THE CONTROL OF SECURITY ISSUES
in
CANADA

A

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THE CONTROL OF SECURITY ISSUES IN CANADA

I. General Survey

(a) The Corporation - its rise, development and present position.

To find the origin of the modern corporation we must go back in history as far as the Greek, and Roman Civilization. At that time manufacturing, transportation, public works and government were financed by a forced levy of treasure, goods, or labor.[1] This scheme was particularly effective in the Greek colonies and the Roman provinces. In return for the goods and services rendered the people obtained the benefits of good roads, effective government, a code of law and military protection against the barbaric tribes on their frontiers. The conquerors gained by the exploiting of labor and materials.

Similarly the early Church collected funds from its members for charitable, educational and religious purposes, granting in return the benefits of the Church[2].

We can see that these early forms of corporate activity embodied the factors of force and necessity. Failure to comply with the requirements meant imprisonment, exile or excommunication. While such a system does not conform to modern standards of business, we may note a fundamental characteristic of corporate activity, viz: officers carrying out policies as the representatives of a body of persons, whom we cannot call shareholders, but who were interested parties, in that their livelihood depended on the actions of those in authority.

During the early Middle Ages we note the rise of a capital-owning class in the Italian cities.[3] This class comprised two groups: first, the sons of land-owning nobles, who moved to the towns in search of fortune, and second, a group of office-holders, tax-collectors and other officials, who had amassed sums of money during their period of office-holding. These two groups purchased lands in the towns, forming the nucleus of the town property owners. It may be noted that the entire income of these groups was based on ground-rents, land being the only principal form of capital goods.

Such capital funds aided materially in the rise to important positions of the Medieval Italian towns, especially Venice[4]. During the time of the Crusades this town gained great commercial importance controlling the Mediterranean trade and extending its influence across the Alps into Northern Europe.

At this same time a number of business associations were formed in various parts of Europe. These may be compared to our modern partnerships. Three types may be noted.[5]

1. Associations of landowners for the collection of tolls from merchants, receipts being divided among the partners.

2. Associations among merchants for purposes of protection against robbery or the fortunes of war. Losses were shared by the parties concerned.

3. Associations among merchants for facilitating trade or manufacture. Often aged or incapacitated men of means employed men of talent to assist them in carrying on their business, or men with pressing business duties hired competent partners to act as agents in distant cities. This form of association comes closest to present-day partnerships.

The later Middle Ages saw the rise of two important corporate forms of enterprise - the guilds and the traders' associations. We may illustrate the former by the English craft guilds and the latter by the Hanseatic League.

The English craft guilds came into prominence in the Thirteenth Century.[6]. They were at first similar in nature to our modern friendly societies and trade-unions, but later were analagous to trade associations. Each trade was organized separately and membership was compulsory. Wardens were appointed by each guild to control production and exercise general overseeing powers.[7] Master craftsmen employed a certain number of journeymen and apprentices according to the size of their shops, and were in charge of the education and training of their employees[8]. Standards of workmanship, wage rates, hours of labor and prices were fixed by the various guilds. In addition to controlling industry, the guilds took an interest in the welfare of their members, having educational, religious, charitable and judicial functions.[9]

In time the craft guilds declined, and the craftsmen became artisans employed by owners of raw materials.[10]. This came about through the inability of the guilds to control the supply, which came to be monopolized by merchants and a rising capitalist class. Similarly the guilds lost control of distribution, finished goods passing into the hands of the same, or other, merchants. Thus the system of guilds gave place to that of domestic production.

The Hanseatic League[11] was a federation of the important Mercantile towns of Northern Europe, for purposes of controlling trade. The association was formed during the thirteenth century, including some 100 towns at the time of its greatest power. The League had extensive commercial relations in Europe, trading in Scandinavia and Northern Russia, possessing interests in London, and meeting the trade of Venice in the South. Each town in the League sent representatives to a central meeting-place. Policies of action were determined and funds were raised to meet administrative needs.

Not until the sixteenth century did English merchants gain a position of prominence in European commerce.[12] Up until that time they had been content to leave the carrying trade in the hands of foreigners. However, they became restive and began a struggle for commercial supremacy. In this they were aided by a rising capitalist class at home, who financed trading ventures, often as a matter of speculation. This form of financing embodied the idea of transferable shares, and a number of trading companies - East India Co., Hudson Bay Co., and others - were formed as joint-stock companies.

We might note by the way the encouragement given to traders by the European Monarchs of this period, particularly Henry VII. Emphasis was laid on the king's patronizing of trading associations, and people came to regard such organizations as creatures of the state. This attitude is also true of the early settlers in America, whose only law was that of the state, based on the English common law. This idea of the state, being parent to the corporation is erroneous, when we view the situation in a historical light. It explains the opinions of certain legal and practical men with regard to the powers of the corporation. In reality the corporation antedates the modern state, particularly in America.

From the trading era we move on to the Industrial Revolution. This important period involved the greatest single change for the corporation of any.[13] The corporation of this period involved changes in the field of capital similar to those changes in the field of labor caused by inception of the Factory System. To meet the growing needs of the people the corporation extended into all branches of industry. The perfecting of new processes enabled producers to assemble machinery in certain areas favorable to production and close to the centres of labor supply, a result of the Enclosure Movement. In their turn the capitalists and financiers of the day sought to concentrate large blocks of capital in the manufacturing centres. The day of the private craftsman was gone - expanding industry required capital and labor resources far exceeding those of the humble spinner and weaver. The needed capital was obtained by the issuing of shares, the proceeds going to finance the needs of the new large-scale production enterprises.

[14] In looking at the features of these eighteenth century corporations, we see many similarities with modern enterprises: free transferability, diffusion of ownership, divorce of ownership from management, and concentration of control. In many respects, therefore, the present-day corporation is little changed from its eighteenth century counterpart. Probably the most notable changes have been in size and in complexity of organization. Today only administrative and technical limitations mark the bounds of corporate extension. The corporation is here to stay. Its roots are to be found far in the past and it has passed through its formative and developmental stages adapting itself to the needs of a constantly changing environment.

The earliest Canadian company was the French Company of One Hundred Associates, formed, early in the seventeenth century for the purpose of developing the fisheries along the shores of Acadia and in the Gulf and River St. Lawrence, and of promoting fur trade with the Algonquin tribes in the country north of the St. Lawrence River and east of the Ottawa River. Some trade was carried on with the Iroquois to the South but these tribes preferred to trade with the English and Dutch settlers in New York and New England.

Later the North West Company was formed as settlement was extended into Upper Canada and the Great Lakes region. The company had its headquarters in Montreal and from there forwarded stores to the Indian settlements and to the scattered country merchants, payment being made principally in furs - (Innis & Lower, Vol. II, p.231) The North West Company extended its business, until in 1821 an amalgamation took place between it and a number of smaller French companies engaged in the fur trade - (Innis & Lower, Vol.II., p.805).

However the French had no monopoly of the fur trade in Central Canada. The English interests had seen hope of making a good profit from the Canadian fur trade and had formed the Hudson Bay Co. in order to curb the extension of French control and settlement into the Great Lakes region. Gradually this firm extended its posts into the North West and finally controlled the fur trade from Hudson Bay and the Great Lakes to the Pacific.

After 1783 a great many Loyalist settlers entered the Eastern Townships and Upper Canada. With this large increase in the demand for land, speculation in real estate took place and the Canada Land Company was shortly formed - (Innis & Lower, Vol.II.p.9). The Company obtained land from the

Crown at a moderate price and sold it at a profit to prospective settlers - (Ibid.p.30) Early in the nineteenth century the company obtained the Huron Tract from the Crown, and was able to open up Western Ontario soon after 1825- (Ibid.p.88).

The activities of the Canada Land Company met with success, a profit of £28,000 being made in 1833. Many settlers complained of the high prices charged for land, averaging from 7/6 to 13/- per acre. It was computed that the company paid for one block of 1,000,000 acres a sum of £301,367 over a period of 16 years- (Ibid p.p.91-2) The company was able to make a considerable profit on its investment in land, altho certain losses were sustained through inability to sell poor tracts of land. In the long run the company was amply repaid for the risk undertaken in real estate speculation.

As Canadian trade increased in volume and a certain amount of industrial activity arose, the need for banking facilities became apparent. In response to this need the Bank of Montreal was formed in 1817 - (Innis and Lower, Vol.II.p.372) Soon merchants in the Maritimes felt themselves cut off from the markets of Central Canada, and were constantly troubled in exchange matters by the inflow of Mexican Dollars and by the bothersome "Halifax Dollar" exchange rate. So the Bank of Nova Scotia was set up in 1832 and business connections were made with the financial centre of Montreal (Ibid p.430)

These two banks were the first chartered banks in Canada and opened the way for the extension of Canada's commerce and trade, both domestic and foreign.

Turning to the field of transportation we find that the earliest work in connection with the building and maintenance of roads and canals was carried on under government supervision.

The country around Montreal was opened up by the building of toll-roads and the St. Lawrence waterway improved by the making of a number of canals. These were completed in the early 1840's and did a good deal to improve Montreal's position as a sea-port. (Ibid.pp.451-7)

With the increase in commercial activity after 1850 the canals became inadequate and a number of railway lines were built in Central and Western Ontario- the Northern, Canada Southern, Great Western and others. These independent lines did much to divert traffic from the Eastern canals and were, in part, instrumental in arousing American railways to compete for traffic from the Atlantic seaboard to the interior. This injured business for Canadian transportation firms and the Grand Trunk, by extending its lines from Montreal through Toronto to Sarnia, co-operated with the St. Lawrence canals in restoring a good deal of inbound traffic to Canadian lines. By the 1880's its position was strengthened by obtaining direct connections with Chicago, and by amalgamations with the Great Western in 1882 and with the Midland line in 1884. A uniform policy and closer co-operation did much to improve the service and expand the traffic over Canadian lines. The Grand Trunk extended its lines to Montreal harbour in 1871 and, with the construction of elevators and suitable machinery for unloading, storing and re-shipping, freight, movement of wheat to the seaboard was greatly facilitated (Ibid.pp.486-91).

The extension of settlement and trade into the Canadian West was aided materially by construction of the Canadian Pacific to Vancouver. In this way a broad expanse of territory was brought into more direct relationship with the centres of commerce and industry. By 1884 much better service was in operation and Western Canada was linked by rail with the East (Ibid. pp.732-3).

However the development of industry and commerce in Canada was not widespread, as the country was still relatively sparsely settled before 1900.

The needs of industry and the demand for capital have not been pronounced in Canada until late years. This meant the discouragement of the extensive growth of corporations until the latter years of the nineteenth century, when changes in the technique of production necessitated larger corporate development. By far the greatest expansion of the corporation in Canada has taken place since the opening of the twentieth century.

The movement toward concentration, noted in all modern industrial countries is equally true of Canada.[15].

In fact the present trend is for large concerns to carry on an increasingly larger proportion of Canadian business as time goes on. Investigation has shown this to be a true appraisal of the situation. Three factors have been responsible for this growth - viz; new security issues, re-investment of earnings, and consolidations and mergers, of which the first was by far the most important method.

Growth of Large Corporations in
Comparison with General Growth of Business.

100 largest non-financial Canadian companies

(a) As a percentage of assets of all corporations for which Balance Sheets could be obtained.

	% of No. of Firms.	% of Assets.
1923	52	89
1932	28	82

No. of Firms publishing Balance Sheets and total value of assets is a fair indication of growth of corporate business activity. Since the selected group represents a decreasing proportion of the total number, but about the same proportion of total assets, large corporations are growing more rapidly than smaller companies.

(b) As a percentage of total invested capital -

	% of total invested Cap.
1923	25½
1932	35

(c) As a percentage of the National wealth

	% of Nat'l Wealth.	% of Nat'l Wealth (corrected for certain items beyond scope of corporate form)
1925	10	17
1929	13½	22

Our selected group of large companies has thus increased its relative importance.

From Report of Royal Commission on Price Spreads. 1935 pp.21-2

Methods of Control.

Percentage of Voting Stock held in 145 largest non-Financial Can. Corporations.

Management Control	No. of Companies	% of Total No.	Assets of Company (000)	% of Total Assets.
(Under 6%)	26	17.9	2,290,058	42.8
Joint Minority Management Control (6%-19.99%)	41	28.3	987,609	18.5
Minority Control (20%-49.99%)	29	20.0	837,157	15.6
Majority Control (50%-79.99%)	28	19.3	756,909	14.2
Private Control (over 80%)	21	14.5	476,941	8.9
	145	100.	5,348,674	100

Over 66% of the companies were controlled by minorities awning less than 50% of the outstanding capital - of these nearly 3/4 are included in Management or Joint Minority-Management Control (owning less than 20%). Of the firms considered (145) 40 were subsidiary companies falling in either the majority or privately-owned group.

Excluding these we find that 83.8% of the remaining 105 were controlled by groups owning less than 50% of the capital, 63.8% (and 82.4% of their total assets) controlled by groups owning less than 20%.

In 91 of the 145 companies no director owned more than 1% of the voting stock. Of the 101 directors of the other 54 companies (owning more than 1% of the voting stock) 60 held between 1% and 3%, 25 held between 3% and 10%, 7 between 10% and 20%, 5 between 20% and 30% and 4 above 30%.

From-Report of Royal Commission on Price Spreads-1935,pp16-7

<u>Extent of the Holding Company as a Method of Control</u>.

Classification of all Industrial Companies with Gross Assets over $1,000,000.- by form of organization and amount of Gross Assets controlled.

	No.	% of Total No.	Gross Assets Controlled (000)	Total % of Gross Assets
Pure Holding Companies	29	10.5	$698,468	19.5
Mixed-Primarily Holding	14	5.1	582,622	16.2
" Primarily Operating	112	40.5	1,682,463	46.9
Pure Operating Companies	121	43.9	623,310	17.4
	276	100	$3,586,863	100

From-Report of the Royal Commission on Price Spreads, 1935-p.18. (D.H.Munger-Holding Company in Canada.- Kingston, Queens University,1934.)

CHAP.II.

The Professional Promoter and Investment Banker - their development and present importance.

(1) The Promoter -

Promotion and Corporation Finance in England, 1650-1875.

While the English trading companies of the seventeenth century were the most important form of joint-stock company, a number of other joint-stock firms were established. These were mainly confined to mining, water supply and drainage - (Lord, p.16) A few were founded to develop new inventions, and a number to finance monopolies. By 1700 a considerable group of persons had appeared who owned stock in industrial and commercial companies but who were not directly connected with the operation of such companies. These persons obtained their supplies of capital for investment from land, inheritance and profits from commerce (Lord p.18)

The development of joint-stock companies from those formerly employing private capital aided materially in bringing treasure and the capital it represented into the hands of men who could apply it to best advantage - the promoting class - (Lord, p.66) Gradually banking became an important opening for joint-stock capital and the banks came into increasing demand for the services they offered the promoters. Capital was difficult to obtain in large amounts and there were many risks entailed in foreign trade investment. So the promoters took advantage of the facilities offered by the banks for amassing large supplies of capital against which loans could be made for developing enterprises with reasonably bright prospects of success - (Lord, p.67) At first the banks were limited in effectiveness due to limited supplies of capital in the country and losses in speculative undertakings, the latter fact causing people to exercise extreme caution in the investment of their surplus funds - (Lord p.68). In time people became more confident, and supplies of capital gradually increased. By 1750 these capital resources reached a considerable amount and became available for productive enterprise through the facilities of the banking houses. (Lord p.69)

By the end of the eighteenth century industry employing capital was of three types - (Lord, p.190)

1. Those such as corn-mills, forges and potteries, which had grown gradually and had little need for credit organization for their means of expansion.

2. Canals, water-works and mines, which, owing to the long period of waiting for returns, and being specially suited to joint-stock enterprise, were floated as ordinary companies.

3. New inventions, which, requiring capital for their development, and having recourse to the ordinary credit agencies, were financed by capital loaned by the banks, in their own interests or invested for the accounts of clients.

In 1800 the investor was in almost the same position as the present-day shareholder, except that he was more closely in touch with the business in which his capital was invested. The personal welfare of shareholders was taken into consideration, and in some cases shareholders were able to take a hand in operating a company. The separation of ownership and management, even in joint-stock companies, was not yet complete - (Lord, p.191)

During the nineteenth century the further extension of the corporate form of enterprise into industry of all kinds went forward rapidly. Especially in the 1860's after limited liability became general in 1855, a large number of incorporations took place, both in the case of new firms, and in the formation of limited companies from existing private companies. This resulted in a considerable increase in the amount of outside capital invested in these firms. As a result a group of business men, known as financial agents, came to the fore in the field of corporation finance. These agents were assisted by expert valuators who were of great service in estimating the capital needs of incorporating firms, both new and old (Clapham, p.360).

This outburst of incorporations after 1860 was encouraged by the investment of considerable sums of capital in railway and public utility stocks and in the securities of the more reputable governments during the previous decade. Growing confidence among both investors and promoters led to numerous incorporations in succeeding years. (Clapham, p.357)

A number of finance companies, formed to encourage enterprise in various types of business, particularly foreign railway, public utility and real estate schemes, in the 1860's, had only slight success and reputation.

Their place was taken by a few sound Trust Companies whose first principle was security rather than enterprise. Naturally, this second class of promoting company was more successful, but not of great financial importance until after 1886 - (Clapham, p.359).

While the corporation was in its early stages the need for capital was limited[16]. Business was financed from private means or by informal agreement among a few friends. At that time firms engaged in production had no need for promoters or other financial men. The proprietor carried on his own financial arrangements and looked after extensions to his business in addition to his administrative duties. Only after the Industrial Revolution and inception of the Factory System did the capital needs of industry require the services of men outside the managing staff. During this period a group of professional men arose whose activity was confined to the launching of new projects and the obtaining of the necessary capital funds for such enterprises. These men were interested only in setting up a concern - they had nothing to do with the administration of the business once it was well started and operating smoothly.

In addition, we may note two other factors which facilitated the development of a professional class of promoters.[17] The first of these was the accumulation of available capital funds in the hands of those ill-equipped for employing it to the best advantage. The presence of these supplies of idle funds encouraged promoters to seek outlets in the industrial and commercial fields.

A second stimulating force was the existence of vast unexplored fields for the development of industry. These industrial opportunities appealed to men with organizing ability, giving them ample employment for their talents. Besides activity in the organizing of new enterprises the promoting class have found a good deal of work in the reorganizing and consolidation of existing enterprises. Consolidations, mergers and associations of various sorts have formed a considerable portion of the activities of promoters. This phase of their work was particularly notable during the reconstruction and reorganization characteristic of the last years of the nineteenth century.

At first promotion was carried on in a rather haphazard way by lawyers, brokers and sometimes, bankers.[18.] They looked upon this part of their duties merely as an occasional, part-time vocation. Taking note of industrial opportunities promising a reasonable chance for making a profit (both for themselves and for the management) these men would assemble the technical requirements, raise the necessary funds, and start new enterprises on their way, apart from their regular professional duties. Such men were shrewd, enthusiastic and self-confident, and they possessed a reasonable amount of negotiating ability. These qualities characterized the professional full-time promoters of the late nineteenth century, who arose in response to the need for professionalized activity in the field of promotion,[19] They also developed the qualities of foresight and leadership. The work of promotion became complex and widespread, requiring sure and certain methods of action. This meant that men came to apply all their time and talents to this type of work, resulting in the formation of a new profession apart from the operating or administering of an enterprise.

The work of promotion is finished when the business has become a going concern, patterned, as nearly as possible, in conformance to the conception of the enterprise in the promoter's mind when the promotion was first planned. Generally one to two years is the time necessary to bring about realization of plans (Burtchett, p.385).

While the promoter undergoes considerable risk in floating a new company and performs an important service, it seems fair to assume that his reward should in no case exceed the gain to society resulting from his work of promotion. (Burtchett p.385)

The costs of promotion are subject to many influences whose effects are not always easy to estimate in advance. Therefore no definite standard exists as to how much money should be spent in promoting a company. As a general rule the estimated net profits of the going concern for one year should form a limiting figure. There seems to be no justification for spending the prospective income of the company for from three to five years in promotional activity (Burtchett, p.379).

The activities of promoters have contributed to the stimulation of saving, by appealing to many classes of income receivers. They have provided investment prospects of various types in order to interest a greater number of investors. At the same time professionalized promotion has tended to raise a number of legal questions. These have been particularly noticeable in connection with suits and inquiries involving control and responsibility. At times promoters have sought to identify themselves with the management or with the investor in order to gain control of profitable enterprises. We will deal with this question much more fully when we come to discuss the evils attendant upon the floating of new projects.

One of the most important classes of promoters is the one engaged in technical research and expansion.[20] Most of the larger construction and engineering enterprises maintain a staff of promoters as a regular unit in their organization. These men are instructed to be continually on the look-out for new industrial possibilities and for opportunities for various extensions and improvements of existing corporations. These firms seek to obtain copyrights of or options on the latest technical developments, so that their services will be of a type suitable to any technical demands made upon them. Activity in the promotion departments of these firms is especially brisk during periods of prosperity, when large supplies of capital are seeking an outlet. Results of such activity are not always good, as a good deal of overexpansion often takes place. We shall consider this question more fully as we proceed.

(11) The Investment Banker

These men may be described as dealers in long-term capital. Their activity centres around the financing of business concerns, and they are the channel through which capital moves from the investor to the field of industry where it is to be employed.

The earliest form of investment banking was carried on as a means of financing certain public undertakings and of assisting in the promotion of a few commercial ventures - particularly in the shipping trade.[21] During this period banking was not very widespread, being limited to certain of the less risky activities of maritime commerce. It was only during the industrial and commercial expansion of the early years of the nineteenth century that investment banking became an important factor in the field of corporation finance.[22] The investment banker became important as a professional man with the coming into prominence of the promoter, to whose work that of the investment banker was complimentary. Like the promoter, the investment banker did not concern himself with policies of operation and administration; he was mainly interested in the problem of supplying the necessary capital for the financing of the undertaking.

At first investment banking was carried on as a branch of established commercial banking institutions. Gradually bankers who dealt only in securities became important as heads of separate enterprises. Firms such as Baring Bros., J. P. Morgan and Company and Kuhn Loeb and Company came to achieve national prominence and reputation in the financial world. Some few firms gained international distinction, particularly those well-established in London, Paris and New York, the three important financial and commercial centres.

During the early years of the present century life insurance companies and commercial bankers, to some extent, supplemented the financial operations of the investment bankers.[23] As supplies of capital increased and profitable investment became a real problem for the would-be investor, investment banking became more and more important with a greater proportion of investors doing their business through well-known investment houses. On the other hand the promoters of numerous new corporations directed the financing of these enterprises by means of similar large investment houses and syndicates. Encouraged by the post-war speculation and expansion programs of investors and promoters alike, the activities of investment bankers increased greatly. Old established houses abandoned conservative methods of action and adapted their business practices to meet the changing tempo of financial activity. As a result the investment field was characterized by keen competition among the various firms. Even so, the older houses, by means of their interests in many leading enterprises,[24] both as holders of securities and as directors, were enabled to hold their own against the inroads of new firms. These institutions of long standing continued to exercise a large measure of control in the investment field. At the same time a good deal of new business was absorbed by the more active firms, sometimes leading to arrangements and concessions of an injurious nature.

The most prominent investment houses are able to determine, quite largely, the distribution of new capital among various industries. This means that large houses often contract for large commitments in their financial operations. In order to protect their own interests as well as those of their clients, bankers often seek to gain a measure of control over new corporations[25]. While a certain amount of watchfulness is necessary for matters of caution, the desire for banker control may be carried too far. This factor of banker control affects both the management and the investing public. It involves important considerations which we shall endeavour to clarify in the main body of our discussion.

CHAP III.

(a) The Stock Exchange - Its Growth and Importance.

The operations of the Stock Exchange involve dealing by members in admitted securities in accordance with certain established rules and regulations. These have been set up from time to time and the mechanism of the exchange has adapted itself to changing demands in the field of finance.

The main purpose of the stock exchange - that of the bringing together in one place of buyers and sellers - was a primary reason for its inception. When trading in the shares of various concerns first attained some volume and importance, buyers and sellers had difficulty in getting in touch with each other. So they formed the habit of meeting at certain times in specified places to transact business[26]. In England we hear of the coffee shops and other places of refreshment as being the first sort of locations agreed upon.

However, such trading methods could handle only a limited volume of business. As the volume of exchange business grew and the number of security holders and investors increased, improved methods of trading had to be instituted. So laws for the conduct of business and various codes of practice were formed. This was followed by the formal organization of stock exchanges and the establishment of definite trading-places. As business further expanded exchanges came to occupy separate buildings and to gain prominence as a necessary part of the financial machinery of a modern state.

Today the stock exchange is one of the most important financial institutions in every modern capitalistic society.[27] Besides facilitating the buying and selling of securities it possesses two other important functions.[28] In the first place it serves as a means of appraising the value of a given security. Active trading in stocks (apart from price manipulation) places a certain market value on them, from which the approximate value of allied issues may be deduced. Secondly, the stock exchange is an instrument for converting invested capital into cash. This giving to stocks the quality of liquidity brings into the capital market volumes of savings which would remain dormant without the added appeal of ready conversion into cash. Besides increasing the volume of securities absorbed by investment, marketability and ready conversion enable capital to move at lower rates of interest. The mechanism for carrying on this service is extensive, requiring brokers, stock jobbers and a central staff, as well as fully-equipped branch officers in all important industrial, commercial and financial centres.

The listing of stocks on the exchange naturally enhances their collateral value as well as their marketability. This makes for wide distribution of stock ownership and the widespread use of stock certificates as collateral for bank loans. Listing requirements [29] are such that admitted stocks have high value as collateral. In addition commercial bankers are enabled to reimburse themselves for losses on unpaid loans by sale of collateral securities at the market price on the exchange.

The stock exchange has been important in facilitating the movement of capital from countries having large stores of idle funds to countries in need of capital. The volume of foreign securities dealt in on the exchange is considerable and of increasing importance.[30]

In this same connection the stock exchange has been a valuable instrument in supplying the capital needed for exploiting the natural resources of undeveloped regions. It has also served in the building of railways, in the financing of public utilities and in the development of the industrial and commercial possibilities of various countries. Thus we can easily understand, the importance to modern finance of the stock exchange. However, it possesses speculative features and means for price manipulation, which detract from its worth. Our discussion will include a study of these less admirable features.

PART II. The Need for Control

In our study of the less desirable features of corporate organization we shall consider the subject under three separate headings. These will include (1) Existing Corporate Devices of an undesirable nature, found in corporations already formed and operating. (2) Abuses, dangers and weaknesses found in the expansion of corporations - These comprise both corporate and managerial shortcomings detrimental to the welfare of the shareholders, both actual and prospective.
(3) Practices in connection with the formation of new companies, especially in the issue of prospectuses and new securities, which lead the investor to subscribe without possessing complete or accurate knowledge of the true nature of securities, he is purchasing. These practices are based on the superior bargaining position of those handling the sale of the securities.

Having discussed these various factors we shall conclude our consideration of the need for controlling security issues by summing up the position of the investor and comparing his situation and bargaining position to that of the investment banker and of the director or manager of the company.

We turn now to a consideration of existing corporate devices.

CHAP. IV. Existing Corporate Devices

1. Undue Complication of Types of Securities.

We are aware that the capital structure of a firm does not consist of but one type of security. Financial practice recognizes two main classifications - stocks and bonds, the first denoting ownership, the second, debt owing to the holder. Furthermore, these two fundamental types of security may be subdivided to some extent, according to the nature of the firm's business, the characteristics of the management and administration and the conditions surrounding the money market at any one time. For example, it may be unwise to allow any dilution of the controlling interest of a competent administrative group, particularly if it be known that other interests are seeking to gain a share in such control for their own purposes. Thus, as a defensive measure, it would be best to issue a second class of common stock which did not carry with it the right to control. Besides, a firm might be temporarily in need of funds, thus making dilution of the interest of its stockholders unnecessary. An issue of short-term bonds would be in order - a junior issue being the best, in order to protect existing bondholders. Again, if interest rates were unduly high, prohibiting bond issues, an issue of preferred stock, perhaps callable, might raise the necessary funds, without increasing fixed charges or endangering administration, and, at the same time appealing to investing public.

We can thus point to three necessary types of security designed to appeal to various classes of investors.[1] In the first place the cautious investor will choose bonds as being the least risky venture, while providing a moderate income. Then the average buyer, desiring a larger and fairly steady, income, and willing to assume a certain amount of risk, will be attracted by an issue of preferred stock. Thirdly, the speculative purchaser, willing to bear greater risk with the possibility of reaping a gain in the long run, will buy a common stock possessing reasonable prospects. These three types may be further divided without unduly complicating the situation, as junior and senior bonds, first and second preferred stock. Such division is still simple enough to enable the average investor to realize his position as a shareholder or bondholder, in relation to other classes of investors in the firm.

However, there is a limit to the subdivision of securities into various types. Undue complication leads to uncertainty on the part of the shareholder as to his position.[2] Difficulties in determining the claims, legal rights and responsibilities of various classes of security holders often arise. New classifications are made, with certain features, intended to attract investors. The elements of risk and income are mingled in varying proportions, according to the present capital structure and the existing feeling among prospective investors. A feeling of caution would mean that prospects of income would have to be raised in proportion to risk.

Usually these subsidiary types are offered to attract capital and at the same time avoid any impairing of the control exercised through ownership of common stock. While large amounts of capital are often obtained at the time, complexity of nomenclature does much to confuse the investor. It also acts as a deterrent to the cautious buyer. The purchaser of such securities is thus placed in an inferior position due to his lack of knowledge.

The conditions under which undue complication most often occurs are those surrounding the reorganization and consolidation of obsolete or unstable companies, when new issues replace existing ones.[3] In such cases certain rights, benefits or options are often attached to the new issues as a means of cloaking weaknesses and shortcomings. The formation of holding companies is often accompanied by great complexity of financial machinery in the tying-in of the various subsidiary plants with the central firm. This complication of issues constitutes a not inconsiderable hazard to the welfare of the would-be investor.

To illustrate complicated capital structures, we refer to two companies - The Dominion Steel and Coal Corporation, Limited, and the International Paper and Power Company.

In April,1930 the Dominion Steel and Coal Corporation purchased the British Empire Steel Corporation, Limited and its constituent companies. These included -

Dominion Coal Company Limited.

Dominion Iron and Steel Company Limited,

Dominion Steel Corporation, Limited.

Nova Scotia Steel and Coal Company, Limited

Eastern Car company Limited

Acadia Coal Company, Limited.

The capital structure of the Dominion Steel and Coal Corporation consists of Common Stock, First Preference Shares, Series B, (Series A, authorized but unissued,) and Second Preference Shares, to a net amount in the hands of the public, of $79,296,075.00.

Prior claims against the various properties, in the form of bonds, debentures, mortgages and so forth amount to some $30,000,000.00. (From Annual Financial Review, July,1930, pp.478-98

The International Paper and Power Company is a consolidation of some 18-20 pulp and paper mills and power companies in Eastern Canada and New England, with total assets amounting in December 1929 to $767,198,302.83.

The capital structure of the holding company consist of no par value, Common Stock, Classes A,B & C, First Preferred Shares and Second Preferred Shares, with a book value in December 1929 of $92,680,900.00.

The subsidiary companies have a total funded debt of $315,651,980.43.

From Annual Financial Review, July 1930-pp679-86.

Securities issued to the public by these corporation are based on the value of the various properties of the constituent companies. The complexity of the situation centres around the question of the position held by these securities, considering the prior claims mentioned above. In case of dissolution these debts would have to be redeemed before the securities of the central company could share in the proceeds. Some difficulty would be experienced by the prospective investor in determining the equity remaining in the property as a basis for calculating the true value of any securities of the parent company he might purchase.

2. Non-Voting Stock.

While this feature was condoned, in the foregoing paragraphs, as a defensive measure against the inroads of investing groups concerned with control alone, yet its practice is not always so worthy. In the issue of common stock it is often carried to excess[4]. The public is offered an issue of common stock, called, often Class A, for better effect. Apparently it has all the desirable features of ownership, yet the purchaser finds he is the owner of stock having all the risks of Class B stock, yet without voting rights. All emphasis was placed on other features and the subject of voting rights omitted. In addition, many investors take no notice of the non-voting feature, being content to trust those in control. Yet this very unwariness weakens the position of the public minded investor who sees in the non-voting clause a handicap for the buyer. Non voting stock has its place, of course, and many controlling groups do act in the interests of the stockholding body as a whole. Yet the issuing of non-voting stock gives unscrupulous directorates and controlling groups a very potent weapon, especially when directed toward the question of declaration of dividends[5].

The issuing of non-voting stock is particularly prominent in the field of corporate mergers and consolidations. The voting rights in the controlling company are limited to a small issue of common stock, of which a majority is easily controllable by the interested group. Stock made available to the public frequently does not carry this privilege with it.

It may be argued that the individual buyer loses nothing since his few votes would have no influence in the annual meeting of a large firm. Individually, the voting right would have little effect, it is true, but collectively, it would be a force for protecting the interests of the small shareholders as a class. Those who absent themselves from the meetings, or who send in their proxies as a matter of course, are aware of their helplessness. But if the voting right were more widespread a greater class of non-privileged holders, would by joint action, stem the advance of those in control. Only in this way could the investor find protection from the group in control. His position is not hopeless, it is merely confined.

An example of the effects of non-voting stock is found in the capital structure of Honey Dew Company Limited. Non-voting preferred stock is held by the public to an amount of $1,500,000. The total amount of common shares carrying voting privileges is $108,500 of which a majority of shares, amounting to some $55,000, would give the holders control of the entire corporation.

From- Report of the Royal Commission on Price Spreads, 1935-p.20.

An especially vivid example of non-voting stock is seen in the formation of Burns and Company, Limited. In a capital structure amounting in total to some $14,000,000 complete voting rights and control of the corporation rest in 3 management preferred shares of no-par-value. The common shares (99,997) have no voting privileges attached.

From-Evidence before the Special Committee on Price Spreads p.2394

During the years 1926-30 some $220,000,000 of preferred Class A and common shares were sold to the public by Canadian houses. Of these only some 16% carried unrestricted voting rights.

From-Report of the Royal Commission on Price Spreads, 1935-p.20.

3. <u>No Par Securities-</u>

The question of no-par stock is by no means a clear-cut issue. Much can be said on both sides. As an instrument providing a degree of flexibility in the capital structure, it has power for good. Also it permits of more definite statement of the real nature of a share of stock - a certain fraction of the net worth of the concern, not a certificate having a so-called absolute value, say- $100.00. Thus far there is little cause for complaint. But there are also evil aspects[6]. The very flexibility of the no-par security involves the placing on it of an arbitrary value. Some price must be put on a security, coming on the market for the first time. Thus the assets of a newly-formed firm may be overvalued by a too zealous management and the initial purchaser give value greater than he receives. On the other hand preliminary estimates may be too conservative and persons purchasing early may have an advantage over those who buy when the assets of the firm come under closer scrutiny and the price of the security advances accordingly. Thus, in one sense, the characteristic of flexibility becomes a blessing for some and a bane for others. It may allow inequalities between the positions of various groups of shareholders.

The investor and creditor may suffer alike from the effects of no-par stock on the condition of the firm. Since the stock is without par, it needs only nominal security. Thus controlling groups are given the privilege of transferring large amounts of capital to Surplus Account.[8] Here the capital is made available for dividend purposes; favored investors alone benefit, and the rest of the stockholders, and the creditors, are left unprotected. Those particularly endangered are the bondholders and the holders of preferred stock. Having no voting power, their position depends on the actions of thos controlling a majority of the voting stock.

Thus we can see that no-par securities involve a number of issues. Should we sacrifice flexibility and clarity of terms in order to avoid false valuations of assets and insecurity for the investor and creditor? Probably each case should be considered in the light of local factors. No doubt an improvement in standards of accounting and appraising, which we shall consider presently, would be a step in the right direction.

4. Activities of Directors -

The director in a firm should possess three qualities - sound business judgment, a sense of responsibility toward the stockholders as owners of the firm, and a reasonable amount of watchfulness and care in the carrying out of his duties.[9] As a director, he does not require special technical or administrative skill, as does the manager or superintendent, but he is expected to exercise a degree of business sagacity in meeting problems. The directors are the ones who map out the general course of business procedure, leaving matters of detail to various officials. Thus a director's position calls for a careful analysis and understanding of all factors influencing the firm's position as well as the ability to use them as guiding principles in the carrying on of the company's work. Of course he is not expected to notice every single relevant factor, only to exercise reasonable care in watching out for the interests of the firm.

Not all directors take these duties seriously. In fact we see a growing spirit of irresponsibility among them.[10] Many directors place their own interests ahead of those of the company, seeming to disregard the nature of their stewardship as shareholders' representatives. This spirit among directors has ~~been~~ subjected ~~to this~~ private ~~influence~~ industry to a lesser extent than public utilities. Let us consider a number of forms which these directors' actions take.

In the first place a number of men consider the position of director in a firm merely as an honorary one. They seek to enjoy the honor while shirking the duty. Through duty elsewhere or lack of interest in the welfare of the company in question they contribute little or nothing in the matter of direction. Along with this class we might include directors whose prominence in the business world is a means of advancing their influence. Their names on a board of directors seem to lend distinction which satisfies the other directors, and nothing more is required of them. This situation may be a means of creating false impressions in the minds of stockholders, actual or prospective, who are content to leave the matter of direction, as they think, in the hands of such capable and well-thought-of business men.

We come now to the question of diversity of interests. Especially in large corporations the directors will have other business interests.[11] These may clash with the interests of the company they are directing. Those outside interests may be of a personal nature or they may concern other companies, possibly competitors. Thus the actions of directors will be affected accordingly. Sometimes directors allow adverse interests to influence them too much and they act to the firm's detriment, either opposing constructive proposals or encouraging actions favorable to these outside interests but not for the best good of the company.

We might say a word here concerning dummy direction. This condition exists when a small group of directors, possibly a minority of the board, are sufficiently powerful to control the actions of the remaining directors so that their plans may be carried out. These inactive members of the board are just so much "dead wood" in the administration of the firms business. Sometimes they are employed as a means of giving apparent majority of consent to particular plans fostered by active directors. Here there is the danger of a form of dictatorship on the part of a few active members of the board of directors, with possible ill-effects on the welfare of the stockholders.[12] This is one possible result of the division of ownership and direction - a case where stockholders have little chance of scrutinizing the acts of directors.

While it is true that many cases of lack of responsibility on the part of directors have been brought to the courts, this procedure has not been effective in reducing the evil. The reason for this is that the courts have not developed a body of decisive principles to serve as a standard in determining the guilt or innocence of directors.[13] As a result a number of men, obviously guilty of neglect of duty, have been freed, due to the absence of any consistent body of legal principles. Also, the practice has been encouraged, for directors consider they have a good chance in the courts so long as their acts do not lead them into clearly fraudulent commitments. We can see that this lack of strict legal standards in the courts has made their efforts toward curbing breach of duty by directors largely ineffective.

Another factor encouraging laxity on the part of directors is the interpretation of majority rule. By many this term has been construed too loosely. They have considered a bare majority of the votes of the shareholders - embodying considerable numbers of proxy votes, to be synonymous with the will of the stockholding body as a whole. Wishes of minority groups have often been disregarded, and a spirit of high-handedness has in many cases characterized the actions of those in control at the time.[14] Consequently, directors, supported by such unreal majorities, have been encouraged to carry out policies not of necessity in accordance with the general wishes, of the whole body of stockholders. At the same time, arbitrary and often dictatorial, actions on the part of officials, protected by so-called majority rule, have been a means of arousing a spirit of independence and detachment among directors. With this in mind they have sought to carry out certain policies on their own responsibility, without considering the possible effects of such actions on the stockholders.

Thus, while many cases of faulty stewardship may be placed on the directors themselves, we can see that the whole responsibility should not rest with them. As we have seen, they are open to the influences of (1) inefficient legal action; (2) the conditions resulting from division of ownership and administration, and (3) the acts of other corporate officers under protection of majority rule. In order to solve the problem of breach of duty by directors it is clear that we must look to these other factors before our plans of reform will become effective. It is apparent that directors encounter both personal and corporate pitfalls which lead to a sense of irresponsibility and independence.

Let us examine one or two well-known Canadian cases involving faulty directorship. In these cases there was no question of dishonesty, but rather one of well-meaning directors being convinced of the integrity and good intentions of those in charge of the board meetings, with the result that the men charged were victims of misleading information.

The Case of Rex vs. Clarence F. Smith. -

As a director of the Home Bank, Smith was charged with:-

1. Making a wilfully false or deceptive statement,
2. Unlawfully using a false or deceptive statement,
3. Negligently signing, approving, or concurring in an account containing false or deceptive statements,

in connection with the preparation of the directors' yearly statement of the financial condition of the Bank, and its filing with the Minister of Finance.

Smith was acquitted on the first two counts. It was shown that he had no actual knowledge that the statements in question were false or deceptive; and such knowledge was not to be attributed to a director who did not possess it. Furthermore, Smith was not made responsible for what took place at meetings of the Board which he did not attend.

The evidence established the absence of any dishonesty on the part of the defendant in his dealings with the Bank; he had no knowledge that would enable him to detect any error, and had confidence in the officers of the Bank who represented to him and others present at the annual meeting of shareholders the correctness of the returns and other documents. In view of this the conviction on the third count was quashed.
(From-Ontario Law Reports-Vol.57,1925-pp.383-4)

The case of Rex. vs. Gough

Gough, as a director and Vice-President of the Home Bank was tried and convicted on six charges in connection with the preparation of statements for December,1922 and for the year 1922, involving:-

1. False and deceptive returns, both the monthly one and the annual one.
2. Unlawful use of each of them with intent to deceive or mislead the Minister.
3. Negligent preparation, signing, approving, or concurring in each of them.

On appeal it was found that there was nothing in the evidence to justify any charge against Gough of dishonorable or improper conduct. He seemed to have believed in the integrity and capacity of the President and General Manager, and to have relied on the information (later proved to be untrue) given to him by them, as to the Bank's position, and was thus misled. He had no reason to doubt the truthfulness of the President and the General Manager, and therefore although misled by them, he was guilty of no negligence. Gough's appeal was allowed.
(From-Ontario Law Reports, Vol.57,1925-pp.426-7,445)

5. Loss of Pre-emptive Rights.

A traditional right of the stockholder is that of having the first opportunity to buy new securities before they are offered to the public. All the benefits of prosperous concerns and the purchasing of new issues at advantageous prices should accrue to him. The object of this pre-emptive right is the provision of new capital without disturbing the existing ratios of investment interest and control.[15] It is intended that this new capital shall be provided at advantageous prices by the primary investors. This is regarded as one way of protecting the stockholder against incoming groups of investors and also against adverse price movements of the securities when once placed on the open market- a means of improving the stockholder's position.

Since the War the practice has grown up of disposing of new stock in whole or in part without any previous offer to the existing stockholders. The argument for this procedure is a purely practical one, put forward by promoting, banking and management interests, backed by legal opinion.[16] It is urged that corporations must have assurance that the funds necessary for the task in hand - say, further construction and development - will be forthcoming. As a rule shareholding bodies move slowly and are not always positively dependable, even in the long run. Their feelings are affected by the general business outlook, by subscription prices and rates of return of new issues, and by relative attractiveness of other issues. As a result work is often held up while the Stockholders make up their minds, and usually a portion, large or small, of the issue has to be assumed by the underwriters. This is done unwillingly as the amount cannot well be determined beforehand, also an indefinite period may elapse before certain knowledge is forthcoming.

Market conditions may change in the meantime, involving the clement of risk. In cases of complex construction projects cash must be forthcoming as direct transfer of shares in payment cannot well be arranged.

Sometimes the shareholders take up the new issue at once. Often the process is slow, cumbersome and expensive. As a result pre-emptive rights are granted only for a limited time, after which general sale to the public takes place. Admitting the impossibility of distributing new issues of the larger concerns among a large group of widely separated shareholders, yet there is not adequate consideration given the shareholders for this removal of one of their traditional rights. The position of the shareholders is weakened by the evolution of the large, complex corporation. Complicated financial structures and relations between corporations often lead to the entrance of stockholding groups whose interests may clash violently with the primary group. New issues are often marketed for reasons apart from financial necessity - as a means toward favorable legislation or as a consideration for trading concessions or increased clientele. Why should the interests of the stockholders be overlooked to this end? It may be argued that the primary stockholder benefits from the improved trading position of the firm, but it is idle to believe this is a primary consideration in such activity.

The stockholders whose interest is jeopardized in the above manner may suffer in two ways. In the first place their voting power is liable to dilution, and secondly their equity in earnings is adversely affected. The vote of the primary stockholder is not so important or forceful as formerly and participation in earnings nets him a reduced sum. It might be suggested that he maintain his position by entering the open market and purchasing enough shares to secure himself. But the price may be excessive and his consideration therefore inadequate. While it is not so dangerous to the welfare of the existing shareholder to issue new shares of a type similar to his present holdings, in many cases new issues are given special priorities, rights or exemptions, all of which tend to weaken the shareholder's position in relation to the incoming group. Actions involving loss of pre-emptive rights should be more closely circumscribed.

CHAP. V. Abuses in Connection with the Expansion of Corporations.

1. Refinancing & Reorganization.-

This type of financial procedure is one of the important methods of developing and enlarging corporations.[17] Refinancing and reorganization schemes are found in every branch of industry and commerce, and the results of such operations are important enough to warrant consideration in our study. While in many cases such expansion has been clearly justified, a number of firms have been guilty of overexpansion - mostly due to a too high estimation of prospects. Seeing prospects ahead for increased profits, an eager management will seek to develop its business in order to take advantage of the new situation.

Often the realization of profits, or increased sales, is not so great as expected, and waste of mechanical and technical, as well as of financial, resources takes place.

In order to raise the necessary capital for an expansion project, a financial plan is established, outlining the methods to be adopted for this purpose. New issues of bonds, preferred stock or common stock (according to the nature of the refinancing plan) are advertised through the press and the mail, and through the agency of brokers and salesmen. Their sale to the public is usually carried out by means of an underwriting syndicate. Sometimes this sale necessitates exchange or conversion of present holdings for new securities with special privileges, rights or options attached.[18] This is the case when the refinancing is a means of obtaining capital at lower rates or of exchanging common or preferred stock for certificates of indebtedness. This process usually requires the attaching of special privileges as a further inducement for holders of bonds or debentures to co-operate. Sale of new securities as a means of obtaining additional supplies of capital are offered to the public without regard for their present holdings. Here we have another case of the minority security-holder. He has no part in the refinancing scheme and is obliged to exchange his holdings for new ones (often inferior in quality) or stand by and see his share in the ownership or his evidence of claim on the assets of the firm involved in a complexity of new interests and claims. Besides he may see his security undermined by too large an expansion, and be faced with reduced income and equity.[19]

Sometimes refinancing and reorganization comes at a time when the capital market does not favor an issue of stock. If need for capital is urgent bonds will have to be sold. This increase in the propoXtion of bonds and debentures to stock will mean heavier fixed charges. This contingency is a drain on the firm's income and will form a source of weakness if the firm is faced in the future with difficulties: falling off of demand, severe competiton or substitution of product.

If an issue of stock can be floated, a weakening of the majority in control may result, unless the amount of voting stock is well guarded. Otherwise the new project may be curtailed, if competitor interests are involved, or other changes inaugurated, to the firm's detriment - capital waste, or reduced efficiency. While the majority now in control may not be working entirely in the interests of the stockholders as a whole, it is doubtful if incoming groups would help matters any.[20] More likely their efforts would be more injurious to the best interests of the firm.

While existing shareholders may have their interests endangered by increases in fixed charges, or by changes in control or dilution of ownership interest, their position is exposed in another direction. Refinancing may include the purchase of assets (land, buildings, materials, etc.) whose value has been written up by the owners in anticipation of a sale.[21] The usefulness of such assets, as well as their value, may be exaggerated. The firm may find them of inferior quality, location, or serviceability. This loss in the efficiency of exploitation means a decrease in earnings in proportion to investment. As a result the stockholder stands to suffer in two ways. First, the return on his investment is reduced, due to reduced earnings and second, his equity in the business is reduced due to the overvaluation of the assets purchased. An expanding firm is apt to overlook shortcomings in appraisals and estimates, which a steady-running company would investigate closely. The purchase of overvalued assets represents an ever-present source of danger for the stock-holder in a firm which is being refinanced or reorganized. Besides, excess prices and unfair credit terms may be enforced by powerful creditor firms assured of the company's trade, at a time when it is particularly vulnerable to pressure from strong creditors and competitors.[22].

Thus refinancing presents a number of possible dangers for the stockholder - increased fixed charges, reduced earnings, dilution and reduction of control and ownership interest, waste of capital and technical resources, inferior bargaining power.

To illustrate the writing-up of the value of assets in a refinancing scheme let us look at the formation of Burns and Company Limited, which took over the business of P. Burns and Company.

A comparison of the capital structures is enlightening -

	First Mortgage Bonds	Preferred Stock	Total
Old Company -	$3,078,000	$3,943,000	$7,021,000
New Company -	7,000,000	6,900,000	13,900,000
Percentage Increase	127%	74%	Nearly 100%

From-Debates, House of Commons, May 29/34, p.3457

Similarly this increase in capitalization is reflected in higher fixed charges.

	Securities		Interest Per Annum
Old Company	First Mortgage 6½% Bonds	$3,078,500	$200,102.50
	7% Cumulative Preferred Shares	$3,906,200	273,434.00
		$6,984,700	$473,536.50
New Company	First Mortgage 5½% Bonds	$7,000,000	$385,000.00
	6% Cumulative Preferred Shares	$6,900,000	$414,000.00
		$13,900,000	$799,000.00
Increase		$ 6,915,300	$325,463.50

Also, the increased value placed on the fixed assets in the new company would involve an increase in the annual provision for depreciation, and consequently a further increase in fixed charges. However, the new company used lower rates of depreciation, thus preventing the appearance of an increase in fixed charges and placing a false valuation on earnings.

From-Evidence before Special Committee on Price Spreads, p.2394.

As a result of the reorganization, the original bondholders lost considerable in amount of income received and had to accept less desirable securities in part. They received a certain amount of compensation by becoming the holders of new preferred shares with some priority as to dividends. Former preferred shareholders became the holders of common stock, losing their position as prior claimants. Holders of common stock had their shares reduced on the basis of 20 to 1.

While the public, as security holders, bore the loss resulting from the writing up of asset values, the original owner sold out at a good price and the underwriters also made a good profit.

From - Report of the Royal Commission Price Spreads,1935,p.360

2. Mergers and Combines.

The above dangers are also often present when the firm is involved in some sort of a merger or combine. Usually this procedure is undertaken as a means of achieving internal economies or of crushing trade competiton, with its effects on sales and profits. It is usually carried out in anticipation of a larger market and of considerable reduction in costs.

The process of financing commercial or industrial mergers and combines is complex - with its centralizing of control, conversion (or substitution) and guaranteeing of the capital liabilities of subsidiary firms, reorganization of the technical and capital assets of the various units and other intricacies of large-scale financial procedure.[23]

Centralization of financial control constitutes the process of "pyramiding", by which a small issue of voting common stock in the central company is the means of controlling many times its amount in the assets of the various subsidiary firms. Here is the chief source of danger for the shareholder in the small subsidiary. When he exchanges his securities for stock in the "holding company" he loses all personal contact with the directing of his firm. The nature of the stock received in exchange varies according to the strength of the subsidiary company. A weak unit will force its stockholders to accept common stock in the "holding company" - a strong unit will probably enable its stockholders to obtain preferred stock in the new company. In any case the voting stock (small in amount) will be closely held.

In connection with the inferior bargaining position of small firms involved in a merger or combine, we refer to the purchase of the Anticosti corporation by the Canada Power and

Holders of 6½% Anticosti bonds given new 5½% bonds,
and Paper Company, thereby sustaining a considerable loss in income.

Holders of 7% preferred shares in the Anticosti Company were given 1½ shares of new common stock for each preferred share held. These shareholders, in addition to losing a large part of their income, were forced to accept junior securities, losing their position of priority.

From Debates, House of Commons, Apr.21/32,p.2252

Issues of bonds and debentures are avoided as far as possible, in order to keep down fixed charges, and preclude the danger of foreclosure in case the merger is unsuccessful.

By its very size, the newly-formed merger or combine is expected to control the market. However, the threat of monopoly may result in concerted action on the part of competitors, and the merger may fail to achieve its purpose. Or the size of the market may be overestimated, as in the case of a reorganized firm (see above). Here again is danger of failure. Any firm can dispose of only what the market will bear, and a newly-formed merger, while able to suspend dividend payments, thus strengthening its reserves, cannot always hold up production of goods without endangering its financial position.

The merger or combine, therefore, faces three dangers, all of them a reflection of overexpansion. These include the writing up of the assets of subsidiaries, united action by competitors, and an overestimation of the market prospects. Through quick action and influence among small firms a merger may be able to stifle competition,[24] but in its early stages there is always the possibility of a quick and devastating union among strong competitors. Often this union includes creditors of the projected merger, and new difficulties are encountered in the way of poor credit terms and high prices for raw material. However, this danger is not so important as over-capitalization and fallacious estimates of the market.

Again the shareholder is the final resting-place of the ill-effects of these shortcomings and contingencies. He loses all vestige of control in the centralization of control, faces possible (often probable) reduction in income through non-payment of dividends, and his share in ownership is endangered. This last may occur in one (or both) of two ways, first, through overvaluation of the assets of the combine, and secondly, through the comparative weakness of his particular firm, by which a share of its stock may exchange for only a fraction of a share in the new company. Altho the stockholders of a certain firm may decide to remain outside the merger, their position is not a happy one, since their firm will be in danger of elimination from the field by reason of the power of the newly-formed merger. In any case the small shareholder's position is one of weakness in the face of strength.

The case of the Robert Simpson Company illustrates the formation of two holding companies, one in 1925, the other in 1929, accompanied by over-capitalization and the writing-up of assets to an amount not by any means justified by increases in earnings. The assets acquired were written up in order to cover the nominal value of the securities issued.

From Report of the Royal Commission on Price Spreads, 1935, p.351.

In 1925 Simpson's Limited purchased shares in the operating company at $150 per share to an amount of $5,025,000. Capital was supplied out of the proceeds of a bond issue to the amount of $5,600,000, secured by a specific first charge on the common shares of the operating company acquired by the holding company. The holding company could only pay bond interest out of dividends received on the common shares of the operating company.

In 1929 a further expansion program took place by which a new holding company acquired the common shares of the operating company held by the old holding company, and redeemed the bonds and preferred shares of the old holding company out of proceeds from a new and larger issue of bonds.

The net increase in capitalization between 1925 and 1929 amounted to some $8,375,000, represented by appreciation of the value of fixed assets in 1925 and 1929, less (1) commissions and expenses written off and (2) the difference-the value of the shares of the operating company in the books of Simpson's Ltd. (1925) and the net tangible value of assets before appreciation. (From Evidence before Special Committee on Price Spreads, p.2768)

The formation of these two holding companies has erected a pyramid of securities based entirely on the common shares of the operating company. Simpson's Limited (1929) to avoid loss of revenue through non-payment of dividends, by purchasing the assets of the operating company, received a further revenue in the form of an annual rental. This meant that the holding company received a revenue whether or not the operating company earned a profit while the operating company has declared no dividend since 1931, the net rental in the year 1933, amounted to $1,133,779.

As a result the holders of bonds and preferred stock in the operating company have had their security lessened through this prior claim on earnings.

(From Report of the Royal Commission on Price Spreads 1935, pp.36-7

3. Administrative and Accounting Practices.

The officers of a firm, as representatives of the owners, are expected to act in the best interests of their principals. This responsibility is not always placed in capable hands. While a company official may possess a certain amount of technical skill, his shrewdness and foresight in dealing with persons or firms, may not be of a high quality[25]. This may lead the firm to purchase goods and services at disadvantageous prices or to enter contracts in which the firms position is unfavorable Shortcomings on the part of officers may not be checked in time to prevent a considerable amount of damage being done the company. Too often men in responsible positions fail to see the long-run effects of their acts - they involve their firm in contracts with only immediate prospects in mind, failing to visualize more distant consequences.[26] For example a contract may be made to purchase goods at a price which, on the face of things, appears to be reasonable. At the same time apparent changes are taking place in the production of those particular goods which will shortly lower prices. The purchaser, unaware of this forthcoming reduction in costs enters a long-term contract at present prices. This short-run view is a source of danger in the realm of efficiency, particularly when the acts of particular persons involve the firm in important financial commitments. This may be further illustrated by reference to purchase of assets by means of a refinancing or reorganizing scheme (see above) in which these assets are given an enhanced valuation, to the detriment of the purchasing firm.

The nature of the capital structure of a firm determines its progress. Often incompetence in the primary financial setup will cripple a company's earning power. One of these failings is distortion - too great a proportion of bonds or debentures to stock, leading to heavy fixed charges[27]. This is often the result of too great optimism, a belief that the company's prospects are so good that it will be able to take care of a large amount of fixed indebtedness and its accompanying charges. Also the desire to limit the number of ownership shares, in the hope that the value of these shares will rise shortly after commencement of operations, places emphasis on fixed liabilities as the most important part of the capital structure.

Rigidity in the capital structure is also a source of weakness. Incomplete estimates made for construction, development, or expansion by persons not fully conversant with all relevant factors may result in only partial completion of necessary work, due to lack of funds. This puts the firm at a disadvantage from the first - its efficiency is greatly impaired. Again rigidity may be of ill effect in the accumulation of capital at high rates (for work that must be carried out immediately) or of capital in excess, not at once useful in carrying on the company's business. These effects take place through untimeliness of action and too liberal estimates of the capital needs of the company. In these ways rigidity of capital structure tend to intensify the effects of inefficient promotion and financing. At the same time distortions in the capital structure result in a weakening of the firm's position. This is most noticeable where keen competiton is in force, and the added burden of heavy fixed charges do much to jeopardize a firms chances of success.

The publication of annual (sometimes quarterly) statements has been enforced for some time. But the publication of an income and expenditure account, except in the case of companies having a Dominion charter, is still to be considered.[28] A financial statement does not, of itself, give sufficient information to the stockholder. It says nothing about the nature or the effectiveness of business procedure during the past period, giving only the position of the company at a given time. One purpose to be served by general publication of an income and expenditure statement would be that of giving the shareholders the means better to judge the action of directors in withholding or declaring dividends. Together, the financial statement and the statement of income and expenditure give a compete picture of the firm's activities and present position, as well as a means of predicting future prospects. As owners, the stockholders are entitled to receive all information available concerning the positions and prospects of the company.

Existing accounting and auditing systems are out of reach of the stockholders. Those administering the company's affairs direct the activities of accountants and auditors. In such cases, where companies employ auditors of their own, an indepemdent audit is impossible. Opportunities for mis-statements and deceptions are frequent, and often a minimum of information is allowed to enter the Balance Sheet.

One of the most widespread shortcomings of accounting methods is the transfer of funds from Capital Account to Surplus Account, making available for distribution funds which are not earnings at all, and giving an enhanced value to the capital stock.[29] In this way capital is being used improperly, and a false sense of security imposed on the stockholders. In this connection a second dubious accounting practice is that of placing enhanced valuations on various classes of assets. This is a means of keeping the minds of stockholders at ease, in order that programs involving expenditure may be carried out without arousing opposition from the stockholders, since they believe the firm to be in a strong position.[30] When the firm is confronted with difficulties-lowered earnings, increasing costs, etc - it may find itself in distress. Weaknesses in accounting methods are not apparent on the surface, and audits carried out by the company itself are usually not intended to bring them into prominence, if it is in the interests of the administration to keep such things from the notice of the stockholders.

It is clear from this that the stockholder or investor is at a disadvantage in not having complete information. He is apt to be influenced too much by an apparently favorable Balance Sheet and a highly-colored commentary prepared by the management. Stock ownership or purchase in such a case involves inequality in bargaining power and often inadequacy of consideration. In acting under conditions of incomplete information the position of the stock-holder or investor is to that extent injured. His right to all available information, as one of the owners of the company, is being overlooked. In addition advantage is taken of his inability to act, or of his natural indifference in the face of strong forces in control. All forms of incompetence, whether administrative, financial, or clerical, adversely affect the position of the stockholder. He stands to lose in any case involving the company in financial losses, and while seemingly apart from temporary effects, which seem only to affect the parties at fault, yet bears the cumulative effects in the long run.

An illustration of incompetent financing, accounting and directorship is the promotion and reorganization of the firm of Canadian Canners Limited.

Investigation has shown that in various transactions in the formation of the present company assets were transferred at enhanced values. The amount of appreciation is equivalent to over 50% of the present outstanding capital stock- an increase of $2,275,000 in connection with the amalgamation of 1910, and one of $2,950,000 in a similar transaction in 1923.

Furthermore none of this capital stock was issued for cash, consideration being paid in the form of assets and services, both probably overvalued. This made for ease of control by interested financial groups, and resulted in gross overcapitalization. This is shown by the fact that during the past 11 years, in spite of decreasing annual provisions for depreciation, operating profits averaged less than 3%, exceeding 5% in only 1 year.

In connection with the company's accounting practices, it has been found that a substantial amount has been invested in the company's own shares, these being carried on the firm's books as an asset - an improper practice in itself. Further it has come to light that there were certain shortcomings in the preparation of the company's Balance Sheet for 1932; also, the statement of income included unrealized profits on the company's own shares, and the profits were distributed as dividends.

All of these facts point to faulty financing, doubtful accounting practices, and a lack of responsibility on the part of directors, who comprised a minority management group.

(From Report of the Royal Commission on Price Spreads 1935, pp.37, 361.)

CHAP. VI. Methods of Underwriting and Selling.

1. The Prospectus

The prospectus is used as a means of encouraging investment in a given enterprise. It consists of an outline of the company's position, resources and prospects. As an instrument for arousing the investor's interest, the prospectus is used to advantage by the professional promoter, who emphasizes the favourable aspects of his company's position, in an effort to elicit stock subscriptions. In this way the prospectus serves a useful purpose in bringing before the public all the facts in connection with the floating of a new company.

Unfortunately in the offering of a new issue of securities the prospectus too often serves the evil purposes of fraudulent promoters. Many instances have occurred in which investors have suffered heavy losses through being influenced to invest their capital in weak concerns. This influence has in many cases been exercised by means of the prospectus.[31] This document is often written in highly-colored and high-sounding terms, sent through the mail and followed up by clever and influential newspaper advertising and salesmanship.

In drawing up the prospectus promoters often make good use of the opinions of technical and financial experts, so called, as well as a list of investors who have already grasped the opportunity. This psychological appeal to the investor has always proved effective. New issues placed on the market at a time when capital is being invested freely, will be readily accepted, especially when accompanied by a cleverly-worded prospectus and a series of influential advertisements in the newspapers and financial periodicals.

While a good deal has been done to avert evil practices in connection with the prospectus, by forbidding use of the mails for fraudulent purposes, and by means of various stock exchange enactments, there is still room for improvement. Even though a prospectus may not be issued with the intention of fraud, it is yet subject to incompetent estimates and opinions.[32] Promoters are prone to transmit their optimism to the prospectus and thus give the prospective investor too favorable an impression. At the same time the prospectus has the weakness of giving to such opinions and predictions an air of authority and finality.

Thus we find the prospectus to be subject to the above weaknesses, which it transfers directly to the investor. He depends on the prospectus, and on opinions based on it, for his information concerning a given company. So, in the interests of the investor the prospectus is one of the most important features in the issuing of stocks and bonds, and should be one of the points of emphasis in discussing means for reform. Such measures, besides requiring presentation of truly reliable information, will seek to increase the amount of material so presented, since, at present, so many prospectuses are characterized by the limited amount of information they convey.[33]

We present an illustration of a misleading prospectus- <u>The Case of Rex vs. Kylsant</u> (Lord)-

According to Section 84 of the English Larceny Act of 1861 a director of a body corporate or public company is guilty of a misdemeanor if he makes, circulates or publishes any written statement or account which he shall know to be false in any material particular with intent to induce any person to intrust or advance property to the company.

In November 1931, Lord Kylsant appealed against the conviction at the Central Criminal Court on the charge that he had made, circulated, or published, or had concurred in making, circulating, or publishing a prospectus relating to an issue of £2,000,000, 5% debenture stock which he knew to be false in a material particular, with intent to induce persons to inter-est or advance property to the Royal Mail Steam Packet Company, he being a director of that company. Kylsant claimed that the statements he issued were in no way false or fraudulent in them-selves.

It was admitted that every statement in the prospectus was true, in itself, but the prosecution alleged that the document as a whole was misleading and false within the meaning of Sect-ion 84, in that the statement that, between 1911 and 1927 the company had paid dividends varying from 5% to 8% (except in 1914 when no dividend was paid, and in 1926 when one of 4% was paid) failed to state a material fact affecting the situation. The omitted statement was that, although the company made very large profits in 1918, 1919 and 1920 when, owing to the Euro-pean war, there was a shipping"boom", in the years 1921 to 1927 inclusive, it made substantial trading losses, and was only able to pay the dividends specified and to produce the "balances available" in those years (averaging £585,673 for the 10 years, 1918 to 1927) by the introduction of items of a non-recurring nature, earned in the abnormal war period.

It was declared that the type of fraud found in the docu-ments showed that they were not fraudulent in the sense of what was stated, but in the sense of what was concealed or omitted, that is, in the sense of what the documents implied. Thus, although every statement and figure in the prospectus was true, if the prospectus was misleading the appellant was guilty of the offence with which he was charged. As a result the appeal was dismissed.

From- Law Reports - King's Bench Division, 1932, Vol. I pp. 442-5

2. The Investment Banker.

The duty of the investment banker is to maintain a ready flow of new securities in order that his customers may find immediate employment for their funds and will not be forced to remain out of the market until the banker finds a suitable type of security for them. As a result the investment banker must keep available many different types of securities to suit the needs of his various clients.

To do this the investment banker sometimes is a means of overtaxing the capacity of productive enterprise as an outlet for supplies of capital, or as a source of profit through quick and easy sales. Thus the banker and promoter often combine their efforts toward the floating of new companies, at times leading to overexpansion. At the same time the banker often obtains large blocks of securities as payment for his services in underwriting issues. Here we have one of the causes of stock watering, in the overvaluation of the banker's services.[34] Too much stock may be given the banker in proportion to the true value of the service he gives.

In connection with underwriting by investment bankers we come to the question of banker control of companies. While control of a firm by the investment banker is limited by the lack of technical knowledge on the part of the bankers they leave technical matters in the hands of managers and are able to control financial policies often to their own profit.[35]

As a result of interest in particular concerns the banker's opinions and advice concerning a particular issue will be biased to some extent. This means that the mind of the investor, influenced by his banker's opinion, will be directed along similar lines. In this way the investment banker is able to direct the flow of capital within his sphere of influence. This activity may not always be in the best interests of industry as a whole, but may result in a certain amount of distortion in the industrial field in which the banker is interested.[36].

From this we can see that the investment banker forms an important link in the transfer of capital from investor to producer. His activities often have far-reaching effects, and his position gives him a good deal of influence and prestige. Restrictions would be particularly applicable in connection with the banker's reward for underwriting services, and in regard to his interest in special issues and its effects on his advice to prospective investors.

3. The Stock Jobber and Speculator.

We may speak of the activity of the stock jobber or of the speculator as an act of transportation between two points in time for the purpose of making a profit.[37]. This dealing in stocks (or commodities) may be done on the long or short side of the market. The activity of the speculator is to the advantage of the public in that it increases the marketability of the stock dealt in, by linking buyers and sellers separated in time. Due to this time element, ordinary knowledge and intelligence are not usually adequate for judging future values. On the contrary, skill, experience and special or, "inside", knowledge often disclose prospective values and may be used as a means of abstracting wealth from those less well informed.[38] In this instance the value of the speculator's services in the form of increased marketability is less than the cost to society, paid as a profit to the speculator. Thus the question of a net advantage to society is settled by determining whether or not the speculator has superior bargaining power in his dealings with the public.

Let us first consider the stock jobber, who is in essence, a speculator[39]. He acts as the intermediary between buyers and sellers for every transaction passing through the exchange. Thus the service of increased marketability is most obvious in his case. His profit is the difference between his quotation as a buyer and his quotation as a seller. The risk involved in holding a supply of securities between transactions may be offset by anticipating price movements-widely fluctuating prices and great uncertainty will mean a wider spread between the jobbers quotations, while general optimism among those dealing in stocks reduces the interval between transactions and enables the stock jobber to give better quotations.

It might be argued, that, since the jobber is, as it were, in the very centre of the market, he has greater opportunity for the exercise of superior bargaining knowledge, based on information not readily available to the public. While he does occupy a central position in the market, he is always faced with keen competition from others in his own class, equally well-informed. In addition, the brokers from whom he receives his orders to buy or sell also serve as a protection to society because of the information they are able to give their clients. Thus, in an organized market the jobber has little or no opportunity of using superior knowledge to obtain a profit of greater value than his services.[40] He only increases the spread between his quotations as his risk increases and then, only to the extent his competitors act, or else he is in danger of losing business to a jobber offering more favorable quotations. We can thus see that the jobber does not present any considerable difficulty as a menace to the public interest.

When we come to expert speculators we find a very different situation.[41] The speculator with experior knowledge is often able to profit from a given situation in two ways. In the first place he may create a buying interest in a certain stock and take his profit by selling when the price of the stock has risen to a certain level. Further, the interest aroused in such a stock may bring in other speculators and force the price up to an unhealthy and temporarily high level. Here the expert speculator may go on the short side of the market, and then buy in on the reaction. We may note in passing, that this secondary action, that of depressing prices from a high level, serves to discourage amateur speculation to some extent, and thus serves as an indirect benefit to the public.

However, this effect is only incidental, and speculation forcing prices away from true investment value, increases the risks of buying and holding securities[42]. Widely varying prices discourage investment of a long-term nature and thereby increase the number of transactions involving speculation, both professional and inexperienced. Constant or repeated "bull" operations, forcing prices above investment value, are a means of encouraging the floating of new issues, often leading to industrial overexpansion and waste of capital and technical reserves.

We may sum up the effects of skilled and unskilled speculation under four headings, as follows:-[43]

1. Speculative operations, in an investment market, based on changes in investment values, tend to establish a truer course of prices and to increase market efficiency.

2. Skilled speculation in markets for securities of variable and uncertain values, has ambiguous effects. It distorts prices when encouraging a boom, and corrects false valuations by operations on the short side of the market.

3. Unskilled speculation in an investment market has no part in improving the course of prices - rather, it is likely to lower the efficiency of the market.

4. Unskilled speculation in a speculative market has consistently bad effects on prices, leading to heavy social waste.

In connection with speculative operations we might take note of the effects on the speculator himself.[44] The cautious speculator or the seasoned jobber seems to suffer little physical or moral damage from the nature of his activities. On the other hand the uncertainties of speculation reduce the will and often the capacity, of intermittent or professional speculators to take part in industrious activities requiring application of time and talents. Also, the nature of speculation tends to promote irrational conduct and to dull the faculty for reasoning and planning on the part of those taking part in this activity.

From the foregoing paragraphs we may draw the following conclusions:-[45]

The stock jobber makes a net contribution to the economic welfare of society.

The skilled speculator makes a net contribution to the public welfare at times, but may act contrary to the interests of society.

The unskilled speculator probably has harmful effects in the investment market and is certainly harmful to the public good in markets for highly speculative securities.

4. Position of Investor.

After discussing these various shortcomings in the corporate organization we can now sum up the general position of the investor. Wishing to enter the market he is presented with numerous types and classes of securities, a variety of opinions on the part of brokers and salesmen, and the necessity of making a choice from among all these propositions. He is confused by the complexity of types of securities and by the multiplicity of influential factors affecting the value and income-rate of any one issue.

Having finally purchased a block of securities, the investor sees the fate of his investment in the hands of others more interested in their own interests than in the welfare of this new stockholder and many others like him.

Barred from participation in control through purchase of non-voting stock or by the handing over of his proxy to the management, the investor is left to watch the struggles of various groups for control, the incoming of new groups and the lack of interest of directors. At least he surmises all this from the meagre information he is able to obtain from his broker or through the press.

If the firm is involved in reorganization or included in a merger the investor visualizes the possibility of lowered income, dilution of interest and further conflict of interests. In addition his investment may be jeopardized by the actions of incompetent administrators, financial advisors, or accountants. He is not given full information as to the position of the company and can only judge for himself by the movement of his stock on the exchange. Even there, the value of his investment is subject to the actions of speculators, who may cause stock values to fluctuate widely.

Outside the corporation and the stock market the investor's position is influenced indirectly by the actions of promoters and investment bankers. To find outlets for capital they may encourage new industry to such an extent that production may be curtailed and our investor's income be reduced.

From this short resume we can see that the investor is in an inferior bargaining position with other groups in the corporate organization. His sources of information are few and his knowledge of "big business" incomplete. He can do nothing to influence the value of his investment and must trust to others to act in his best interests. We have seen that they do not always do this. The investor is the recipient of all the effects of shortcomings in the corporate structure, and his present position is one of weakness, as opposed to a number of strong forces, many of them incalculable by him.

We turn now to a discussion of methods of controlling some of the evil practices attending both promotion and administration as a means of improving the investor's position.

Part III. The Means for Control

CHAP. VII. Special Prohibitive & Coercive Measures.

The Ontario Securities Commission -

According to the Security Frauds Prevention Act of 1931 the Lieutenant-Governor of Ontario has the power to -

Appoint a Board to administer the Act.

Provide for the appointment of members, officers and employees of the Board.

Prescribe the powers and duties for anyone connected with the Board.

Approve the salaries of such members, officers and employees as fixed by the Board.

The Board is to have and assume all the powers conferred on the Attorney-General by the Act of 1930.

(Statutes of Ont. 1931 pp.163-4)

Powers

To examine a person or company to ascertain whether an offence against the Act, has been, is being, or is about to be committed.

To summon witnesses as a means of gaining evidence from testimony or from the presentation of documents or records. This power is similar to that vested in the Supreme Court or a Judge thereof.

To appoint an accountant or other expert to examine documents, records, property and other matters and to report thereon.

Failure, without reasonable excuse, to give any information or evidence demanded under the powers conferred by the

Act shall constitute an offence and become prima facie evidence upon which the Board may base an affirmative finding concerning any fraudulent act to which such failure may be deemed relevant.

(Statutes of Ont. 1930, pp.188-9)

If any fraudulent act or offence against the Act has been is being, or is about to be committted, the Board has the power -

Where a registered #broker, company or salesman is concerned, to order such registered party and any other registered party connected with the same organization to be suspended from registration for a period up to 10 days' duration, or

Where a 10-day suspension is considered to be inadequate or where an unregistered person or company is concerned in a fraudulent act or offence against the Act, to enjoin the guilty parties from trading in securities, or

To give public notice of the fraud, by advertisement, letter, or otherwise, whenever deemed advisable.

Further, the Board - during, before or after examination or during, before or after application, or receipt of injunction papers, or where criminal proceedings are about to be or are instituted against any person - may direct any person having in Ontario any funds or securities of the guilty persons, to hold such in their possession,

May direct the guilty parties to refrain from withdrawing any funds or securities held by any other person or company, and

May direct persons concerned to hold the funds or securities of clients in trust for any receiver to be appointed.

Until revocation of such direction or consent to release any particular fund or security from such direction.

Failure to comply with the above rules constitutes an offence, except in the case of funds or securities in a stock exchange cleaning house or in process of transfer, to which direction does not apply, or where transactions take place in bank, loan or trust company offices not named in the direction. (Statutes of Ont. 1930, pp.190-1)

#. Section 3 of the Security Frauds Prevention Act, 1930 states that all persons acting as brokers, broker's salesmen, or salesmen employed by partnerships, or companies to trade in securities, must have their names entered in a Register open to public inspection. Also all partnerships or companies trading in securities or employing persons to act on their behalf, either officially or as salesmen, in connection with trade in securities, must be registered.

Applications for registration must be made in writing upon forms provided, stating name and business address, and accompanied by the prescribed fee and a required bond ($500.00) which is forfeited upon conviction of fraud. All applications must be approved by the Attorney General, thus giving dealers in securities official standing, and bringing them directly under the Regulations of the Attorney General's Department. (From-Statutes of Ontario,1930-pp.182, 183,185.)

The Commission thus has fairly wide powers, but of course, its jurisdiction is limited to companies having an Ontario charter. In addition its action is positive rather than preventive. While taking action in cases of fraud already committed and brought to its attention, the Commission has no power to attack the inherent weaknesses of the corporation as now constituted

Let us see what has been done in a preventive direction by the federal government at Ottawa.

In looking to the federal government for remedial action in connection with corporate promotion and administration, we must consider the limited power to act on the part of the Dominion Parliament.[1] In Canada there are ten legal jurisdictions - one federal and nine provincial governments. All of these have rights in the matter of the incorporation and the surveillance of Canadian companies. Any action in the direction of restriction on the part of the federal government will mean a transfer of incorporation business from the dominion office to one of the provincial offices. This multiplicity of jurisdictions complicates the situation for those primarily interested in the corporation - the investor, the shareholder and the creditor, and has proven to be a force restraining commercial and industrial development.

While federal action tends to be limited on this account, yet it seems fair to urge that the Dominion Government should lead the way in the matter of reform.[2] The prestige of federal incorporation, particularly in providing advertising value in the sale of securities, and the added social gain from a stringent Dominion Act would more than offset the temporary loss of revenue entailed in transfer of incorporation business to one or another of the provincial offices.

Three solutions have been offered for settling the problem of multiple jurisdictions, as follows:[3]

1. Exclusive federal jurisdiction, the provinces to surrender their rights so as to make federal control effective. This is an idealistic scheme, and many practical difficulties stand in the

way, involving the question of constitutional amendments, a lengthy process in itself.

2. Uniformity of company law under divided jurisdiction, as at present. While inferior to the first proposal, this change would be a practical step in the right direction. Discussions on this point in the two Dominion - Provincial conferences have not yielded very satisfactory results, but difficulties in the way do not appear to be insurmountable.

3. Dominion incorporation and Provincial surveillance under unified legislation. This scheme, somewhat similar to the second one, does not seem to be in a hopeful position. On the whole, the scheme for uniform legislation under divided jurisdiction seems to be the most practical one. Also, while difficulties are considerable, they are not so great as for other proposals, and some hope may be entertained for such an eventuality, in the not too distant future.

Let us examine the latest piece of federal legislation in regard to company reform, the Dominion Companies Act of 1934 and its amendments in 1935, and see how far it has gone in combating the existent evils of corporat promotion and administration.

In the matter of the issue of no-par shares the Act provides that not more than 25% of the issue price shall be transferred to Surplus Account. Further, any transfers subsequent to the time of issue shall only be permitted if the Secretary of State is assured that the firms' creditors are sufficiently well protected.[4]

Companies are given the power to provide funds for stock purchase by trustees in the interests of employees - an encouragement to employee ownership of stock.[5]

Rules are laid down for the redemption of preferred shares.[6] There must be no cumulative shares in arrears, and a redemption fund must be supplied out of the proceeds of a new issue of stock or out of ascertained net profits appropriated for the purpose in the form of liquid assets. It must be shown in an audited Balance Sheet that this procedure does not impair the capital reserves of the company.

Provision is made that creditors are given a period of one year following dissolution in which to present claims.[7] This protects creditors by making the company liable during this period.

As to publication of accounting statements, a company with a Dominion charter has to present yearly the following statements - a Balance Sheet containing all assets and liabilities, classified more systematically and clearly than before, a statement of Surplus, and a statement of Income and Expenditure.[8] Specifications are to be made of the following - total remuneration paid to directors for services in that capacity, net operating profit, before deducting reserves for depreciation and for income tax, amount written off for depreciation, reserve for income taxes, income from investments, all non-recurring special profits or losses, amount written off for goodwill. The statement of Surplus is to distinguish between distributable and non-distributable Surplus. There must also be a statement of all adjustments affecting previous financial periods, and of all credits, charges and appropriations for the current period. Copies of these statements are to be sent to shareholders if and when demanded.

In connection with the holding company, a consolidated statement is not necessary. However, in the case of a subsidiary whose accounts are not consolidated, an audited statement is to be attached to the Balance Sheet of the parent company explaining how the profits or losses of the subsidiary firm are treated in the accounts of the holding company.[9]

Prospectus requirements apply only in the case of direct sale of securities to the public.[10] Sale of securities through investment houses is not placed under this rule, there being no special governmental requirements.

The Act allows limitless diversifications of types of securities offered to the public. There are no restrictions to the number and nature of various classes of securities which may be sold.

Directors are not allowed to vote at board meetings on contracts in which they have private interest. They are made liable for unpaid wages for a period not exceeding six months, and are responsible for the amount not repaid on an illegal dividend, and for the amount of a loan sanctioned in violation of the Act.

We can thus see that the Act has some merits, particularly in regard to the publication of accounting statements. Requirements in this section of the Act are more stringent than in any other British country.[11] There is also some advance in limiting transfers to Surplus account in connection with the sale of no par securities. The Requirements for publication of statements by holding companies are also more strict than formerly.[12]

However, the Act has not done a great deal to improve the security of the investor, shareholder, and creditor - really its prime purpose.[13] For example, the issue of securities through investment houses, the most usual procedure, is left free of government supervision. In addition, no machinery has been set up for appraising considerations, other than money ones, received for allotment of blocks of securities. Also directors' liabilities have only received superficial treatment. The main issue, their position as representatives of the stockholding body, has been passed over, as well as the social significance of the corporation.

Thus, while the Act has done something toward remedying corporate evils, there is much still to be done. The following suggested remedies will include, with others, the neglected points referred to above.

CHAP. VIII. Publicity.

While it has been provided in the Dominion Act that certain annual statements must be presented, presentation is only required at the Annual Meeting and made available to shareholders only on request. It seems desirable that such statements should be published in a daily paper having a wide circulation in the city or town where the company's head office is located, also in cities where the company has established transfer offices. This would provide local shareholders with the necessary information without the need of requesting it from the company. It would also do something to stimulate a greater interest on the part of the shareholders in the affairs of the company, and they would be able to obtain a clearer impression of the company's position and prospects, and have a more intelligent and concise understanding of the manner in which the management is operating the company. At present annual meetings give little opportunity for questioning the administrative officers regarding policies and the lack of necessary information prevents the average shareholder from raising intelligent and well-timed questions. For those shareholders living at a distance from the head office of the company, all information available should be published in some official paper, such as the "Canada Gazette" and filed with a public official, such records being open to public inspection.[14]

These official publications would be more useful to the shareholders, especially for purposes of comparison, than statements mailed to each shareholder periodically.

Besides creating a more wide-awake and active spirit among the shareholders, leading to a more efficient and careful supervision on the part of the company's officers, widespread publication would be a means of prohibiting the superior bargaining position of directors, acting on information known only to them. In this way directors would be placed on an equal footing with the shareholders generally. Publication of information a few days before the annual meeting would thus give all parties concerned, directors, officers, and shareholders alike, a common fund of information. This would mean that discussions in the annual meeting would be more active and intelligent, and therefore more valuable, in that criticisms and suggestions would be forthcoming and administration made more efficient and progressive.

At this point a few suggestions, toward broadening present requirements as to publicity, might be in order. In the first place it would be better to have a more detailed statement of the fixed and intangible assets of the firm, for the purpose of a better knowledge of their value and of forming a more complete basis on which to pass judgment on the amount such values have been written up, if any, since the previous appraisal.[15] A second suggestion would be the publishing of the nature and present market value of all investments and securities held in the firm's name. This would enable the shareholders to learn of any important changes in the value of such forms of quick assets, and would allow interested persons, with special knowledge concerning particular holdings, to advise against the accretion of large amounts of that security, in case of impending financial losses from that direction.

Receivables and inventories might be treated similarly in order to show the extent to which these assets are kept liquid, and contrarily, to indicate trends in the amount of valueless or slow-moving goods and of bad or doubtful debts on hand. Thirdly, publication of executive salaries and bonuses, consisting of the number of executives and the total amount paid, would enable the shareholders to take note of what the services of the chief officers in the company are costing them. At present the Dominion Companies' Act (amended 1935) requires only the total amount paid as salaries, bonuses, fees, and so forth to legal advisers of the company and to the executive officers. (Statutes of Canada, 1935, p. 338.) In this way a check could be kept on the efficiency of these men in proportion to their income, and necessary changes made.

In order that the above provisions be carried out according to requirements, responsibility should be placed on the Board of Directors. At the end of each fiscal period reports should be filed with a public authority, appointed for the purpose, showing that such obligations have been carried out. In case of non-compliance with such requirements, suitable penalties would be imposed.[16]

While the question of publicity is under discussion, some suggestions in connection with accounting methods, which affect the published statements, will be introduced at this point. First, the provision in the Dominion Act, restricting transfer of funds from Capital account to Surplus account to 25% of the issue price, should be more stringent.[17] In reality the full consideration received for no-par shares should be regarded as capital and placed entirely in Capital account. Even in cases where no-par shares sell at a premium, (or at the original price) investors will be able to recover their primary investment if consideration is regarded as non-distributable. Transfers to distributable Surplus account would impair the Capital account and would be to the detriment of shareholders by reducing their equity in the assets of the company.

An alternative method would be to limit transfers to Surplus account to a fraction of the issue price in proportion to the fraction which the present Surplus bears to the Capital and Surplus of the company.[18] This would prevent newly-formed companies (having no present Surplus) from transferring funds for immediate distribution of dividends as a further incentive to purchase. A Surplus account would have to be built up out of earnings, thus establishing a sounder capital structure and a saner dividend policy. This plan is not so restrictive as the first since it allows for transfer of a certain amount (according to the size of the existing Surplus account) from the proceeds of future issues. This second plan might be further strengthened by having all subsequent transfers made to a non-distributable Surplus account.

Similarly, transfers made by reason of a writing-up of fixed and intangible assets should be made to a non-distributable Surplus account, to prevent distribution, in dividends, of unearned Surplus. As mentioned above, such writing-up may not be justified, and in any case, the surplus created should be treated as a capital surplus. On the other hand a stock dividend in respect of appreciation in the values of assets would not be harmful, provided present holders would not be affected by incoming groups. Such stock dividends should be apportioned according to the present holdings of the shareholders.

Turning to the question of publicity for acts of directors, we find the Dominion Act rather lacking in this respect. There is no discussion of the director's status or of his responsibilities, merely the pointing out of financial responsibility in certain cases of inefficient or illegal financial procedure.

In the first place it might be suggested that all dealings by directors in shares of their own company should be published, as a means of prohibiting active speculation on their part. In addition, any actions on the part of directors toward extending the firm's activities into new fields should be first approved by the shareholders and thereupon authorized by the federal government by the issue of supplementary Letters Patent. This federal surveillance would prevent shareholders from becoming, through the acts of directors, involuntary participators in a business not contemplated at the time the shares were purchased.[19]

A second means of bringing the acts of directors before the minds of the shareholders would be the explanation of certain policies followed by them in reply to questions raised in the annual meeting. In this way, informed shareholders would be enabled to re-elect only the active directors while discharging those whose activities were half-hearted or harmful.

The question of adverse interests is a difficult one to solve. It is natural that directors in large firms have business interests, of a personal or corporate nature, outside of the firm. In order to prevent this situation from leading to results harmful to the welfare of the company and its shareholders, it would be necessary to arouse in the directors' minds a sense of their position as trustees, acting for the stockholders. This process is not an easy one. It might be carried out through the methods outlined above for providing the stockholding body with a fund of information concerning the company, and by means of the proposed reforms regarding accounting methods.

In addition it might be suggested that the names of firms supplying the company with goods to the value of, say $100,000 or more in a year be published with a view to learning the extent of directors' interest in such transactions. By thus encouraging the active participation of shareholders in the annual meeting, and by creating in their minds the necessity of a report on the stewardship of the directors, a good deal might be accomplished in this direction.

The position of directors as trustees, and not as actual owners, would be greatly clarified by the laying down of a body of general legal principles for the carrying out of the duties of this office.[20] If the courts, once for all, established a concise code of rules for directors, it would soon be seen that the office was one of trust and responsibility. With this co-operation on the part of the courts, the problem of creating in the minds of directors a true understanding of the nature of their office would be greatly simplified.

Thus, while something can be done to bring about efficient and constructive directorship by reforms in other branches of the corporat structure, it is necessary, by either educational or legal means, to arouse in the directors themselves a due sense of their real position. If all the acts of directors are judged on the grounds of their effects on public welfare, a beginning has been made. Only by co-operation among all interested groups, directors, public, and state - and a growing sense of the social nature of the corporation, will the office of director assume its normal function, that of duty carried out in the interests of the shareholders.

CHAP. IX. Aids for the Investor.

We have seen that the Dominion Companies' Act requires prospectus statements only in the case of direct sale of securities to the public. In practice the usual means of placing securities on the market is through the agency of an investment banker. This procedure is not under government supervision, and the investor is open to the effects of the practices of promoters and investment bankers that we noted in our discussion of promotion and selling of securities. Prospectus provisions should be extended to apply to the selling of securities through investment bankers.

Those not likely fully to understand the amount of risk they are assuming should be protected by the state. According to Section 37 of the American Companies' Act, 1929, "promoters are to compensate all persons who subscribe for any shares or debentures on the faith of the prospectus for any loss or damage sustained by reason of an untrue statement therein". By the Federal Securities Act of 1933, omission or misstatement of a material fact creates liability.
(From Burtchett, p.386,ff.)

The bankers should be regarded as the agents of the company.21 In this way the company would be responsible for all material used by the bankers in advertising the securities or otherwise influencing investors to subscribe.

In addition, the prospectus should contain the amount of commissions, fees, and other remunerations paid to promoters, underwriters or middlemen so that it will be clear to the investor what is the net consideration received by the company.

All such information should be made available to the investor at the time of application. Also it should be placed on file in a public office for purposes of record, and published at the time the securities are placed on the market in a daily paper in the city where the head office of the company is located, and in the Canada Gazette.[21a]

We have seen that the issuing of a great many different types of security has done much to complicate the situation for the investor. This diversification has been the means of keeping over-cautious investors out of the market, and more often, of leading a great many security-buyers into purchasing securities without knowledge of their real status in the capital structure of the company. Unfortunately the Dominion Act has done nothing to remedy this situation, and the investor still has to face the problem of selecting a security from among so many types. Limitation of classification would lead to a simplification of the capital structure, a good move in itself, as well as minimizing confusion in the mind of the investor. This would mean that investors would approach the market with greater confidence and would be in less danger of making unfortunate choices in selecting their investment.

Regarding speculation on the exchanges, we have noted the effects of such activity - widely fluctuating prices, leading to great uncertainty for the bona-fide investor. It is quite possible that stiffening of the rules regarding purchases of securities on margin would tend to limit the number of inexperienced speculators coming into the market. While purchase on margin may enable well-meaning investors to accumulate blocks of interest-bearing securities by gradual stages, with a small amount of initial capital, it also encourages careless or inexperienced persons to endanger their own interests, as well as those of others. The requiring of a somewhat larger proportion of the market value of securities, as a deposit, and more stringent rules in connection with bank loans for purposes of stock purchasing, would doubtless be beneficial in eliminating the most dangerous groups of speculators. The effects in limiting true investment to some little extent would be offset by the favorable results of less widely fluctuating prices and a safer market for the investor. He would buy more confidently in the knowledge of a more stable price trend among securities in which he was interested.

Coming to the problem of stock-watering- the issuing of securities against overvalued assets - we find another source of danger for the investor. Even complete concise statements and schedules, giving full information regarding the company's position, will be falsified by an illusory capital structure. So regulations necessitating the publishing of all sorts of financial and technical statements are made ineffective if appraisals and estimates regarding the value of assets, are not in accordance with the facts. At present there is no legal authority to pass judgment on the truth or falsity of such calculations. The courts are not required to investigate cases in which a consideration other than cash has been received in payment for securities.[22] By way of reform it is suggested that it be declared illegal to issue fully paid-up securities unless the company has received adequate consideration in cash, property, or services. The duty of determining the adequacy of such consideration, as well as the ascertaining of the true value of property and services tendered as full or part payment, should rest on the courts. For this purpose a body of legal principles should be enacted, and officers appointed to supervise all investigations. Further, it should be provided that liability for the difference between given and true valuations should rest on the directors, provided it be shown[23] either -

1. That they had knowledge of the overvaluation, or
2. That they failed to take reasonable steps to ascertain whether or not the consideration was adequate. In this way a good deal could be done to eliminate the practice of stock-watering with its accompanying effects. The position of the investor would be correspondingly strengthened and his equity in the company's assets freed from danger of serious diminution.

NOTE: Following the recommendations of the Price Spreads Commission, the Dominion Companies Act (amended 1935) States in section 96 (B) that shares are only fully paid-up if consideration, in property and/or services, be equivalent to nominal amount of the shares to be issued. This fact is to be determined and affirmed by express resolutions of the directors who may appeal to a judge for a declaratory order corraborating their statements, making use of oral and documentary proofs if necessary. Liability is fixed as recommended-directors to be jointly and severally liable to shareholders for any deficiency. (Statutes of Canada,1935-pp.334-5)

These changes in the regulations governing sale of securities and valuation of assets would serve to strengthen the investor's bargaining position. He would be enabled to select his investment more readily and with greater confidence. His position would be on the whole, only slightly inferior (on grounds of inexperience) to that of the broker or investment banker. In addition, the investor would be in a much better position to guard against fraudulent or one-sided dealings, based on the possession of special or superior knowledge on the part of brokers or investment bankers. As a result investment would be made easier, safer and with greater understanding and skill on the part of the investor.

X. Market Planning.

One of the characteristics of the present financial system is the lack of a definite group of persons who oversee and investigate, if necessary, all new issues of securities. New issues of securities come on the market, accompanied by persuasive advertising and salesmanship, and the investor has nothing to depend on for information regarding the issue, except the opinions of promoters and bankers. We have seen that these groups are often the means of placing inferior grades of securities in the hands of investors, having regard only for the sale of the issue at a profitable figure. So it is clear that there must be some reliable group of officers whose duty it is to investigate the affairs of firms wishing to place securities on the market. Among its duties, such a commission, or board, would see to the carrying out of the suggestions outlined in our last two chapters.

To this end it is urged that a Securities Board be set up, with headquarters in Ottawa, and branch offices in the larger cities[24]. This board would be operated as a department of the federal government, and should be regarded as one of the higher branches of the civil service, free from political or other group influence, in order to insure a continuous and definite policy.

Further, it should be provided that the Chairman of the Board should be enabled to present to the Cabinet suggestions in the matter of further legislation affecting his department. These suggestions would be based on difficulties or shortcomings encountered in the process of carrying out the existing plan.

Doubtless a number of points would be overlooked when first organizing the Board and this would be a convenient method of bringing these points to the attention of the Cabinet.

The first duty of the Securities Board would be to investigate all new firms whose securities were coming on the market for the first time.[25] This would include a general supervision over the activities of engineers and other technical experts in estimating construction or developmental costs. This surveillance would tend to encourage greater care in estimating the amount of capital required, and would thereby more effectively ensure the accumulation of funds which would be adequate for the work involved. In addition the Board would scrutinize closely the general make-up of the proposed capital structure of the firm. Here efforts would be made to ensure a proper degree of flexibility, also to avoid distortion as far as possible. Of course the proportion of bonds to stock would depend on the industry in which the firm proposed to be engaged, as well as on the general economic outlook for new firms. A profitable industry, or bright prospects for the future, would permit the issuing of a larger proportion of bonds, since fixed charges could be met more readily, and conversely for unfavorable conditions.

In the case of firms already in business, wishing to float a new issue of securities, the Board would have power to appoint auditors to investigate their financial history and their current transactions and commitments, if statements audited by bona fide auditing firms were not available.[26] In this way it would be learned whether or not the issue of further securities was justified or expedient. In addition all advertising and other publicity in connection with the issue should be inspected.[27] In this way all facts used in the prospectus or other publicity statement, which did not give a true picture of the existing state of affairs, would be discarded, and the investor correspondingly protected. Firms whose financial position did not warrant the assumption of further commitments, or whose methods of issue aimed at creating a false sense of security in the mind of the investor, would be forbidden the right of issue until such time as these matters were cleared up to the satisfaction of the Board.

In attacking the problem of overcapitalization the Board could act in two ways.[28] In the first place it could restrict the proportion between fixed liabilities and the corresponding assets. For example, a holding company, controlling certain assets, (already mortgaged) through the ownership of shares in a subsidiary, would not be allowed to issue further fixed indebtedness unless the total remained within fixed limits. Enhanced valuation of assets would be prevented by an audit conducted by the Board's technical experts. In this way true values for the company's assets would be maintained, and the holders of bonds would be protected by the limiting of the total amount of their claims to a certain percentage of such values. This percentage would vary from one case to another—being higher when the assets in question were especially productive and useful to the company, or readily saleable, and lower when such assets were of comparatively small usefulness, or in a poor condition or location which would result in a much lower realization from their sale. This method of meeting the problem of "stock-watering" would apply also in cases of financial combination involving fewer firms than the formation of a holding company - that is, in all cases involving the issuing of mortgages or bonds against assets already so encumbered.

A second method would be applied to firms issuing securities as part of an expansion of activities or of a refinancing scheme. In this case the company's auditors would be made responsible for the giving of a true valuation in connection with the appraisal of the firm's assets. The Board would pass judgment on their reliability and exercise restraint over their activities. The firm's auditors would be held liable for any damage suffered through purchase which was clearly influenced by the appraisal itself. Such liability would hold only if it could be shown that the appraisal was untrue in any material respect, and was issued either without an honest belief in its accuracy, or without reasonable steps being taken by the company to verify the accuracy of the auditors' report.[29]

Further duties of the Board would include, the enforcing of the rule that debentures issued without special security should have such facts stated on their face, and also the power to provide that all bond issues be assented to by shareholders only to the amount actually required at the time.[30] These two rules aid in protecting the investor, in that they provide the purchaser of an unsecured debenture with a better idea of the real nature of his purchase, and guarantee the bondholder that all capital supplied by him will be used for the purpose intended.

In addition the investigating activities of the Board should extend to private companies desiring to place an issue of securities on the market for the first time.[31] The affairs of these private companies should be looked into before they are allowed to invite public subscription in order that it may be learned whether their financial conditions and prospects are a good investment field for the prospective purchasers.

Regarding the powers of the Board in overseeing the promotion of new companies, it should be pointed out that all types of firms are not to be treated along exactly similar lines.[32]. While the initial costs of financial, mercantile and commercial undertakings can be estimated with a relatively high degree of ease and accuracy, all new firms are not so fortunate. Those firms whose costs of establishment and development are particularly difficult to predict with anything approaching accuracy are the companies entering the mining or power industry. In these industries a number of factors enter the situation which prevent the making of accurate appraisals and costs. Mining is perhaps the most hazardous industry in this respect, since the work to be done in building a power-house or constructing roadways or doing excavation work can be estimated with somewhat less difficulty. Companies entering the field of manufacturing would occupy a position between those entering mining and those setting up as trading or financial concerns.

Clearly all of these many types of firm cannot all conform to one set of rules, in connection with their promotion and development.

We have seen that it would be one of the duties of the Board to see that technical estimates were to be as nearly accurate as possible, in order to prevent the occurrence of a shortage of capital. Such rules should vary in strictness, the greatest leeway being given the engineers and construction experts estimating the primary costs of mining projects. Other industries would conform to rules whose strictness would be in proportion to the ease of calculating costs.

In the case of mining enterprises, the natural speculative element in this industry would modify rules as to prospectus provisions. The developing of a property in the hope of finding a supply of profitable ore does not permit the entering in the prospectus of a long list of material facts. Opinion and conjecture enter the case to some extent. Thus the investor should understand that he should not rely too much on the prospectus of a mining enterprise as a means of supplying clear-cut indisputable facts regarding the firm's prospects of success. Naturally the Securities Board would be less strict regarding the prospectus provisions in connection with mining projects, modifying rules to suit the case.

The value of such a Board would apply both to investor, and to entrepreneur who would benefit by having a definite line of procedure laid down, and the assurance of a more ready sale for the securities of his firm. While the Board would not allow its name to be mentioned in the advertising of such securities, and its approval of the issue of certain securities would merely consist of non-rejection, yet it is fair to assume that the investor would purchase securities with greater confidence, and the financing of new, as well as established, firms be carried on along sounder lines, if such a type of Board were to function. True, the Board would not be responsible for losses by the public in purchasing certain unprohibited issues, but it is not the function of such a body to sponsor particular issues - the prime purpose would be to aid the investor by laying down rules for sound and proper financing, and by raising his bargaining position in the market.

CHAP. XI. Conclusion

It is clear that the activities of financial experts have been largely directed toward improving methods of production, with a corresponding lack of interest in the welfare of the investor. Means of raising capital have been established with the purpose of enabling productive enterprise to acquire funds with the least possible inconvenience and loss of time. Investment bankers and promoters have looked more to profits from security sales than to the effects upon the purchasers of these securities. As a result the investing public, through lack of organized effort, has been the victim of the activities of well-organized groups of bankers and promoters. To this has been added the weakening influence of inconsistent and faulty financing methods, and the actions of directors and other company officials, working in their own interests, have tended still further to weaken the investor's position.

Only lately has there been anything resembling an organized movement in the interest of the investor. This has resulted in the passing of certain legislation by both the federal and provincial governments. While such efforts have been only partly effective in improving the situation, at least a beginning has been made in the right direction. We must look to the legislators as the prime means of accomplishing further results. This can only be achieved by the arousing of public opinion and the laying down of strict legal principles by the courts for the conduct of financial affairs. We cannot expect the entire emancipation of the investor to take place within a short period. There must be a widespread public belief in the true and just position of stockholder and administrator - the stockholder as the ultimate recipient of the benefits of competent financial action, and the director and officer as the trustees, administering the investor's capital with a view to his best interests, not their own profit. Only then will the investor's position be as strong as that of other financial groups. All socially minded education, legislation, and legal procedure should be directed to this end.

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will be made only to their Report.