

\$1,106,000 was the Continental Securities Corporation's money. Securities of the Continental Securities Corporation had been sold by this stock exchange house, so that Continental had with it at least \$1,106,000. The remainder, approximately \$500,000, had to be provided, and this was provided by the house, in receivership or bankruptcy, by utilizing the securities of its customers, borrowing on those securities so as to get sufficient money to pay this difference of \$500,000.

Now, that brings you to the 1st of January. The directors of Reynolds Investing Co. step out on this first payment and the new so-called fiduciaries step in; and, of course, that gives them control of the portfolio of Reynolds Investing Co., and this portfolio is sent over to the stock exchange house that I speak of, and they start to sell securities of the Reynolds Investing Co. that were in the portfolio so as to accumulate a cash balance.

Senator HERRING. I caught the word "Reynolds" several times. Do you mean Arthur or George Reynolds?

Mr. COOK. Oh, no.

Senator WAGNER. Mr. Cook is talking about the Reynolds Investing Co.

Senator HERRING. Oh. I thought he was talking about some Reynolds of the Continental Commercial Bank of Chicago.

Mr. COOK. Oh, no. I am talking about the directors of the Reynolds Investing Co. Two of them reside in Virginia, and—

Senator HERRING (interposing). Oh. I see; it is another Reynolds altogether.

Mr. COOK (continuing). And one does business in New York as a member of a stock exchange house, and the other is his partner. If there is anything I said that gave you that thought, pray pardon me.

Senator HERRING. I came in a little late, and was interested in your reference to "Reynolds."

Mr. COOK. I have purposely avoided, I think with the consent of the chairman, giving names, and when I speak of "Reynolds" I mean Reynolds Investing Co. And when I speak of the directors of Reynolds I am not singling out any particular Reynolds but mean the Reynolds directors.

Now, Mr. Chairman, perhaps this is too long.

Senator WAGNER. Oh, no. I think it is very valuable testimony you are giving the subcommittee.

Mr. COOK. I believe I said: Now that they have control of the portfolio what are they going to do with it? A great many of the securities were sold by this stock exchange firm and a cash balance built up; and they had to build up a cash balance because they have not only paid \$1,500,000 on this purchase, which has been guaranteed by them, but they have got to raise the difference, something like \$610,000.

All right. They go ahead and sell. They raise a cash balance on the books. Here are photostatic copies of the three checks I mentioned in connection with the Reynolds deal. You will recall that I said there was \$700,000 so-called par value of preferred stock of Fiscal Management Co., Ltd., in the portfolio of Continental Securities Corporation, put there by the "looters."

During the course of a few months, in connection with another investment trust known as First Income Trading, which the "looters" likewise "looted," there was given up 182,500 shares of preferred stock of Fiscal Management Co., Ltd., used in connection with First

Income Trading exactly as the \$700,000 was used in the Continental Securities Corporation case; and that made a total of \$882,500. Now, in order to arrange for the payment of the balance due to the Reynolds directors, it became necessary to raise some money. So securities of the Reynolds Investing Co. were sold, and then the scheme was devised of having Continental Securities Corporation, with the board of directors of the "looters" sitting there, sell to the Reynolds Investing Co., with the board of directors of the "looters" sitting there, \$882,500 of this Fiscal Management Co. preferred stock, which was worthless.

Senator WAGNER. That is the Canadian company?

Mr. COOK. Yes. And as \$882,500 of perfectly good securities of Reynolds Investing Co. had been sold, for bookkeeping purposes it was necessary to put in some kind of entry to show where the \$882,500 went. So that was put through, and then out of the cash which remained with the stock-exchange house I am speaking of, the remaining two payments were made; and of course this \$882,500 had to be taken care of in some way or other, so from a bookkeeping viewpoint it might look sacrosanct.

Therefore, the house in receivership draws its check to the order of Reynolds Investing Co. for \$882,500—which of course represented the proceeds of the sale of their securities. But this check to the order of Reynolds is endorsed to the order of Continental Securities Corporation to pay for the stock of Fiscal Management Co. Then Continental Securities Corporation endorsed this check to the order of this stock-exchange house, and the stock-exchange house put this into its bank account. No, I have made a mistake there; it was never deposited. It was just a sort of carrousel, with nobody getting the ring.

Now, we have lost so far \$700,000, and when I say "lost," it was filched from us, the \$700,000, and \$354,000 in Corporate Administration and \$1,106,000 in connection with this—

Senator WAGNER (interposing). That is, the Reynolds Investing Co.?

Mr. COOK. Yes. That amounts to \$2,160,000.

Now then, somebody wanted to acquire the securities of a corporation known as South American Utilities Corporation, and made arrangements with some of the banks in New York to acquire all of the securities for \$2,400,000. The banks and their associates evidently had loaned the money, and in order to get their position back had to acquire the company because the obligations were not met.

A contract was made for \$2,400,000 with one of the associates—those that perhaps did not behave as well as they should—and the money on account paid from time to time with respect to the purchase price of \$2,400,000, was \$447,000; and that also because the nominees of these people signed anything they wanted—although I do not recall that their death warrant was offered to them to sign, but beyond that, anything; and there is \$447,000 again because the contract was not completed, the balance could not be paid, and the contract was declared at an end by the banks, by the bank and its associates, so that the bank today has all the original securities which it wanted to dispose of; and the \$447,000—

Senator WAGNER (interposing). Where did that \$447,000 come from?

Mr. COOK. From the Continental Securities Corporation.

Senator WAGNER. Out of the portfolios?

Mr. COOK. I am trying to explain the \$3,300,000.

That brings you to \$2,400,000 that is gone. Well, they were sort of interested in a sort of aircraft company, and \$150,000 went into that. I think they succeeded in buying some second-hand airplanes, which I suppose was for an investment trust.

It all seems to me to be so weird that it is difficult to speak of. The house seemed to think that one of their clerks ought to be dignified by having a seat on the stock exchange, so they bought a seat on the stock exchange for this young man and also dipped into the Continental Securities, and paid \$75,000 for the seat, and I think in order to put that transaction through the looters and those associated with them felt that a brokerage fee or a commission fee, or something or other—I do not know what to call it—of \$31,000 ought to be paid.

Senator WAGNER. To be paid for what? For the purchase of this seat?

Mr. COOK. Yes.

Senator WAGNER. In addition to the money paid for it?

Mr. COOK. Yes.

Then there were losses in connection with commissions claimed by the banking house for trading, buying, and selling back and forth, and then also some of the moneys were utilized to take care of the First Income Trading Corporation. That amounts to some \$250,000, so I think, Senator, if you feel that I have approached the \$3,300,000 with reasonable accuracy, I can be relieved of that phase of the situation.

The Reynolds Investing Co. was forced into bankruptcy and Mr. Ballantine as trustee has engaged in litigation, and there is 1 suit, an omnibus suit, in equity in New York against 97 defendants and everybody who was interested in this situation either correctly or improperly, on the theory, Senator, that equity, when it has all the facts, can mold an appropriate decree, so that justice shall be done to all of the parties in court.

The Reynolds Investing Co. is a party in that suit and the Reynolds Investing Co. has brought a suit against the Reynolds directors for breach of their duties and their obligations. Those cases have not yet been disposed of.

Senator GLASS. Is that bank still a member of the stock exchange?

Mr. COOK. No. The stock exchange house? They are off. They are a failure. The stock exchange took them over to see that none of the customers were hurt. That had been arranged. They are off the exchange.

I think, as far as this entire transaction is concerned, if I may be permitted to say it, we have received the fullest cooperation from the stock exchange, and I think the stock exchange has done everything that it possibly could do in the matter.

I think perhaps in fairness I should say this, because I referred to the suit that we have brought: between the house that provided the \$580,000 and the house that sold it shares for the \$580,000 we have, with the two, already made an adjustment, with the approval of the court, upon notice to everybody interested directly or indirectly, for \$1,250,000, and of the \$1,250,000 about \$700,000 has already been paid and the balance is in course of collection, and we have some legal details to observe, and I think that will be paid during the course of the coming week.

Senator WAGNER. I would have said that what you have told us is incredible, that it just can't happen here.

Mr. COOK. Senator, I told you when we first took this up we were impressed with the thought that truth is stranger than fiction.

Senator WAGNER. Where did the original money that went into Continental Securities come from? Do you know whether it came from small investors?

Mr. COOK. I do not know. I should say large and small investors. I think it was organized in 1924. The company got quite a lot of money from the sale of debentures and their preferred stock. As far as I am able to determine, I do not know of anything in connection with the organization of Continental Securities in 1924 that was the subject of criticism.

Senator WAGNER. The whole transaction deals with other people's money. Where did that money originally come from?

Mr. COOK. From the public.

Senator WAGNER. From the public?

Mr. COOK. Yes. If you have the small investor in mind, remember, I referred to the Administered Fund Second, where you have 330,000 investors.

Senator WAGNER. 330,000 of about \$4,000,000?

Mr. COOK. Yes.

Senator WAGNER. That must represent small investors.

Mr. COOK. I brought that out to call attention to the fact that there were a lot of small investors.

I want you to know that as far as I am personally concerned the reason why the provisions of the bill which will prevent things happening such as have happened here have appealed to me is that the small investor is protected. Sometimes, I say, the large ones protect themselves; I do not know.

May I be forgiven for just saying one thing? It is not within my sphere; perhaps I ought not to say it. It is outside the provision of this bill that I have been speaking of, but I hope it will be weighed by the committee when it comes to it. I think some thought ought to be given to the fact, if Mr. Schenker will forgive me, as to whether, even under the mantle and protection of the S. E. C., investment trusts with only \$100,000 should be permitted. That is in the bill.

If I may speak as to that—

Senator WAGNER. Certainly.

Mr. COOK. I am not against the small man or the man who tries gradually to develop and grow. He has got to be protected. We were all once, I think, small ourselves, but I do not see how it is possible, in connection with an investment trust, with a capitalization or assets of just \$100,000 for it to have that degree of knowledge which, honestly meted out, is essential for the protection of investors, and I regard an investment trust as something which should be an investment, as it is in England.

I am fearful—I may be all wrong—that with a company of just \$100,000 appeals will be made by the salesmen, those who represent them, to the speculative desires (and I suppose we all have a little flare for that in some direction or other) of many who can ill afford to lose the small amounts that they put in, except on the best of security. I am fearful of that.

Senator WAGNER. Of course, in these transactions you mentioned here the small investor not only had no say about it but he had no

knowledge of what was going on at all. He had no information of any kind.

Mr. Cook. So far as what was done here, and that is the provision in the bill requiring information about changing your policy, changing your management, if you want to throw out some directors. I am entirely in accord with things concerning which the stockholders should be and must be consulted. One cannot overnight put somebody in charge of a portfolio which you have trusted, if you please, to the efforts of somebody else and not know the slightest thing about the person who disposes of the portfolio, and that is evidenced by what was done by the Continental Securities, where you have \$3,300,000 of a perfectly good portfolio disposed of in 5 months so that you have \$50,000 left.

I am obliged for your patience. I am sorry I did not speak a little louder.

Senator WAGNER. Are there any questions of Mr. Cook? Thank you very much, Mr. Cook. You have been very helpful.

Senator DOWNEY. I wonder if I could intervene with a comment that is not concerned with Mr. Cook's statements at all?

Senator WAGNER. Yes.

Senator DOWNEY. Is there not a better arrangement or better table we could get for this hearing?

Senator WAGNER. The other day I pleaded with two members who are on the Committee on Rules. I have been after those two members about that. One of them was here a little while ago, Senator Miller, and the other is Senator Tobey. I realize that we need it very badly.

Senator DOWNEY. Mr. Chairman, there are a hundred people here who are vitally interested in this and they cannot hear what is going on.

Senator WAGNER. I realize that.

Our next speaker is Mr. Hugh Fulton.

STATEMENT OF HUGH FULTON, ASSISTANT UNITED STATES ATTORNEY, SOUTHERN DISTRICT OF NEW YORK

Senator WAGNER. Mr. Fulton, you are the Assistant United States Attorney for the Southern District of New York, and you have had charge of some of the prosecutions and investigations?

Mr. FULTON. I am the attorney who has brought the prosecution of those persons who were convicted in connection with the looting of investment trusts, some of which Mr. Cook has referred to and some of which he has not.

I might give something of my background. For 8 years I defended corporate litigation in the offices of Cravath, de Gersdoff, Swaine, and Wood, and after Mr. John F. Cahill was appointed district attorney he asked me to go to his office and prosecute certain of these complicated corporate cases.

Now, among those there came up the question of the looting of these investment trusts. In the first place, I think an investment trust is a very useful thing. A person who has a small income and small savings is particularly interested in it for the reason that it enables him in effect, you might say, to bet on the United States. He could not possibly afford to buy a share of stock of each of the numerous corporations that are dealt in on, say, the New York

Stock Exchange board, but if an investment trust were pooled with the savings of thousands of these small savers into a fund of some millions, it would be able to buy blocks, which would be substantial in size, of a great number of corporations, so that the small investor would be able in effect to take an interest in all of those corporations which he could get through no other means.

Now, the particular investment trusts that are involved in Mr. Cook's litigation, and in my trial in the southern district, in the first instance issued securities to the public on circulars which made representations as to an investment policy, but, of course, that is a mere statement of future expectancy, and as the years went by the investments of those companies were changed from time to time.

In all instances they were set up in such a way that a large part of the investment was made by persons who had nothing whatever to do with the management or control of the company. For example, in the *Insuranshares Corporation of Delaware* case fifteen millions of securities were sold to the public, but the control of the company was vested in stockholders who had contributed only \$50,000.

That difference between management and ownership interest is quite important because of the temptation which it affords to any person who might be dishonest to sell the corporation something that is not worth what he sells it for or to buy from the corporation something that is more valuable than he paid. Worse still, they may make an exchange, and that, of course, makes it necessary for anybody in the position of Mr. Cook and myself to establish in any litigation that we may have that the exchange was not only a bad exchange but that it was an exchange that was intentionally bad, because a mere honest mistake is a defense. In cases such as the ones that we have had we really have situations where to some extent amateurs, without sufficient financial backing, were doing it in such a raw, crude way that it was apparent, or could be made apparent. After 6 weeks' trial the jury concluded that it was intentional and convicted them.

Those convicted consisted of lawyers, some of whom Mr. Cook referred to, and two financial people, one of the financial persons being the individual who in the first instance loaned the money that was necessary to acquire the stock.

The whole thing might be said to stem back to a barroom meeting in the Hotel Book-Cadillac in Detroit. There is always the temptation on the part of a dishonest man to buy this stock which would control an investment trust. He does not care whether it has any value. He does not care what the price he pays for it might be, because he intends to foist all of it off on the corporation itself, but those who own the stock cannot, of course, sell it unless they get paid for it. They are unwilling themselves to participate in what you might term the looting of the trust, so they want to be paid—before they turn over the management—that is, before they cause their directors to resign and before they cause new directors to be elected who are nominees of the purchasers.

That means that anyone seeking to buy an investment trust would have to have cash, and in this Book-Cadillac Hotel one of the lawyers who had been convicted realized that another lawyer, who was a former associate of his, was an attorney of supposed reputable standing for one of the largest brokerage houses in the United States, and he conceived the idea that they in the first instance, through deceiving that firm, would get the firm to advance the hundreds of thousands

of dollars by a certified check temporarily, so that they could pay for the stock and get control, and in that first instance the First Income Trading Corporation—the old management—changed the board of directors and then in effect wrapped up all of the securities that were readily salable in the investment trust, took them downstairs in an elevator, and delivered them to the brokerage firm against the receipt of the check, which was then, of course, used by the sellers as the payment for their worthless stock.

That, of course, was a very easy transaction, and the conspirators went on to further fields.

Senator WAGNER. Using the same methods?

Mr. FULTON. Yes; they immediately contacted a second trust and in that case they found that the sellers would not cause the board of directors to resign until after the sellers were paid, so that there had to be what they termed an hiatus; in other words, the banking firm or brokerage firm had to loan its money without any security at all for the time being and then wait until the conspirators could get control and could loot the investment trust, by this method that Mr. Cook has described, and hand back to the brokerage firm the portfolio of the investment trust.

Now, that meant that as time went on and as transaction piled on transaction, the brokerage firm, I think—beyond a question of doubt through this one partner, at any rate, and the jury has so found by convicting him—knew that this method was being pursued.

Now, an investment trust, while it may have hundreds of thousands and even millions of dollars of assets, is little more than a safe deposit box. The securities, which, of course, represent millions, could be placed on several square feet of this table, and they are usually in the custody of a banking house.

In addition to that, the investment trust is nothing more than a set of books, ledgers, journals, and minute books, and letters back and forth to security holders.

There were one or two people who would determine what investments were to be purchased, and their whole offices in some instances were put in a space less than a third of the size of this room, and, of course, the securities are extremely liquid, and the very nature of an investment trust presupposes that there will be purchases and sales.

The only way you can approach one to see whether or not it is legal or illegal is by determining the motives which actuated the sale, and if you have got, in effect, to get into a man's mind and determine that he really knew that it was improper, it is a very difficult thing to do.

Now, Mr. Cook has described several of them and I will not describe those any further. I could not do as well as he did on those. To proceed to the next one after his, there was a corporation called Insuranshares Corporation, which was organized through the sale of \$10,000,000 of securities to the public and ultimately of another \$5,000,000, and, as I say, the management contributed \$50,000 and it got in return the voting control which enabled them to change the board of directors and thereby to control the policies of the company.

The depression naturally resulted in losses, and at the end of about 1932 the portfolio had declined in value to about \$4,000,000, making a realized and unrealized total loss of \$11,000,000, if they sold out at that time. Control of that company was sold at that time for \$2,000,000, and the stock had been reclassified, so that the \$2,000,000

was probably a fair enough price, but the persons who got in control of this company adopted this policy of paying for the control shares in installments and they sold to the investment trust such securities as were necessary to get the money to make the investment trust in effect finance its own purchases at its own expense, and in a year's time the securities of that investment trust had declined from \$4,000,000 to about \$300,000 in value.

Senator WAGNER. Where did that money go?

Mr. FULTON. The money went in this way: the securities of the investment trust were sold for securities which were not worth as much as the securities which were sold. Of that sum \$2,000,000 went to pay for the investment trust——

Senator WAGNER. Were there any personal profits made?

Mr. FULTON. To the stockholders?

Senator WAGNER. No.

Mr. FULTON. To the management?

Senator WAGNER. To the management, yes.

Mr. FULTON. After all, if they paid \$2,000,000 for the management and then the investment trust paid that for them in effect by overpaying them in transactions in which they were interested, you could term if you wished to do so, the \$2,000,000 as a profit to the management.

Now, had they been honest and kept the same securities in that portfolio, they would have gone, through the rise in the market that occurred in 1933, from \$4,000,000 to about \$7,000,000, so you see the result of that management was the depletion of assets by something over \$6,000,000.

Senator FRAZIER. In these cases you mentioned did the original investors lose all the money they put in there?

Mr. FULTON. You can see that the people who had originally invested now had investments in a company that had only \$300,000 of assets.

Senator WAGNER. Out of \$15,000,000?

Mr. FULTON. Out of \$15,000,000 originally. Of course, suits were instituted and they were waged over a period of years and they resulted in a net recovery in 1937 of about \$300,000 after all expenses and all difficulties had been incurred.

Now, at that time that \$300,000 was invested by Insuranshares in the stock of another investment trust, New England Fund, which is what we term an open-end trust. It is one of those trusts that values its securities periodically and will give any stockholder his proportionate share of his investment if he cares to turn in his securities.

In addition to that block of New England Fund, Insuranshares had about \$200,000 of good, salable stock exchange securities, and in addition to that it had a third set of securities that you might term cats and dogs. They had value. Some of them had substantial value and some of them had practically no value and they were not readily salable.

The sum total of these assets by that time was, according to the management's own methods of computation, as set forth in their own contract of sale, about \$815,000, and the book value, if you had liquidated the company as of that date and accepted the management's estimate of value for each share of stock, was about \$2.80 to \$2.90 a share.