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THE INVESTMENT COMPANY: A STUDY OF INFLUENCE AND CONTROL IN THE MAJOR INDUSTRIAL CORPORATIONS

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Growing concentration of economic power among institutional investors by virtue of their large investments in voting securities of major American corporations has become of increasing concern. The Patman Report of 1968,[1] which deals principally with the existing influence and control of banking institutions, concludes that these investments provide the banking community with "enormous potential power, for good or evil, over important parts of the nation's corporate structure."[2] The open-end management investment company (mutual fund)[3] is an important institutional investor with a potential for significant influence and control in its portfolio companies.[4] The mutual fund industry's investment in equity securities represents a heavy commitment in the industrial sector. Mutual funds, while accounting for only 3.3 per cent of total institutional assets in 1967,[5] have been esti-

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1 Staff of House Subcomm. on Domestic Finance, Comm. on Banking and Currency, 90th Cong., 2d Sess., 1 Commercial Banks and their Trust Activities: Emerging Influence on the American Economy (Comm. Print 1968) [hereinafter cited as Patman Report].

2 Id. at 3.

3 A management investment company is, structurally, either open-end or closed-end. Unlike the latter, the security of an open-end company is redeemable, i.e., upon presentation to the issuer, the holder is entitled to his proportionate share of the issuer's current net asset value. The open-end company is commonly referred to as a "mutual fund."

4 "Portfolio company" refers to a corporation in which the fund has invested.

5 Patman Report, supra note 1, at 19, table 1.

mated to account for roughly 23 per cent of institutional common stock holdings.[6] Since the most important element in determining control of a portfolio company is the extent of voting securities held by the fund, the 23 per cent figure is particularly significant. Moreover, the mutual fund industry has experienced sharp growth during the ten-year period ending in 1967, in which total net assets increased more than five times.[7] This pattern of growth will undoubtedly continue, further enhanced by the introduction of the "variable annuity" contract by the insurance industry,[8] and, perhaps, the "collective investment fund for managing agency accounts," administered by banks,[9] both of which operate essentially the same as a mutual fund. As a result of this anticipated rapid growth and increased share of ownership of the total outstanding public stock of major industrial corporations, institutional investors will be under increasing pressure to exercise their right of franchise on behalf of their shareholders and thus to exert influence and control over the management of their portfolio companies. The purpose of this study is, first, to examine the extent of influence and

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6 SEC, Statistical Series Release No. 2358, table 3 (May 1, 1969). This table is used with reservation. Among other things, it is not clear to what extent agency accounts of bank trust companies are reflected in the stockholdings of financial institutions.

7 Arthur Wiesenberger Services, Investment Companies, Mutual Funds and Other Types, at 18, table 2 (1968 ed.).

8 A variable annuity plan is one in which an insurance company undertakes to make a series of payments for the life of the participant or for a term of years, the amount of which vary in accordance with the investment experience of a common pool of assets. Twenty-two such plans were registered with the SEC as of June 30, 1968. 34 SEC, Ann. Rep. 113 (1968).

9 Manuel F. Cohen, former SEC Chairman, described the collective investment fund as consisting of

> assets entrusted to a bank by individual investors who enter into the so-called managing agency agreement, authorizing the bank as agent and manager to invest their money collectively in a diversified portfolio of securities. Commingled funds for managing agency accounts, like mutual funds, offer investors the opportunity to share in the economies of size through the pooling of their funds and to obtain professional management of a diversified securities portfolio. Since they are essentially the same as mutual funds the Commission traditionally has taken the position that investors in bank collective funds for managing agency accounts ought to receive the same protections under the Securities Act of 1933 and the Investment Company Act of 1940. . . .

Hearings on Amendment No. 438 to S. 1659 Before the Senate Comm. on Banking and Currency, 90th Cong., 1st Sess., pt. 3, at 1297 (1967).

A recently passed bill in the Senate, amending the Investment Company Act, was reported on as follows:

> The provisions of this bill encourage competition in the field of collective investment and provide full consumer protection by subjecting those banks and savings and loan associations collective funds known as managing agency accounts, *which are functionally indistinguishable from mutual funds*, to full regulation by the Commission under the Investment Company Act of 1940, as well as the Securities Act of 1933 and the Securities Exchange Act of 1934. (Emphasis added.)

Report on S. 2224 Before the Comm. on Banking and Currency, S. Rep. No. 184, 91st Cong., 1st Sess. 11 (1969).

control held by mutual funds based on voting power and representation on boards of directors, and second, to propose a legal framework within which investment companies may maintain justifiable influence over their portfolio companies, particularly those which are major industrial corporations, without attaining "working control"[10] in them.

I. CONCENTRATION OF ECONOMIC POWER IN MUTUAL FUNDS

The problems accompanying the growing economic power of the mutual fund industry are common to all financial institutions. The potential consolidation of large segments of the financial and industrial sectors in the economy raises the fundamental economic question whether concentration of business assets will create a market structure which obstructs effective competition. Market concentration can exist within a single industry, principally as an oligopoly with three or four firms constituting the dominant share of the output of a particular industry, or at the aggregate level involving more than one industry, exemplified by the conglomerates and one-bank holding companies.[11] The financial institution, by acquiring working control in the large industrial corporations, will represent aggregate concentration at its highest level, for it will combine the concentration of the financial institution with the concentration of the major industrial corporations to create a powerful and wealthy "investment holding company."[12] Since the passage of the Sherman Antitrust Act[13] in 1890, it has been recognized that large aggregations of business wealth are incompatible

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[10] "Working control," as used in this article, means the power to consistently implement major policy or operational changes in the company, and is based on a stock interest in excess of 10 per cent of outstanding shares.

[11] A conglomerate is a corporate structure in which the parent company holds controlling interest in a number of diversified subsidiary companies representing various categories of industries.

A one-bank holding company is a holding company, usually formed by a banking institution, which holds controlling interest in that banking institution and in other non-banking financial and non-financial activities. The one-bank holding company presents another aspect of the problem of the financial institution. A.A. Berle describes it as follows:

> [T]he one-bank holding company, left unlimited, can go in all directions, and there is no limit. It crystallizes around itself, first, a concentration of financial power, and, second, a concentration of industrial power beyond belief in the United States. There is no question that a one-bank holding company, with the resources of its bank, with the stockholding power in the bank's trust department, and especially if it also acquires control of mutual funds which have further stock interests, can probably attain control of any corporation in the country it really wants to get, aside from a few of the very large giants that are too large. This is already beginning to happen.

Hearings on H.R. 6778 Before the House Comm. on Banking and Currency, 91st Cong., 1st Sess. 9 (1969) (statement of A.A. Berle).

[12] For an explanation of the investment holding company concept, see p. 12 and note 58 infra.

[13] 15 U.S.C. §§ 1-7 (1964).

with an economic system based on an impersonal market for the determination of prices and output of goods and services, and on a diversity of buyers and sellers within that market. Current antitrust policy, as indicated by recent guidelines[14] and proposed legislation[15] is being directed toward concentration at the aggregate level. Conglomerates, for example, are allegedly anti-competitive because this structure lends itself to such practices as reciprocal arrangements, the elimination of potential competition, and extensive market power.[16] The institutional investor may also become vulnerable to such charges if it achieves working control in a number of its portfolio companies.

The problem is magnified many times in the case of large mutual funds which have substantial equity holdings in numerous major corporations. Table 1 in the Appendix shows the holdings of the 10 largest mutual funds or mutual fund complexes[17] in voting securities of the top 100 industrial corporations in the United States.[18] The position that funds and complexes hold in the voting securities of these corporations has particular significance. In 1967, the first 100 industrial corporations listed in Table 1, measured on the basis of corporate assets, accounted for approximately 47.6 per cent of the total assets of all manufacturing corporations.[19] In 1968 this percentage increased to 49.3 per cent,[20] although, of course, the composition of the top 100 in 1968 has changed somewhat. Likewise, the 10 major funds and complexes in Table 1 account for approximately 49 per cent of total net assets held by open and closed-end investment companies at the 1967 calendar year-end.[21]

14 Address by Attorney General John N. Mitchell, Georgia Bar Association, June 6, 1969.

15 White House Task Force Report on Antitrust Policy, July 5, 1968, BNA Antitrust & Trade Reg. Rep., No. 411, pt. II, 8 (1969) [hereinafter cited as Neal Report].

16 Merger Guidelines, Dept. of Justice, Release 20-25 (May 30, 1968).

17 The fund complex is defined as a group of funds which, while separate legal entities, are related by either common management, a common advisor, or, as is frequently the case, by both. Report of the SEC on the Public Policy Implications of Investment Company Growth, H.R. Rep. No. 2337, 89th Cong., 2d Sess., 47 (1966) [hereinafter cited as 1966 SEC Report].

Since the effect of a fund complex structure is to establish a single decision-making body for all funds in the complex, the fund complex is the appropriate unit for measuring voting strength in a portfolio company.

18 The top 100 industrial corporations are taken from the Fortune Directory of the 500 largest United States Industrial Corporations. Fortune, June 15, 1968, at 188-94.

The selection of funds, complexes and portfolio companies is based on size, as measured by total corporate assets, and all figures on outstanding shares and fund holdings have been adjusted to reflect the number of shares as of December 31, 1967.

19 Studies by the Staff of the Cabinet Comm. on Price Stability, 45 (January 1969).

20 FTC, Economic Report on Corporate Mergers, pt. 3, at 11 (October 1969).

21 Arthur Wiesenberger Services, supra note 7, tables 15 & 29, at 104-09, 330-33. Table 15 contains statistical information for all open-end investment companies in the United States at the end of 1967 for which information could be obtained. This represents an overwhelming majority of open-end companies.

Table 2 in the Appendix summarizes the extent of voting power held by the top 10 funds and complexes in the top 100 corporations as of December 31, 1967. These major funds held 10 per cent or more of the outstanding voting shares in 8 per cent of the top industrial corporations. One-fourth of these major corporations have 7 per cent or more of their voting securities held by the top 10 funds and fund complexes, and more than one-third have 5 per cent or more of their voting securities so held. Frequently the voting power is concentrated in less than 10 funds. However, only two of the corporations have 5 per cent or more of their voting securities held by any single fund or fund complex.

The overall picture for the mutual fund industry at the 1967 year-end does not reveal widespread concentration of voting power in the top industrial corporations by the major funds. Holdings which might constitute the minimum for working control by any one fund or complex are nonexistent,[22] and even the holdings of all 10 funds and complexes represented in Table 1 exceeded 10 per cent of the outstanding voting securities in only eight cases.

However, these facts do not negate the potential for the exercise of significant influence in the major corporations by the top mutual funds. It is noteworthy that, among large industrial corporations whose securities are normally widely-held, even a holding of 5 per cent or less of the outstanding shares might be sufficient to influence management.[23] The degree of influence that a mutual fund may exert on its portfolio companies is principally dependent upon two factors: voting power and representation on the boards of directors. It would be expected, in the case of mutual funds, that representation on the board of a portfolio company is tied closely to the extent of voting power. Voting power in a large publicly-held corporation is derived principally from the ability to control a relatively large block of voting securities, which could be cast for or against the existing management on various issues, including the crucial, although normally routine, matter of reelecting directors.

A party with less than a majority of the outstanding voting shares can have a wide range of potential influence, depending principally on: (1) the holdings in the company's voting securities, as a percentage of total outstandings shares, relative to the extent of dispersion of the stock among shareholders, and (2) the financial and technical expertise and prestige of the stockholder. Of course, in the event of a proxy contest or tender offer, a holder of substantially less than a majority vote would have to muster enough support to constitute a majority. But a holding of even less than ten per cent of the outstanding voting

[22] See Table 1, col. A.

[23] 1966 SEC Report, supra note 17, at 308.

securities of a major industrial corporation normally can be used to exert considerable influence over management,[24] particularly when held by a prestigious financial institution, such as a major mutual fund, and substantially greater influence should several funds act in concert. In this light, the 1967 year-end holdings in the 100 largest industrial corporations by the 10 largest funds and fund complexes reveal a substantial basis for the exercise of influence.

In addition, although the mutual fund industry, relative to other financial institutions, is characterized by a high portfolio turnover, it is almost certain that the large funds and complexes will increase their investment position in these major corporations. This will happen essentially for three reasons. First, these corporations provide the type of quality, blue-chip investment that attracts mutual funds. Second, the funds are limited in the number of available alternative investments. Third, these corporations are making a less than proportional increase in their outstanding shares relative to the demand for their securities.[25]

In the light of current concern about the effect on competition of the aggregate concentration of industry, the discernible movement of the mutual fund industry in that direction suggests the need to consider the adequacy of existing legislation to deal with the problems likely to arise. Much difficulty can be avoided by the introduction of prophylactic measures before anti-competitive concentration occurs. In devising a statutory scheme, however, care must be taken not to deprive the mutual funds of a legitimate level of influence in their portfolio companies. It should be recognized that the presence of the institutional investor in the American economy may contribute significantly to the growth and development of the free enterprise system. Banks and insurance companies have been a major source of capital for American industry. In addition, by virtue of their size, the skill of their managers, and their fiduciary duties, the investment companies and other financial institutions could employ their voting strength in the large publicly-held corporation to add a system of checks and balances to what is normally, for all practical purposes, an autonomous corporate structure. The institutions, in performing their fiduciary duties, can incidentally serve as effective, articulate spokesmen for all public investors.

Statutes relevant to the problems under discussion are: (1) the Investment Company Act of 1940 (hereinafter 1940 Act),[26] enacted in part to eliminate the abuses of the so-called "investment-holding

[24] Id.

[25] For a report of the increase in portfolio holdings of all funds between 1952 and 1958, see Wharton School of Finance and Commerce, A Study of Mutual Funds, H.R. Rep. No. 2274, 87th Cong., 2d Sess., 406-08 (1962).

[26] 15 U.S.C. §§ 80a-1 to -52 (1964).

company," and (2) the antitrust laws. The remainder of this paper will examine certain provisions of the 1940 Act and certain new policy developments in the antitrust field to determine their adequacy in meeting the problem. Specific statutory recommendations, designed to permit the mutual funds and other institutional investors to exercise legitimate influence over their portfolio companies and to serve as a source of capital without acquiring great concentrations of wealth and power, will then be made.

II. Investment Company Act of 1940[27]

Although the 1940 Act does not deal specifically with the problem of concentration of ownership by mutual funds in their portfolio companies,[28] it does contain sections that indirectly affect the composition of a mutual fund's portfolio. Furthermore, the SEC Investment Trust Study,[29] which provided the impetus for the enactment of the 1940 Act, deals extensively with this problem, considering it "one of the most important aspects of the investment company movement, particularly from the point of view of the national economy."[30]

A. *Section 5(b)*

Section 5(b)(1) of the 1940 Act defines a diversified management company as one in which at least 75 per cent of total assets of the fund must be in cash, cash items or securities, and, as to this 75 per cent segment, the holdings in any one portfolio company cannot constitute more than 5 per cent of the total asset value of the fund and not more than 10 per cent of the outstanding voting securities of such company. Thus, if a management company opts for classification as a diversified fund, it is prohibited from investing more than 5 per cent of the 75 per cent segment in any particular company and from holding more than 10 per cent of the outstanding voting securities of any particular company. Since approximately 96 per cent of the assets of management companies are diversified,[31] this provision is a relatively effective restriction on the concentration of ownership in portfolio companies.

There are, however, practical limitations on the effectiveness of section 5(b)(1). First, the unrestricted 25 per cent segment of a

27 Id.

28 1966 SEC Report, supra note 17, at 307.

29 SEC, Report on Investment Trusts and Investment Companies, pts. 1-4 (1938-42).

30 Id., pt. 4, at 1. The SEC study expressed concern for the effects of control upon investment companies in that concentration of fund assets in a few large holdings would limit the diversification of risk. Id. at 22. Moreover, there was concern over the effects of such concentration upon the portfolio companies, because of the possible undesirable realignment of the capital structure, excessive dividends, and promotion of mergers and consolidations. Id. at 27-29.

31 This figure is based on the investment companies listed in Arthur Wiesenberger Services, supra note 7, and the classification of these companies by the SEC.

fund's assets can be freely invested in control situations. For a fund the size of Investor's Mutual, for example, this segment might amount to three-quarters of a billion dollars. Second, and more important, a fund can change its classification from a diversified fund to a nondiversified fund by simply obtaining the authorization of the holders of a majority of its outstanding voting securities.[32] A nondiversified management company, unlike a diversified company, can invest at least 50 per cent of its assets in one portfolio company.[33] This change in classification is usually easy to achieve for most fund shareholders are indifferent to the fund's investment policy as long as the fund is performing well. If, however, the shareholders of a fund refuse to approve the change, nondiversification can still be achieved by creating a new nondiversified fund in the fund complex.

B. *Registration Statements*

A registered investment company is required to submit to the SEC a report indicating which of its investments in portfolio companies are for the purpose of exercising control.[34] "Control" is defined by the 1940 Act as "the power to exercise a controlling influence over the management or policies of a company. . . ."[35] "Controlling influence" is determined by examining such factors as voting strength, representation on the board of directors of the portfolio company, and the size and prestige of the fund.[36] There is, however, a presumption that a fund does not control a portfolio company when it owns 25 per cent or less of the voting securities of the company.[37] Alternatively, a presumption arises that a fund does control a portfolio company when the fund owns more than 25 per cent of the voting securities of the portfolio company.[38]

Although most of the cases in which the SEC and the courts have had the opportunity to define "controlling influence" have been situations where the fund has owned more than 25 per cent of the stock

[32] Investment Company Act of 1940, 15 U.S.C. § 80a-13(a)(1) (1964).

[33] A non-diversified company, under the 1940 Act, is any management company other than a diversified company. Investment Company Act of 1940, 15 U.S.C. § 80a-5(b)(2). Tax considerations, not 1940 Act requirements, determine as a practical matter the 50 per cent limitation on non-diversified companies. A non-diversification status does not affect the tax benefits available under Subchapter M of the Internal Revenue Code, as long as, among other things, 50 per cent of the fund's assets are diversified and 90 per cent of the earnings are distributed. Int. Rev. Code of 1954, §§ 851(b)(2),(4).

[34] See, e.g., Registration Statement of Management Investment Company, Form N-8B-1, Item 5(d).

[35] 15 U.S.C. § 80a-2(a)(9).

[36] See, e.g., In re M.A. Hanna Co., 10 S.E.C. 581, 588 (1941).

[37] 15 U.S.C. § 80a-2(a)(9).

[38] Id.

of the portfolio company,[39] there have been a few cases in which the fund has owned less than 25 per cent of the stock of its portfolio company.[40] In *In re Int'l Bank and Financial Gen. Corp.*,[41] the SEC determined that the investment company, which owned only 17.4 per cent of the voting securities of an affiliated company, nevertheless controlled the affiliate despite the presumption against control. The fact that the investment company was the largest single stockholder in the affiliated company, and exercised control over the affiliate through mutual directors and officers, was instrumental in rebutting the presumption against control.[42] Although the Commission has failed to formally delineate the standard for overcoming the presumptions, this case does suggest the factors that should be considered in ascertaining whether a fund controls a portfolio company.

There are at least three reasons why the present reporting requirement under the 1940 Act is insufficient to deter mutual funds from concentrating their ownership in portfolio companies. First, while disclosure of the intention to control informs the investor of the fund's policy, it does not actually prevent large concentrated holdings in major industrial concerns. Second, assuming that disclosure would deter a fund from acquiring more than 25 per cent of a corporation's voting securities, the fund could in effect acquire a controlling influence by owning less than 25 per cent of the voting securities of the corporation. Finally, the 25 per cent figure applies only to individual investment companies, so that a fund complex is unaffected by the restriction.

C. *Section 17(d)*

In evaluating voting power, there is the additional consideration that funds or fund complexes may act in concert to influence or control management of a portfolio company. Section 17(d) of the 1940 Act and Rule 17(d)-1[43] require that affiliated parties apply to the SEC for its approval of any proposed joint arrangement.[44] For purposes of the 1940 Act, two funds are indirectly affiliated if each of them holds 5 per cent or more interest in the same portfolio company,[45] and directly affiliated if they have common management.[46] It appears that an agreement by two funds so affiliated to vote their holdings in a common

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[39] See, e.g., The Chicago Corp., 28 S.E.C. 463 (1948); In re M.A. Hanna Co., 10 S.E.C. 581 at 587 (1941).

[40] In re Transit Inv. Corp., 23 S.E.C. 415 (1946); In re Int'l Bank and Financial Gen. Corp., 41 S.E.C. 521 (1963).

[41] 41 S.E.C. 521.

[42] Id. at 526-7.

[43] 17 C.F.R. § 270.17d-1 (1969).

[44] For the definition of "joint arrangement," see 17 C.F.R. § 270.17d-1(c) (1969).

[45] 15 U.S.C. §§ 80a-2(a)(3)(A), -17(d) (1964).

[46] 15 U.S.C. § 80a-2(a)(3)(D) (1964). See In re Axe-Houghton Fund A, Inc., SEC Investment Company Act Release Nos. 3538, 3547 (Sept. 14, 1962; Sept. 28, 1962).

portfolio company as a block would constitute a joint arrangement within the scope of 17(d), requiring the filing of an application. It is unlikely, however, that the SEC would refuse to approve the application. The purpose of section 17(d) and rule 17(d)-1 is to prevent affiliated persons from injuring the interests of stockholders of investment companies.[47] In passing upon applications, the SEC is primarily concerned with preventing a fund from participating in the arrangement "on a basis different from or less advantageous than"[48] that of the other participant. Where the two participants are funds, both, of course, are to be protected. It is doubtful whether a mere joint exercise of voting rights by two funds holding the same equity securities in a common portfolio company would be considered to be different from or less advantageous to one of the funds so as to injure the stockholders of either fund.[49]

It seems that the SEC could challenge a proposed joint arrangement by two funds to pool their voting power for the purpose of achieving control of a portfolio company, in light of the broad policy declared in Section 1 of the 1940 Act:

> investment companies are affected with a national public interest in that, among other things . . . such companies customarily invest and trade in securities issued by, and may dominate and control or otherwise affect the policies and management of, companies engaged in business in interstate commerce. . . .[50]

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[47] 15 U.S.C. § 80a-1(b) (1964). SEC v. Talley Indus. Inc., 399 F.2d 396, 405 (2d Cir. 1968), cert. denied, 393 U.S. 1015 (1969).

[48] 17 C.F.R. § 270.17d-1(b).

[49] See SEC v. Talley Indus. Inc., 399 F.2d 396 (2d Cir. 1968); General Time Corp. v. Talley Indus. Inc., 403 F.2d 159 (2d Cir. 1968), cert. denied, 393 U.S. 1026 (1969); SEC v. General Tire Corp., 407 F.2d 65 (2d Cir. 1968), cert. denied, 37 U.S.L.W. 3246 (1969). In this series of three decisions growing out of the attempt of Talley Industries to take control of General Time Corporation, the Second Circuit affirmed the finding of the SEC that the plan of Talley and American Investors Fund, Inc., a registered investment company, to achieve a substantial stock interest in another company constituted a "transaction in which such registered company . . . is a joint and several participant" within the meaning of the 1940 Act. SEC v. Talley Indus. Inc., 399 F.2d at 402-3. Talley, while not an investment company, was an "affiliated person" of the Fund within the meaning of § 2(a)(3)(B) of the 1940 Act, by virtue of the fact that 9% of its voting shares was held by the Fund. But the court held that the participation of the Fund did not appear to be less advantageous than that of its affiliate. Id. at 405. In reaffirming this in its third decision, the court stated:

> [I]t is . . . hard to perceive how the Commission could find that voting by an affiliate and an investment company under democratic election rules would amount to participation by the investment company "on a basis different from or less advantageous than" the affiliate.

SEC v. General Time Corp., supra at 70. Thus it is not likely that the concerted action of two or more funds will be considered "different from or less advantageous than" for any of them.

[50] 15 U.S.C. § 80a-1(a)(3) (1964).

In addition, section 14(b) authorizes the SEC to investigate the effects of the size of investment companies on the concentration of ownership of portfolio companies.[51] The Act itself does not regulate or prohibit such concentration, but it might be argued that prevention of it is one of the policies implicit in the Act. However, the SEC has recently indicated that it was not the intention of the SEC or Congress to restrict investments of funds in their portfolio companies.[52] Thus, section 17(d) and rule 17(d)-1, regardless of their possible application to the problem, are ineffective, because of the SEC's position that "the Act in general imposes no restriction on the capacity of investment companies to control the enterprises in which they invest."[53]

D. *Interlocking Directorates*

Another means through which a mutual fund can exert influence over a portfolio company is to seek representation on the portfolio company's board of directors. Two problems arise from such representation. First, it might provide the fund, by virtue of its representation, with a competitive advantage over other investors which do not have such representation. Second, it may serve as an additional vehicle for acquiring working control of the portfolio company.

The first problem has been somewhat alleviated by the recent decisions of the federal courts which interpret Section 10(b) of the Securities Exchange Act of 1934[54] and Rule 10(b)-5[55] as prohibiting insiders in a corporation from disclosing material information concerning the corporation's affairs.[56] A fund director sitting on the board of directors of a portfolio company is held to a high standard of conduct with regard to the disclosure of the portfolio company's business affairs.

The other problem, and the most difficult to solve, is the use by a fund of representation on a portfolio company's board of directors to attain working control over the portfolio company. Even if formal representation on a portfolio company's board of directors were prohibited, a fund could still exercise its voting power as a stockholder to support a candidate for election to the board who is sympathetic with the fund's views. The result, in either case, is that the fund will obtain a voice in the management of its portfolio company.

The 1940 Act does not prohibit fund directors or advisors from sitting on the board of directors of portfolio companies. Such representation may be disclosed at the time of registration or at the time of

[51] 15 U.S.C. § 80a-14(b) (1964).
[52] 1966 SEC Report, supra note 17, at 307.
[53] Id.
[54] 15 U.S.C. § 78j(b) (1964).
[55] 17 C.F.R. § 240.10(b)-5 (1969).
[56] SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968).

filing the fund's annual report.[57] Disclosure in the annual report is not required, however, unless the fund director's or advisor's principal occupation has been his position on the board of directors of a corporation. There is no provision requiring the fund to disclose the directorships held by the fund's directors or advisors where the fund merely has an equity interest in a corporation. Thus, there are no effective controls regulating the interlocking directorates between mutual funds and their portfolio companies.

III. Antitrust Laws

The growing equity position of the mutual funds in their portfolio companies may be indicative of a trend toward the re-emergence of the so-called "investment holding company." This term was used to describe the structure of the investment company industry prior to 1940, which was comprised principally of closed-end companies.[58] This "investment holding company" was partly an investment company by virtue of its investment of approximately one-half of its assets in diversified securities, and partly a holding company as to the balance of its assets, because of its substantial ownership of voting securities of various portfolio companies, usually representing between 10 per cent and 50 per cent of the outstanding shares.

Despite its statutory restrictions and its characteristic high level of portfolio turnover, the open-end investment company, which is the prevailing investment company structure today, could likewise develop many of the characteristics of the investment-holding company. As previously indicated, a diversified fund may invest up to 25 per cent of its assets and a non-diversified fund may invest up to 50 per cent of its assets in control situations. Portfolio turnover of the closed-end companies prior to 1940 was very low, which was indicative of a policy of investing in securities for long-term gains or control. However, it is anticipated that the investments of the open-end funds in "blue-chip" securities will not experience as high a turnover as in the past. Also, mutual funds are expected to acquire an increasing share of the outstanding stock of these industrial corporations.

It is also anticipated that the investment company will increasingly resemble the "pure conglomerate." In this structure, the parent company holds a controlling interest in a number of diverse subsidiaries, which retain most of their operating autonomy. The parent company, however, through its ownership of controlling interests in the subsidiaries, is able to formulate the major policies of the subsid-

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57 SEC Registration Statement of Management Investment Company, supra note 34, Items 16, 17, 23; Annual Report of Registered Management Investment Company, Form N-1R, Item 1.11.

58 SEC Investment Trust Study, supra note 29, pt. 4, at 2.

iaries. The investment company may become susceptible to anti-competitive charges as a "pure conglomerate," at least with respect to those portfolio companies in which it acquires working control. For example, there may be reciprocal arrangements in which a diversified investment company favors a third party with business from one of its portfolio companies in exchange for the third party's promise to purchase goods from another portfolio company. An additional anti-competitive effect is that the sheer financial strength of a major industrial concern affiliated with a large investment company might discourage other industrial concerns from competing in the same market. Such a market structure may effectively weaken the incentive for vigorous competition between two or more large portfolio companies affiliated with a common investment company. A recent Federal Trade Commission study on conglomerates revealed that many of the top 200 industrial corporations are already linked with each other through management interlocks and corporate joint ventures, as well as by centralized control of institutional investors.[59] Moreover, in an industry which is already concentrated, the common large holdings of the investment company may serve to further weaken the competitive environment.

The conglomerate structure, as indicated above, is identified with reciprocal arrangements, the exclusion of potential competition, and extensive market power. The investment company poses similar anti-competitive problems, but its structure should be identified with an aggregation of business wealth far exceeding that of the typical industrial conglomerate. The institutional investor, by investing a relatively small portion of its assets in as little as 10 per cent of the outstanding shares of a portfolio company is capable of acquiring working control of a corporation. By acquiring working control in a number of large corporations, the institutional investor represents the highest form of business concentration because it combines the aggregation of large industrial corporations with the concentration of a large financial institution.

Attempts to justify the investment company's concentration of control in its portfolio companies are not very convincing. While the pure industrial conglomerate may yield some economies in management services, advertising expenditures, and capital costs,[60] the investment company can offer only a reduction of capital costs. This reduction results from the portfolio company's affiliation with an investment company willing to extend loans to the portfolio company. Even this economy should be scrutinized carefully because of the potential for

59 FTC, Economic Report on Corporate Mergers, supra note 20, pt. 3, at 37.

60 Turner, Conglomerate Mergers and Section 7 of the Clayton Act, 78 Harv. L. Rev. 1313, 1330 (1965).

a conflict of interest and breach of fiduciary duty in the investment company's dual role as creditor and residual owner of its portfolio company. With the development of a holding company structure, other economies may be available to the investment company, but the substantial economies arising from common maunfacturing, research and distribution facilities are clearly not available to this form of corporate structure.

There are social and political ramifications to this potential large-scale amalgamation of the financial and industrial sectors which should also be scrutinized. There exists a basic premise that the concentration of economic power leads to a concentration of political power. This premise served as the basis for the enactment of the Federal Corrupt Practices Act,[61] which, among other things, prohibits corporations and labor organizations from making direct political contributions of expenditures. The statute was enacted in its original form in 1907, at a time when large corporations . . . sought and achieved influence and favorable legislation in state capitals and in Washington. . . ."[62] The Statute was amended in 1943 to include labor organizations, which came permanently within its scope in 1947. However, the extensive loopholes in the present federal statutes have been well documented,[63] revealing that the large corporate entities and labor unions may still wield great influence in the political sphere. Financial institutions already exert great influence in our economy by serving as a major source of capital. If these same institutions acquire working control in major industrial corporations, it is conceivable that the larger financial institutions could control an even greater segment of the economy than at present.

Aside from the potential for political influence which such concentrated economic structures might entail, there are other elements in the economy which may also be influenced by business concentration. The formation of corporate conglomerates has led to a concomitant need for labor unions to combine in order to exert greater pressure in collective bargaining.[64] As bigness in the business sector is matched by bigness in the labor sector, it will be countered by even greater bigness in government. The emergence of a business and labor oligarchy with the associated widespread intervention of government would be inimical to a free enterprise system and to a political system

61 18 U.S.C. § 610 (1964).

62 Lambert, Corporate Political Spending and Campaign Finance, 40 N.Y.U.L. Rev. 1033, 1035 (1965).

63 See Epstein, Corporations, Contributions and Political Campaigns; Federal Regulation in Perspective, Chapters VI and VII (1968); Haley, Limitations on Political Activities of Corporations, 9 Vill. L. Rev. 593, 614-18 (1964); Lambert, supra note 59, at 1039; Lobel, Federal Control of Campaign Contributions, 51 Minn. L. Rev. 1, 39-40 (1966).

64 The Wall Street Journal, May 14, 1969, at 1, col. 6.

enmeshed in the concept of diversity and fractionalism of economic and political power.

Prior to suggesting any statutory amendments to alleviate the problem of aggregate concentration, it is necessary to examine the present antitrust laws to determine their applicability to such concentrations. There is some authority that they are at least partially applicable, although antitrust policy, until recently, has not been directed at economic aggregation generally but at specific mergers which have been considered anticompetitive. Perhaps the broadest interpretation of the Sherman Act of 1890[65] as it relates to the problem of business concentration was expressed by Judge Learned Hand in *United States v. Aluminum Co. of America.*[66] In finding a violation of Section 2 of the Sherman Act in the manufacture and sale of virgin aluminum ingot by Alcoa, Judge Hand expounded on the social implications of industrial concentration:

> Congress . . . did not condone "good trusts" and condemn "bad" ones; it forbad all. Moreover, in so doing it was not necessarily actuated by economic motives alone. It is possible, because of its indirect social or moral effect, to prefer a system of small producers, each dependent for his success upon his own skill and character, to one in which the great mass of those engaged must accept the direction of a few. These considerations, which we have suggested only as possible purposes of the Act, we think the decisions prove to have been in fact its purposes.
>
> . . . .
>
> We have been speaking only of the economic reason which forbid monopoly; but, as we have already implied, there are others, based upon the belief that great industrial consolidations are inherently undesirable, regardless of their economic results.[67]

Mere size was an offense by Alcoa because it acquired an overwhelming share of the market by means other than superior skill, foresight and industry.[68] This doctrine was later affirmed in *United States v. United Shoe Mach. Corp.*[69] However, in both of these landmark decisions, the court was concerned with concentration at the industry level. Moreover, Judge Hand's interpretation of the legislative history of

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65 15 U.S.C. §§ 1-7 (1964).

66 148 F.2d 416 (2d Cir. 1945).

67 Id. at 427-28.

68 Id. at 429-30.

69 110 F. Supp. 295, 343 (1953).

the Sherman Act, as encompassing broad social policies, has met with both refutation[70] and limited application.[71]

The legislative history of Section 7 of the amended Clayton Act[72] also reflects a concern for market concentration, both at the industrial and aggregate levels.[73] Likewise, the Department of Justice "guidelines,"[74] issued in May, 1968, are directed at both industry-wide and conglomerate mergers. The guidelines outline the Department's standards for opposing corporate acquisitions or mergers under section 7. The most significant part of the guidelines are those which deal with horizontal mergers involving direct competitors. Horizontal mergers will be challenged based on the share of the market held by the four largest firms in the industry, as well as the share of the market held by each of the merging firms.[75] While the absolute size of the merging corporations is not the only factor, there is a presumption inherent in the provisions that any horizontal merger is anticompetitive when the merging firms are part of a highly concentrated market and represent a certain minimum share of that market. Although in the case of horizontal mergers the anticompetitive effects are clear, it is implicit in the guidelines that mere size might also constitute a violation of the antitrust laws.

Absolute size of a corporation, however, is a controlling reason for opposing a merger in the Neal Report[76] released in May, 1969. The Report concluded that mergers between very large firms and firms holding a dominant position in a concentrated industry were "most likely to have anticompetitive consequences."[77] The report recommended that "mergers between very large firms and other firms that are already leading firms in concentrated markets significant in the national economy" should be forbidden by statutory enactment.[78] A "large firm" is defined as one with sales in excess of $500 million or assets in excess of $250 million for the most recent base year. A "leading firm" is one which has a market share exceeding 10 per cent during at least two "base" years and in which the aggregate market share of any four or fewer firms during the same period was more than 50 per cent, provided that the merging firm is among the four largest

[70] Bork, Legislative Intent and the Policy of the Sherman Act, 9 J. Law & Econ. 7 (1966).

[71] C. Kaysen & D. Turner, Antitrust Policy: An Economic and Legal Analysis 107 (1965).

[72] 15 U.S.C. § 18 (1964).

[73] See Hearings on H.R. 2734 Before a Subcomm. of the Senate Comm. on the Judiciary, 81st Cong., 1st & 2d Sess., 59-60 (1950) (statement of Representative Celler).

[74] Supra note 16.

[75] Supra note 16, at 9.

[76] Neal Report, supra note 15.

[77] Id. at 8.

[78] Id.

in the market.[79] The implication of the Neal Report is that mere size is an offense when a giant corporation merges with a firm in a highly concentrated industry. The provision of section 7 that requires a showing that the effect of a merger "may be to substantially lessen competition" is notably absent. However, the report expressly rejects the notion that economic concentration has reached a level which would justify challenging mergers on the basis of social policy.

The concepts set forth in the Neal Report are apparently reflected in large measure in the current policy of the Justice Department. Attorney General Mitchell, in a June, 1969 address, stated:

> The Department of Justice may very well oppose any merger among the top 200 manufacturing firms or firms of comparable size in other industries . . . [and] will probably oppose any merger by one of the top 200 manufacturing firms of any leading producer in any concentrated industry.[80]

This statement reflects an extension of the policy of the Neal Report, in that any merger among the top 200 manufacturing concerns will be opposed, regardless of whether one of the merging companies is a leading firm in a concentrated industry. Moreover, the top corporations in other industries, presumably including financial institutions, are within the prohibition. The test is size, although the prohibitions are aimed at the anticipated anticompetitive effects of such size. In this regard, the new policy represents a significant departure from previous antitrust policy. The Department of Justice guidelines of 1968 and 1969, and the Neal Report together reveal a new awareness by practitioners and regulators that a market structure composed of high aggregations of business assets is inherently anticompetitive.

The Neal Report does not examine the problem of aggregate concentration within the context of the investment company. However, one provision of the proposed "Merger Act" in the Report has particular applicability to this issue. Section 1, entitled "Prohibited Acquisitions," contains the following subsection:

> This section shall not apply to firms acquiring any equity security solely for investment and not using the same by voting or otherwise to bring about, or in attempting to bring about control of firms in which any equity security is acquired.[81]

This provision is significant because of its implied recognition that "investment" in equity securities does not preclude the voting stock

79 Id. at 16.
80 Address by Attorney General John N. Mitchell, Georgia Bar Ass'n, June 6, 1969.
81 Neal Report, supra note 15, at 15.

from being used for purposes of acquiring control. Under this provision, a stock acquisition is exempt from the prohibitions of the statute only if there is both (1) an investment and (2) an absence of an intention to acquire control. Similarly, in *United States v. E.I. DuPont DeNemours & Co.*,[82] the Supreme Court held, in connection with the 23 per cent stock interest held by DuPont in General Motors, that "even when the purchase [of stock] is solely for investment, the plain language of § 7 contemplates an action at any time the stock is used to bring about, or in attempting to bring about, the substantial lessening of competition."[83]

In summary, the objections to size that were raised by Learned Hand, in connection with industry-wide concentration, apply with even greater force to aggregate concentration as represented by the investment company. The defense of efficiency resulting from economies of size, which Judge Hand recognized as the only valid economic justification for very large corporate structures, appears to have little applicability to the investment company. The antitrust policy reflected in the Neal Report and in the Justice Department's guidelines finds further suport in the doctrine of Judge Hand. This policy will serve as the statutory framework for proposed legislation to deal specifically with the problems of the institutional investor.

IV. Suggested Legislative Proposals

There are several legislative approaches that might be taken to prevent domination by financial institutions of the industrial sector of the economy while at the same time protecting the legitimate exercise of influence by these institutions. Legislation could be directed at each type of financial institution by amending those federal statutes which govern them, such as the 1940 Act for investment companies and the Banking Act of 1933[84] for bank trust companies. The basic problem, however, undue economic concentration, is common to all financial institutions. It is essentially an antitrust problem.

Another alternative, therefore, is to amend Section 7 of the Clayton Act[85] to include the provisions of the proposed "Merger Act" of the Neal Report. The prohibitions of section 7 would clearly reach all of the financial institutions in light of *United States v. Philadelphia Nat'l Bank*.[86] There the Supreme Court held that "[B]y its terms, the present § 7 reaches acquisitions of corporate stock or share capital by any corporation engaged in commerce. . . ."[87] "It is un-

[82] 353 U.S. 586 (1957).

[83] Id. at 597-98.

[84] 48 Stat. 162 (codified in scattered sections of 12, 39 U.S.C. (1964)).

[85] 15 U.S.C. § 18 (1964).

[86] 374 U.S. 321 (1963); see also United States v. Third Nat'l Bank, 390 U.S. 171 (1968); United States v. First City Nat'l Bank, 386 U.S. 361 (1967).

[87] Id. at 335-36.

questioned that the stock-acquisition provision of § 7 embraces every corporation engaged in commerce, including banks."[88] Moreover, the Court acknowledged that

> Congress' principal concern was with the activities of holding companies, and specifically with the practice whereby corporations secretly acquired control of their competitors by purchasing the stock of those companies.[89]

There is little question, then, that section 7 would apply to the "investment-holding company" and other "quasi-holding company" structures. However, there is an inherent weakness in section 7 because it prohibits only those mergers which may tend substantially to lessen competition. It does not reach mergers where the adverse effects on competition are likely to occur but cannot be readily predicted.[90] This is the principal reason given by the Neal Report for the need for separate legislation. What is required is an "incipiency statute," i.e., one which would prohibit a stock acquisition which, by its very nature, is likely to have an anticompetitive effect or a previous acquisition which "threatens to ripen into a prohibited effect."[91]

With the addition of certain provisions, the proposed "Merger Act" of the Neal Report could well serve as the statutory framework for resolving the potential problems of economic aggregation emanating from the institutional investor. The provisions under Section 1 of the "Merger Act" dealing with prohibited acquisitions are directed at mergers involving the large publicly-held industrial corporations. The following provisions are here recommended for addition to this section:

> (c) No large firm shall directly or indirectly merge with, combine with or acquire any equity security in any other large firm, or directly or indirectly acquire all or the assets of a large firm or a part thereof sufficient to constitute a large firm.
>
> (d) This section shall not apply to firms, engaged in either financial or non-financial trade, acquiring any voting security solely for investment and not using the same by voting or otherwise to bring about, or in attempting to bring about, control of firms in which any such voting security is acquired.

In addition, Section 2 of the proposed Merger Act should include the following definitions:

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88 Id. at 343.
89 Id. at 338.
90 Neal Report, supra note 15, at 3.
91 United States v. E.I. DuPont de Nemours & Co., 353 U.S. at 597 (1957).

(j) "Control" means the power to exercise a working control over the management or policies of a company. Any firm, or other appropriate economic unit, which owns beneficially, either directly or through one or more controlled companies, more than 10 per cent of the voting securities of a company shall be presumed to control such company.

Working control is distinguished from *absolute control*, requiring greater than 50 per cent voting stock interest, and *influence*, which is based on a voting stock interest of less than 10 per cent but includes an ability to initiate or affect some policies of the company.

Any firm which owns 10 per cent or less of the voting securities of any company shall be presumed not to control such company. Any such presumption of or against control may be rebutted by evidence.

Other factors that may be taken into account in rebutting the above presumptions include, but are not limited to, direct or indirect representation on the board of directors, and the ability to consistently implement major policy changes or major operational changes in the company.

(k) The term "appropriate economic unit" is intended to cover situations (1) where the voting securities are held by a number of legally separate investment entities but are under the common control of a single management; and (2) where two or more firms exercise their voting securities jointly by either formal or informal arrangements.

(l) "Financial trade" is intended to include bank trust and agency accounts, investment companies, life insurance companies, and any other financial institution serving in a fiduciary capacity to collect funds for the purpose of investment. All other business would be considered non-financial.

(m) "Voting security" means any equity security presently entitling the owner or holder thereof to vote for the election of directors of the company.

The basic premise of the above provisions is that the institutional investor should be able to freely exercise its right of franchise and influence management of its portfolio companies in furthering the interests of the public investors which it represents. To restrict the right to vote would have the effect of disarming the mutual funds and other institutional investors of the ultimate power, which is the basis for any influence they might exert on management. To sterilize the institutions' holdings would also have the effect of permitting control by an even smaller percentage of the other outstanding voting stock. At the same time, the above provisions attempt to provide some tangible basis for distinguishing control from influence.

Subsection 1(c) is intended to reach the problem of aggregate concentration resulting from the combination of two large firms through merger or acquisition, whether or not one of the parties is a "leading" firm. It gives formal recognition to the policy guidelines announced by Attorney General Mitchell, opposing any merger between the top 200 manufacturing firms.[92] By specific reference to the "financial trade" in subsection 1(d) and a definition of that term in subsection 2(1), subsection 1(c) is made clearly applicable to acquisition of stock in a major industrial concern by a large financial institution. This is not clear in the "Merger Act" as originally proposed. The Act defines a "large firm" as one with sales in excess of $500 million or assets in excess of $250 million. Asset size would be the principal test for financial institutions, and under this test about 120 bank trust companies and 50 investment companies would have qualified as large firms at the 1967 year-end.

Subsection 1(d), expanding on a provision of the "Merger Act," makes the provisions of the act inapplicable to both financial and non-financial companies which acquire voting securities as part of ther investment activities and abstain from exercising control in their portfolio companies. While this provision is based on language of Section 7 of the Clayton Act, it omits the requirement of establishing that the merger will cause the "substantial lessening of competition." The new provision is based on the concept that a merger of major corporations is likely to have anticompetitive results and does not require the "factual and theoretical judgments" to support a "substantial lessening of competition."

The key to this provision is the term "control" and its definition in subsection 2(j). A presumption of control would arise when more than 10 per cent of the voting shares of a company is held. The 10 per cent standard, as the minimum voting power for exercising working

[92] While the provisions of the Neal Report will reach beyond the top 200 industrial corporations, its scope with the proposed amendments is significantly less than that recommended by the Patman Report. The Patman Report proposes to prohibit "any bank trust department (from) holding in the aggregate in all capacities more than 10 per cent of any class of stock of any corporation required to be registered with the Securities & Exchange Commission." Patman Report, supra note 1, at 9. The 10% restriction, therefore, would apply to all corporations listed on the American and New York Stock Exchanges, as well as many corporations whose securities are traded over the counter.

control over a portfolio company, appears to be more realistic than the 25 per cent standard of the 1940 Act.[93] Particularly where major industrial corporations with widely-dispersed stock are involved, the 10 per cent standard reflects the prevailing view as to the appropriate dividing line between influence and control.[94] However, the presumption either for or against control can be overcome by evidence to the contrary. The rebuttable presumption provides a necessary quality of flexibility to the standard. For example, a firm holding 8 per cent of the voting shares of a portfolio company might, in fact, have working control of the company by virtue of the apathy of the other stockholders. Conversely, a bank trust company holding 15 per cent of the voting shares of a portfolio company may have acquired the shares acting as trustee of an estate and, at the time of the acquisition, had decided as a matter of policy not to exercise its voting rights or to participate in the affairs of the company.

Two significant indicators of working control, representation on the board of directors and the ability to consistently affect major company policies, are specifically made considerations in overcoming the presumptions of or against control. Board representation supporting the existence of control may be direct, where the director is affiliated with the stockholder or had the stockholder's voting support at his election, or indirect, where the director is sympathetic to the views of the stockholder although the ties between the two are tenuous. But board representation itself is not determinative unless the stockholder has exercised his power and manifested an ability to consistently affect major policy decisions. Consideration of this element of consistency is important because the ability of the institutional investor to occasionally influence or advise management ought not to be curtailed. The parties are not precluded, of course, from introducing other factors which bear on the determination of control.

The term "appropriate economic unit" is introduced into subsection 2(j) and defined in 2(k) to bring within the scope of the Act such functional entities as the mutual fund complex. As noted previously, the fund complex is frequently the appropriate unit for measuring voting strength, but it is not recognized as such in the 1940 Act. This proposed provision is directed at any structure, similar to the mutual fund complex, in which the investment securities of several legally independent entities are pooled in measuring the extent of voting power, because of the common control of voting rights by a

93 See p. 8 supra.

94 Enstam & Kamen, Control and the Institutional Investor, 23 Bus. Law. 289, 315 (1968); Larner, Ownership & Control in the 200 Largest Nonfinancial Corporations, 1929 and 1963, 56 Am. Econ. Rev. 777, 779 (1966); Disclosure to Investors, A Reappraisal of Federal Administrative Policies under the '33 and '34 Acts [The Wheat Report], 246, Appendix VI-1, 7 (CCH).

single management. For example, bank trust companies may manage and exercise the voting rights of private trust accounts, agency accounts, pension plans and endowments, among others, and while each of these accounts may constitute separate legal entities, their investments in voting securities are controlled by the management of one institution. Furthermore, control may be based on the holdings of two or more independent institutions when they act jointly in the exercise of their voting rights. A large mutual fund and a bank trust company may wish representation on the board of a large portfolio company by individuals who are sympathetic to their views. The financial institutions, by joining forces, could easily acquire working control of many industrial concerns. The purpose of this provision is to discourage such joint undertakings.

The limitations imposed on investments by financial institutions in major corporations by the proposed legislation, in addition to precluding anticompetitive economic concentration, would make available new capital to foster the growth of small and medium corporations, thereby further enhancing competition. With the growing demand for new investment opportunities and the increase in outstanding shares of major corporations failing to keep pace with this demand, financial institutions will be forced to invest an increasing share of their assets in other than "blue-chip" securities. There is little need for concern about impairing the ability of large firms to raise capital. The major industrial corporations, particularly those listed on a major stock exchange, have access to the public market for issuing their equity and bonds, as well as the use of privately-placed loans and internally generated capital.

Conclusion

The dividing line between legitimate influence and anticompetitive control in the relationship of financial institutions to their portfolio companies is difficult to ascertain. It is also difficult to restrict control without infringing upon the desirable exercise of influence. It is submitted that the proposals made above provide both realistic criteria for distinguishing control from influence and sufficient flexibility to balance the conflicting objectives. They would permit the full utilization of the resources of the financial institutions without undermining the competitive structure of the market place.

APPENDIX

TABLE 1

Top 100 Industrial Corporations (December 31, 1967)	Largest % of Common Stk Held by One Fd A	% of Common Stk Held by 10 Fds B	% of Voting Stk Held by 10 Fds C	% of Common Stk Held by All Fds D	% of Voting Stk Held by 10 Fds & 49 Banks (Approx.) E	Fds Represented on Board F
1. Standard Oil Co.—N.J.	0.6	1.5		2.7		
2. General Motors Corp.	0.3	1.0		1.5		
3. Ford Motor Co.	0.6	2.5		3.1	3.0*	
4. Texaco Inc.	0.9	3.0		4.8		1
5. Gulf Oil Corp.	1.0	3.4		5.6	16.0	
6. Mobil Oil Corp.	1.1	1.8		4.4		
7. U.S. Steel Corp.	0.7	1.6		3.2		
8. IBM Corp.	1.2	4.2		7.0		
9. General Tel. & Elec. Corp.	2.1	2.4		4.3		
10. General Elec. Co.	0.5	1.9		3.8		1
11. Standard Oil Co.—Cal.	0.6	2.0		3.5		
12. Standard Oil Co.—Ind.	1.0	2.0		3.2	3.0	
13. Chrysler Corp.	2.7	7.1		11.3		
14. Tenneco Inc.	0.7	0.7	0.7	2.5		
15. Shell Oil Co.	0.7	2.3		3.3		
16. Union Carbide Corp.	1.3	2.7		3.9		
17. Bethlehem Steel Corp.	1.2	5.2		7.0		
18. E. I. Du Pont	0.4	0.8		30.8		
19. IT&T Corp.	2.0	9.5	9.1	16.5	10.0	
20. Phillips Pet. Co.	2.4	4.6		5.0	5.0	
21. Continental Oil Co.	2.8	8.5	7.9	18.0		
22. Eastman Kodak Co.	0.8	2.0		4.1		
23. RCA	1.4	5.5		8.8		

* Common stock represents a maximum of 60% voting power.

TABLE 1 (*continued*)

Top 100 Industrial Corporations (December 31, 1967)	Largest % of Common Stk Held by One Fd	% of Common Stk Held by 10 Fds	% of Voting Stk Held by 10 Fds	% of Common Stk Held by All Fds	% of Voting Stk Held by 10 Fds & 49 Banks (Approx.)	Fds Represented on Board
	A	B	C	D	E	F
24. Goodyear Tire & Rubber Co.	3.0	5.8		7.4		
25. Westinghouse Elec. Co.	1.9	6.8		12.0		
26. Aluminum Co. of America	1.0	4.3		6.0	25.0	
27. Boeing Co.	2.8	8.2		12.5	17.0	
28. Union Oil of Cal.	1.7	5.2	3.9	7.7		
29. Dow Chem. Co.	0.6	1.3		3.3		
30. Atlantic Richfield Co.	3.3	11.6	10.0	18.0	14.0	
31. Monsanto Chem. Co.	0.9	1.4		2.5		1
32. Cities Service	1.0	2.0		6.4		
33. Celanese Corp.	2.9	6.5		9.5	12.0	
34. International Harvester Co.	1.8	1.8		3.5		
35. Sinclair Oil Corp.	2.0	3.9		7.2		
36. Getty Oil Co.	2.9	6.7		10.5		
37. Avco Corp.	4.8	6.9	6.5	11.7		1
38. Allied Chem. Corp.	2.3	4.7		6.9		
39. Sun Oil Co.	0.0	0.0		0.0	6.0	
40. W. R. Grace & Co.	2.3	5.8	4.8	7.5		
41. Firestone Tire & Rubber Co.	2.0	4.4		6.9	18.0	
42. Republic Steel Corp.	1.8	5.8		8.5		1
43. Reynolds Metals Co.	2.2	8.9		13.0	14.0	
44. Procter & Gamble Co.	1.0	2.5		3.6		
45. International Paper Co.	1.8	5.4		9.7		
46. Armco Steel Corp.	2.5	9.7		12.2		
47. Anaconda Co.	2.7	9.9		16.0		
48. McDonnell Douglas Corp.	1.4	3.7		8.8		
49. Caterpillar Tractor Co.	0.8	1.8		3.2		

TABLE 1 (*continued*)

Top 100 Industrial Corporations (December 31, 1967)	Largest % of Common Stk Held by One Fd	% of Common Stk Held by 10 Fds	% of Voting Stk Held by 10 Fds	% of Common Stk Held by All Fds	% of Voting Stk Held by 10 Fds & 49 Banks (Approx.)	Fds Represented on Board
	A	B	C	D	E	F
50. Deere & Co.	1.6	3.0		5.8	9.0	
51. R. J. Reynolds Tob. Co.	1.5	3.6		5.3	8.0	
52. United Aircraft Corp.	4.1	11.2		15.4	17.0	
53. American Can Co.	0.9	2.1	1.3	4.1		
54. Kaiser Alum. & Chem. Corp.	2.4	7.1		14.6	13.0	
55. National Steel Corp.	2.2	5.0		6.2	19.0	
56. North Am. Rockwell Corp.	1.3	1.9		5.4		1
57. Inland Steel Co.	1.9	8.6		11.3		1
58. Kennecott Copper Corp.	2.5	8.2		12.1	21.0	
59. Georgia Pacific Corp.	0.6	0.6	0.6	3.0		
60. Jones & Laughlin Steel	1.8	4.2		9.2	10.0	
61. Signal Oil & Gas Co.	3.7	4.9	3.8	7.8		
62. American Tobacco Co.	3.1	5.8		6.1		
63. Singer Co.	1.9	2.3		5.5		
64. Minnesota Mining & Mfg. Co.	1.5	3.4		5.2		
65. Sperry Rand Corp.	4.6	14.6		23.1	20.0	
66. Burlington Indus., Inc.	2.8	5.1		8.8	16.0	1
67. Pittsburgh Plate Glass Co.	2.1	2.9		4.2		
68. Uniroyal, Inc.	4.8	12.7	12.1	17.6		
69. Continental Can Co.	2.6	6.5		12.3		
70. Borden Co.	1.6	2.3		4.1		
71. National Cash Register Co.	2.3	4.9		12.1		
72. Owens Illinois, Inc.	3.9	4.4		5.3		
73. Weyerhauser Co.	0.2	0.3		2.2		
74. Youngstown Sheet & Tube Co.	1.6	2.3		6.1		
75. Marathon Oil Co.	5.0	9.1		11.3		

TABLE 1 (*continued*)

Top 100 Industrial Corporations (December 31, 1967)	Largest % of Common Stk Held by One Fd	% of Common Stk Held by 10 Fds	% of Voting Stk Held by 10 Fds	% of Common Stk Held by All Fds	% of Voting Stk Held by 10 Fds & 49 Banks (Approx.)	Fds Represented on Board
	A	B	C	D	E	F
76. Olin Mathieson Chem. Corp.	2.2	4.8		10.0	11.0	
77. Litton Indus., Inc.	2.5	8.5	7.3	9.7	8.0	
78. FMC Corp.	2.0	2.1	2.0	5.3		
79. General Foods Corp.	2.3	4.6		.5.7		
80. U.S. Ply. Champ. Paper, Inc.	3.5	9.8	9.1	17.0	15.0	
81. General Dynamics Corp.	4.1	15.3		24.5	22.0	
82. National Dairy Products Corp.	0.0	0.0		1.3		
83. Crown Zellerbach Corp.	2.2	7.7		9.1	18.0	
84. American Cyanamid Co.	0.2	0.2		0.7		
85. B.F. Goodrich Co.	3.3	3.9		17.0		
86. Lockheed Aircraft Corp.	3.1	9.9		15.6		2
87. Boise Cascade Corp.	1.3	1.6	1.3	5.7	4.0	
88. Honeywell, Inc.	0.9	3.3		8.4	16.0	
89. Ling-Temco-Vought	5.4	16.0	14.6	32.9	16.0	
90. St. Regis Paper Co.	1.0	1.0		12.3		
91. Bendix Corp.	3.6	12.5	11.7	18.5		
92. Corn Prods. Co.	0.0	0.0		0.9		
93. National Dist. & Chem. Corp.	1.3	1.3		NA		
94. Xerox Corp.	1.5	4.6		10.4	14.0	
95. Occidental Pet. Corp.	3.0	7.0		14.5		
96. Swift & Co.	3.4	4.7		8.6		
97. Borg-Warner Corp.	1.9	4.4		6.9		
98. Gulf & Western Indus., Inc.	3.0	11.3	9.1	25.3		
99. Sunray DX Oil Co.	1.1	2.4		5.2		
100. General Tire & Rubber Co.	3.8	8.8		12.6		

(1) The figures in this Table are derived from the following sources.

Columns A-C: Equity holdings of funds and their complexes are derived from Arthur Wiesenberger Services, Investment Companies, Mutual Funds and Other Types 374-410 (1968 ed.); the 1967 quarterly reports filed with the SEC, pursuant to § 30 of the Investment Company Act of 1940 (Form N-1Q). Outstanding equity shares of industrial corporations are derived from Moody's Investors Services, Inc., Moody's Industrial Manual (July 1968); 1967 annual reports filed with the Commission pursuant to § 13 or 15(d) of the Securities Exchange Act of 1934 (Form 10-K).

Column D: Vickers Associates, Inc., Special Report, Holdings of Common Stocks by Ten or More Investment Companies (April 1968).

Column E: Staff of House Subcomm. on Domestic Finance, 90th Cong., 2d Sess., Report on Commercial Banks and Their Trust Activities; Emerging Influence on the American Economy 93-132 (Comm. Print 1968). This column only reflects those shares in which the banks had sole or partial voting rights. The absence of figures reflects the fact that those companies in which the banks held only 5% or more of the outstanding equity were contained in the Patman Report.

Column F: Annual reports filed with the SEC supra.

All figures are adjusted for December 31, 1967 except the outstanding shares of Procter & Gamble and North American Rockwell Corp. Adjustments for a few industrial corporations may be off several thousand shares because of the unavailability of a breakdown between shares issued and shares outstanding. The holdings of the 49 banks are for various dates during the third and fourth quarters of 1967.

(2) Column B provides the basic data on percentage of shares held by 10 funds. Column C shows only the changes in percentage held as a result of adding the outstanding voting preferred shares. Column E shows only the changes in columns B and C, as a result of adding the holdings of voting securities of the top 49 banks surveyed in the Patman Report. Column F does not show the extent of representation on the board, but merely the fact of representation. The maximum number, therefore, is ten. These percentages are also adjusted to reflect voting rights where each share has more or less than one vote.

(3) The following ten funds and complexes are represented in Table 1 (adviser:funds):

1. Investors Diversified Services, Inc.: (a) Investors Mutual, Inc.; (b) Investors Stock Fund, Inc.; (c) Investors Variable Payment Fund, Inc.
2. Fidelity Management & Research Co.: (a) Fidelity Trend Fund, Inc.; (b) Fidelity Fund, Inc.; (c) Fidelity Capital Fund, Inc.; (d) Puritan Fund, Inc.
3. (a) Massachusetts Investors Growth Stock Fund, Inc.; (b) Massachusetts Investors Trust.
4. Waddell & Reed, Inc.: United Funds, Inc. (a series fund represented here by United Accumulative Fund, United Income Fund, and United Science Fund).
5. Dreyfus Fund, Inc.
6. Wellington Management Co.: (a) Wellington Fund, Inc.; (b) Invest Fund, Inc.; (c) Windsor Fund, Inc.
7. Anchor Corporation: (a) Fundamental Investors, Inc.; (b) Diversified Growth Stock Fund, Inc.; (c) Diversified Investment Fund, Inc.
8. Lord, Abbett & Co.: Affiliated Fund, Inc.
9. The Putnam Management Co.: (a) Putnam Growth Fund; (b) George Putnam Fund of Boston; (c) Putnam Income Fund, Inc., (d) Putnam Investors Fund, Inc.
10. Capital Research & Management Co.: (a) Investment Company of America; (b) American Mutual Fund, Inc.; (c) Washington Mutual Investors Fund, Inc.

TABLE 2

Per Cent of Voting Securities of Top 100 Corps. Held by Top 10 Funds and Complexes	Per Cent of Top Corps. with Voting Shares Held, as Indicated in 1st Column
less than 5%	62%
5% or more	38%
7% or more	25%
8% or more	19%
10% or more	8%
15% or more	1%

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