unfair. The Du Pont stockholders, including the objectors, have no property interest in the Christiana stockholders' tax problems. A principal reason why Section 17 of the Investment Company Act requires us to pass upon the fairness of transactions such as this, is to prevent persons in a strategic position from using that position to effect transactions for other than fair value. And fair value does not change simply because a strategic position arises from something other than affiliation.

X

That brings us to what we think the crux of the case: the objectors' claim of detriment by reason of market impact.

Here we find a hot dispute about the probable facts: Objectors envision endless torrents of Du Pont shares descending on the market. Although never too clear about exactly what they expect to happen, they profess great alarm about the low prices to which Du Pont common will fall.⁴⁶ Applicants laugh at that. They say that nobody is going to sell anything. Christiana's brief tells us that:

"In the present situation, there is no reason to suppose that the distribution of Du Pont shares to Christiana stockholders will add even one share to the market for Du Pont stock. The consummation of the merger will simply leave the Christiana stockholder with Du Pont shares in place of the Christiana shares he has formerly held—in most cases—for many years. There is no reason to suppose that the Christiana stockholder will sell those shares . . . [A]dverse tax consequences will be visited on a former Christiana stockholder if he does sell Du Pont stock. Those consequences are a strong deterrent to sale since receipt of the Du Pont stock in the merger will be tax-free."

We think the objectors' prophecies much too gloomy.⁴⁷ Hence it looks to us as though the applicants have the better of the argument. But

⁴⁶ But they never explain why Christiana's holders would be eager to sell at such depressed levels. Objectors have no doubts about Du Pont's investment merit. Indeed, they think Du Pont a pearl of great price. Nor do they suggest that those who guide Christiana's destinies have any real doubts about Du Pont. The objectors' position is self-contradictory. On the one hand, they stress the great wealth of the Du Ponts. On the other, they are (or claim to be) obsessed by the virtual certainty of massive sales at distress prices. But why should people whose remoteness from the brink of destitution is constantly stressed by the objectors themselves rush off madly to dispose of valuable property for less than its intrinsic worth? Objectors never answer that question. Instead they shift their ground by moving from the Christiana control group to the non-controlling public investors who own about 25% of Christiana. These people, they note, will be free from the Securities Act's registration and prospectus-delivery inhibitions. They proceed to postulate devastating waves of helter-skelter selling by the public holders. These horrors seem fanciful to us. We see no reason to assume that there will be a psychosis epidemic among either the controlling or the non-controlling Christiana stockholders. We think that in financial matters at least both groups are at least as rational as the general run of Humanity.

⁴⁷ Our reasons have been stated in the preceding footnote.

we refrain from enmeshing ourselves in this thicket of conjectures about what people are likely to do in the future with their own property.

We assume that the merger may engender some selling that would otherwise not take place. We assume further that such selling may at certain points in time be substantial. Proceeding on those assumptions, we are nevertheless after considerable thought unable to detect any uncompensated detriment to the Du Pont stockholders of a type that we can properly take into account.

The stock market has its peculiarities. In essentials, however, it is much like other more basic markets in goods, services, and the factors of production. Here as elsewhere increased supply will (all other factors being equal—which in practice they may or may not be) lower prices. Should the Wilmington Trust Company decide to sell a substantial amount of Du Pont common, the price of the issue will be affected to some extent.

We agree with the objectors about that. But we disagree with their contention that this short-run view of the pricing process is the one that governs here. What we have before us in these proceedings is a proposal for a fundamental corporate readjustment. In that context transitory market phenomena are of secondary significance. We look at the case not from the objectors' tape-watcher perspective,⁴⁸ but as a problem in economic realities and business fundamentals.⁴⁹

⁴⁸ We cast no aspersions on tape watchers. They have every right to speculate. And while pursuing their own self-interest, they sometimes perform a useful social function. Hence they are often the objects of our solicitude. But that is so in matters arising under the Securities Exchange Act. When we work under this Act, under Chapter X of the Bankruptcy Act, and under the Public Utility Holding Company Act, their interests yield to those of the long-term investor.

⁴⁹ We may draw attention to what we consider the striking parallel between Section 17(b)(1)'s reasonable, fair, and free from over reaching test and the "fair and equitable" standard that Congress laid down in the Bankruptcy Act (Sections 174, 221(2)), and in the Public Utility Holding Company Act (Section 11(e)). True it is that the words "fair and equitable" have a precise technical meaning in insolvency law. Nor are we unmindful of the distinctions that may be drawn between a legally mandated reorganization under the Holding Company Act and a consensual arrangement such as the one now before us. But the ancient reorganization concept of "fair and equitable" also has a broader meaning that we think indistinguishable from the Investment Company Act test that governs here. See *Protective Committee v. Anderson*, 390 U.S. 414, 424-441 (1968).

Hence we find the many reorganization cases that emphasize intrinsic value and deprecate market factors persuasive here. See, e.g., *S.E.C. v. Central-Illinois Securities Corp.*, 338 U.S. 96, 152 (1949) ("Congress, perhaps believing that the application of such an amorphous standard as that of 'colloquial equity' was beyond the competence of courts and commissions, has instead prescribed the requirement that investment values be preserved."); *Niagara Hudson Power Corp. v. Leventritt*, 340 U.S. 336, 346-348 (1951) ("The informed judgment of the Commission, rather than that of the market, has been designated by the Act as the appropriate guide to fairness and equity within the meaning of the Act. Under the standards approved by this Court, that informed judgment looks for investment values. . . . [T]he *Central-Illinois* case . . . expressly rejected the 'colloquial equity' approach of the District Court, which placed special emphasis upon market history. . . . Moreover, we find no lack of authority . . . [for] the general principle that

Hence we find ourselves compelled to discount objectors' market impact worries even more heavily than they would have us discount Christiana's net asset value. A share of Du Pont common is a fractional proprietary interest in a large business. In no way will the Christiana merger detract from either the assets or the earning power of that business. The fundamentals of the situation will remain as they are. Thus the merger cannot affect—and no contention has been made that it would or could affect—Du Pont's intrinsic investment value. That the merger might possibly engender selling of a volume that could on occasion cause Du Pont's market price to dip below the level at which it would otherwise stand is of little moment. Such undervaluation would undoubtedly attract the attention of investors and speculators interested in chemical issues. They could scarcely escape noticing it. And why would they spurn the resulting bargain? Nothing brought to our attention suggests that the marketplace might be slow to notice Du Pont's cheapness relative to comparable stocks. And we see no reason to assume that it would. We therefore conclude that such depressing effects on the price of Du Pont common as may occasionally manifest themselves by reason of the proposed transaction will be of relatively brief duration. We proceed on the premise that over time the securities markets are rational.⁵⁰ And if that premise be sound, an issue as well-known and as conspicuous as Du Pont common cannot remain on the bargain counter for long.⁵¹

a class of securities may go unrecognized in a reorganization when . . . they have no investment value.") Pertinent here are the District Court's observations at the close of its opinion in *In re Imperial '400' National, Inc.*, 374 F. Supp. 949, 978 (D.N.J., 1974): "Concern has been expressed . . . with respect to the market value of new . . . stock as opposed to its investment value. No matter how carefully I may calculate 'value,' I have no control over what may happen to price in the public market. But my concern under the Bankruptcy Act is value and not price."

⁵⁰ The premise may or may not be empirically demonstrable. Some academicians who speculate about the nature of speculation question it. But see the observations on "central value" and "intrinsic value" in GRAHAM, DODD & COTTLE, *SECURITY ANALYSIS* 26, et seq. (4th ed., 1962). We, however, are not at liberty to question it. The statutes we have been directed to administer start from the axiom that markets are or can be made economically rational. We are no freer to question that axiom than we are to question the desirability of registration statements and prospectuses under the Securities Act. If prices and values are as unrelated to each other over time as the objectors contend, the Investment Company Act is nonsensical and this Commission's labors under it farcical. For obvious reasons we take a different view.

⁵¹ The closed-end discount that pervades this case may raise doubts about this. The closed-end discount phenomenon, which is neither peculiar to Christiana nor of recent vintage (see our previously cited 1966 report on the PUBLIC POLICY IMPLICATIONS OF INVESTMENT COMPANY GROWTH at pp. 42-44; see also Metz, *Unkindly Year in Closed Ends*, N.Y. Times, January 11, 1974 at 42, col. 3; *Where Stocks Can Be Bought at a Discount*, U.S. NEWS & WORLD REPORT, May 27, 1974, p. 61) has its intriguing and to some extent disquieting aspects. But we see nothing in it that serves as an augury about the probable market action of a stock like Du Pont. Closed-end companies are seldom liquidated. Investors attracted to them by the discount assume the risk that the discount may widen against them. And in Christiana's case special factors come into play. Du Pont is an active, well-known listed stock. Christiana, on the other hand, is a thinly traded over-the-counter issue. The relative illiquidity of an investment in Christiana would seem to have had some influence on the discount.

Suppose that we were inclined to see more abstract merit than we do in the objectors' market impact argument. Even then we would be unable to give it much weight in deciding the concrete case before us. How can we possibly tell how much Du Pont common is likely to come to market by reason of this merger in 1976? 1980? 1985? And even if we could form some educated guesses about that, how would we measure the impact of the additional supply on the market price? The objectors are unable to supply us with supply and demand schedules for Du Pont common for the ensuing decade.⁵² And we decline to construct our own.⁵³ Speculations about the probable behavior patterns of speculators are much too slender a reed on which to predicate findings of fairness under the Investment Company Act.⁵⁴

Even if we had the light of hindsight available to us, we could not properly focus on the factors that the objectors consider central.

Suppose that we were able to take another look at this case some years after the merger. Du Pont's actual post-merger market history would then be available to us. But it would be of little help. Stock prices are volatile and the factors that influence them multifarious.⁵⁵ We know of nothing that would permit an accurate post-merger assessment. A pre-merger one would obviously be an even wilder guess.

XI

At times the law undertakes explorations almost as speculative as those on which the objectors ask us to embark. Thus in the law of tort judges and juries place price tags on pain and suffering—and indeed on human life itself. And to come closer to home, in reorganizations under the Bankruptcy and Public Utility Holding Company Acts we and the courts try to estimate the probable future earnings of business enterprises and the multiples at which it is appropriate to capitalize those earnings.⁵⁶ Those inquiries are undertaken because justice requires that the effort be made.

⁵² Were there any such schedules, their very existence would alter the situation. If investors and speculators had the benefit of perfect foresight, they would alter their plans.

⁵³ Having denounced investment advisers who "vie with each other in making unsupported claims to prophetic insight" (*Spear & Staff, Incorporated*, 42 S.E.C. 549, 556 (1965)), we refrain from similar transgressions of our own.

⁵⁴ Compare *Jade Oil & Gas Co.*, 44 S.E.C. 56, 65 (1969).

⁵⁵ Du Pont is generally regarded as an issue of prime investment quality. Applicants and objectors agree on that. Yet during 1974 its price has ranged from 179 to 84½. Lest 1974 be tossed off as an especially disturbed year, we look for comparative purposes to 1970-1972. And we find that during those years the price ranged from 184 to 92. Du Pont is now selling at 8 times earnings. Not too long ago it was selling at 24 times earnings. Some years ago it was at 27 times earnings. These numbers show the inherent futility of any effort to measure the impact of incremental supply. Yet objectors ask us to assess the psychological effects of purely potential supply.

⁵⁶ See *Consolidated Rock Products Co. v. Du Bois*, 312 U.S. 510, 526 (1941) quoted with approval in *Protective Committee v. Anderson*, 390 U.S. 414, 441-442 (1968): "The criterion of earning capacity is the essential one . . . Since its application requires a prediction as to what will occur in the future, an estimate, as distinguished from mathematical certitude, is all that can be made."

That differentiates those situations from this one. Here justice requires no ventures into the unknown and unknowable. An investment company, whose assets consist entirely or almost entirely of securities the prices of which are determined in active and continuous markets, can normally be presumed to be worth its net asset value. What better guide to its value could there be? The simple, readily usable tool of net asset value does the job much better than an accurate gauge of market impact (were there one) could. The record indicates that most of Christiana's stock is held by long-term investors. Hence there is no pressing need to depart from the net asset value test.⁵⁷

That understates matters. In these circumstances, any significant departure from the net asset value criterion would work positive injustice. Objectors' proposals would strip the long-term Christiana investor of some of the intrinsic value of his holdings. Such expropriation would be wholly unjustifiable. It would also be most inappropriate to frustrate the reasonable expectations of those who bought into Christiana in the belief that it was a legitimate way of buying Du Pont at a lower price.⁵⁸

XII

Having concluded that pecuniary assessment of hypothetical future market impact would be unnecessary and inappropriate,⁵⁹ we turn to

⁵⁷ Investment companies are as a general rule media for long-term investment. That makes net asset value the touchstone. And the Act is based on that premise. Section 2(a)(41)(B) states that "'Value' with respect to assets of registered investment companies . . . means . . . with respect to securities for which market quotations are readily available, the market value of such securities." And although the closed-end discount phenomenon was well-known in 1940, the Congress that passed the Act chose to protect closed-end stockholders against dilution of the intrinsic values rather than to facilitate the sale of new closed-end shares. Section 23(b) of the Act shows that. It provides that "No registered closed-end company shall sell any common stock of which it is the issuer at a price below the current net asset value of such stock." And we have viewed net asset value as the controlling factor in Section 17 proceedings. See, e.g., *Harbor Plywood Corporation*, 40 S.E.C. 1002, 1010 (1962); *Delaware Realty and Investment Company*, 40 S.E.C. 469, 473 (1961). Compare *Central States Electric Corporation*, 30 S.E.C. 680, 700 (1949) (advisory report on plans for the reorganization of a closed-end investment company under Chapter X of the Bankruptcy Act urging "net asset value as the primary measure of value of an investment company.")

⁵⁸ Objectors talk of windfalls. We cannot detect them. True, people bought Christiana on the theory that it was a cheap way of buying Du Pont. But those who did that took the risk that the closed-end discount might widen against them. Those who reasoned that long-run value would win out in the end and that Christiana could not last forever will do well. But such rewards for astuteness and lucky guesses are inherent in the nature of markets.

⁵⁹ Objectors make much of certain assertedly contrary positions said to have been taken by the applicants, their controlling persons and their counsel and financial advisers in the Du Pont-General Motors divestiture proceedings. See *United States v. E. I. du Pont de Nemours & Co.*, 353 U.S. 586 (1957); 177 F. Supp. 1 (N.D. Ill.), 1959; 366 U.S. 316 (1961). But the views that the applicants found it convenient to take in another case under another statute before another forum are not controlling here. Moreover, the General Motors situation had nothing in common with this one. There Du Pont was to distribute its millions of General Motors shares to Du Pont's stockholders. Under the Internal

the objectors' suggestions for restraints on the alienation of the Du Pont shares to be issued under the merger.⁶⁰

The Securities Act is now 41 years old. Hence there is nothing novel about the idea that it is in the public interest and appropriate for the protection of investors to inhibit certain strategically situated persons from selling securities whenever and wherever they choose. But neither the Securities Act nor the Securities Exchange Act prohibits such people from selling. What those statutes prohibit are offers and sales without appropriate disclosure. It is a long, long jump from that to an unconditional ban on any sales at all. And quantitative limits on a holder's freedom of sale that rest not on the buyers' need for disclosure, but on the assumed desirability of protecting other holders from the market effects of large-scale selling would entail almost as broad a leap. We see no need for such a leap in this case.⁶¹

XIII

We said earlier that this is not an easy case. But its difficulties do not stem from the hypothetical market impact on which objectors focus. They flow rather from the striking disparity between the substantial benefits to be received by Christiana and the far more modest ones inuring to Du Pont. This disparity justifies the proposed 2.5% or 1.8% discount from Christiana's net asset value. That is not to say that applicants have come up with *the* one right figure. There is no such figure. Fairness is a range, not a point. Something less than the discount arrived at by the applicants might well pass muster.⁶² And a

Revenue Code, as it then was, the recipients of those shares would have been deemed to have realized taxable income. So they would have had to pay taxes. To raise the money with which to pay those taxes, they would or might have had to sell at least some of the General Motors shares that they received by reason of the divestiture. (This problem was solved for the most part by the addition of Section 1111 to the Internal Revenue Code.) Here no taxes need be paid except by those Christiana holders who may voluntarily decide to sell. Nor are the governing legal standards the same. The Internal Revenue Code's standard is "fair market value." The word "market" is conspicuously absent from Section 17(b).

⁶⁰ No specific suggestions are made.

⁶¹ Objectors seek to protect their property rights. But the Christiana stockholders also have property rights. It is not for us to prefer one group's property rights over the other's. The Du Pont stockholders are far more numerous than the Christiana stockholders. See n. 34 on p. 657, *supra*. But that is of no consequence. These matters are not resolved by plebiscite. Section 17(b)(1) seeks to prevent "overreaching on the part of any person concerned." Compare *Protective Committee v. Anderson*, 390 U.S. 414, 435 (1968): "[A] plan of reorganization which is unfair to some persons may not be approved by the court even though the vast majority of creditors have approved it."

⁶² Objectors say that the applicants' negotiations were not at arm's-length. And in view of the links between Christiana and Du Pont they may well be right about that. It matters not. In assessing fairness we look not to the nature of the negotiations but to their results. It is precisely because transactions of this character are replete with inherent conflicts of interest that the Act requires that they be submitted to us. As we said in *Atlas Corporation*, 37 S.E.C. 72, 85-86 (1956): "It is evident that Section 17 of the Act

slightly higher discount would also be within the permissible range. But one appreciably higher than the discount now before us would divest Christiana's stockholders of a significant portion of the intrinsic investment values to which they are legally and equitably entitled. It would therefore run afoul of Section 17(b) (1) of the Act.⁶³

XIV

We find the proposed merger:

- (A) Reasonable and fair;
- (B) Free from overreaching on the part of any person concerned;⁶⁴ and
- (C) Consistent with the general purposes of the Act.⁶⁵

The standards of Section 17(b) being met, there is no need to invoke Section 6(c).⁶⁶

An appropriate order will issue.

By the Commission (Chairman GARRETT and Commissioners LOOMIS, EVANS, SOMMER and POLLACK).

was not designed to prohibit transactions solely for the reason that they are not negotiated at arm's-length. On the contrary, Section 17(b) of the Act directs us to exempt transactions between controlling or affiliated persons where the evidence establishes that the terms thereof are reasonable and fair and do not involve overreaching on the part of any person concerned. Clearly, Section 17 contemplates that transactions meeting these standards will be permitted although arm's-length bargaining may not have been present or, indeed, may have been impossible in view of the relationship of the parties."

⁶³ That being our view of the law of the case, we see no merit to the objectors' contention that the record is so inadequate on the market impact aspect of the matter as to require a remand. Nor do we see any basis for the claim that adequate discovery about the Christiana control group's present intent to sell refrain from selling in the future was improperly denied. To have delved into the matters into which objectors sought to inquire would have swelled the record pointlessly. Moreover, our Rules of Practice make no provision for the taking of depositions in situations other than those covered by Rule 15(a) of those rules. There may be a trend toward liberality in pre-trial discovery. But that did not empower the administrative law judge to disregard the plain meaning of our rules. Due process does not require depositions. See *Miner v. Atlas*, 363 U.S. 641 (1960); *N.L.R.B. v. Interboro Contractors, Inc.*, 432 F. 2d 854, 857-858 (C.A. 2, 1970), cert. denied, 402 U.S. 915 (1971).

⁶⁴ We make no findings under Section 17(a)(2), which requires that the proposed transaction be consistent with the investment company's policy. That section has no bearing on cases in which investment companies propose to go out of existence. See *Aviation and Transportation Corporation*, 8 S.E.C. 527, 538-539 (1941).

⁶⁵ That is so because it will eliminate pyramiding duplicative operating expenses, and unnecessary taxation. See the *Aviation and Transportation* case cited in the preceding footnote, at page 539 of 8 S.E.C.

⁶⁶ Applicants also pray for exemptive relief from Section 17(d) of the Act and our Rule 17d-1 thereunder. No issue has been raised as to the applicability of those provisions. Hence we assume without so deciding that they may have some bearing here. To the extent, if any, that this is so, we find the standards of that section and that rule satisfied.

IN THE MATTER OF
THE COLUMBIA GAS SYSTEM, INC.
COLUMBIA COAL GASIFICATION CORPORATION

File No. 70-5561. Promulgated December 31, 1974

Public Utility Holding Company Act of 1935

MEMORANDUM OPINION AND ORDER

The Columbia Gas System, Inc. ("Columbia"), a registered holding company, and Columbia Coal Gasification Corporation ("CG"), its wholly-owned non-utility subsidiary, have jointly filed an application-declaration pursuant to Sections 6, 7, 10 and 12 of the Public Utility Holding Company Act of 1935 ("Act") and Rules 43, 45 and 50(a) (3) promulgated thereunder regarding the following proposed transactions. An appropriate notice of filing was issued.¹

CG was organized by Columbia as the corporate vehicle for the development of synthetic pipeline quality gas from coal to augment the Columbia system natural gas supplies.² It was then stated that CG would seek to acquire or develop coal reserves for that purpose.

In March 1971 CG acquired, by lease, all coal rights underlying approximately 300,000 acres of land in West Virginia from Columbia Gas Transmission Company, an associate company. Details of that transaction are set forth in a companion order issued this day.³

CG has engaged independent mining engineers and geologists to conduct core drilling and exploration activities to evaluate the extent of commercially minable coal in the acreage. As of May 1974, approximately 60,000 acres have been explored, and it appears that such acreage contains proven reserves of 324,177,000 tons of recoverable steam coal, of which approximately 233,000,000 tons have an average sulphur content of 0.85%.

CG has entered into several agreements, subject to our approval, with a non-associate, The Carter Oil Company ("Carter"), a subsidiary of Exxon Corporation. One of these agreements provides for an exchange of an undivided one-half interest in approximately 43,000 acres of CG's West Virginia land for an undivided one-half interest

¹ Holding Company Act Release No. 18660 (November 15, 1974), 5 SEC Docket 510.

² Holding Company Act Release No. 16968 (January 18, 1971).

³ Holding Company Act Release No. 18748 (December 31, 1974), 6 SEC Docket 21.