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UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

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GENERAL GOVERNMENT DIVISION

RELEASED

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The Honorable Bob Dole  
United States Senate

Dear Senator Dole:

In your June 26, 1974, letter, you asked us to investigate the proceeding under chapter X of the Bankruptcy Act for the reorganization of the First Home Investment Corporation (FHI), to determine whether there has been unreasonable court delay in settling the case and whether the Securities and Exchange Commission (SEC) has been remiss in its oversight. On July 24, 1974, we briefed your Office on the results of our examination. As requested, this letter summarizes our briefing. Also, in a January 17, 1974, letter, SEC's Director, Division of Enforcement, gave you detailed explanations on many of the particulars of the case.

SEC monitors registered investment companies to insure compliance with the Investment Company Act of 1940. As part of the monitoring program, SEC inspects investment company records and activities as often as possible on a rotating basis. Late in 1972, SEC's Fort Worth regional office made a routine inspection of FHI and its principal underwriter, Bush and Company, Inc., and found evidence that provisions of various Federal securities laws, in connection with the offer, purchase, and sale of FHI securities, and the management and operation of the company had been violated.

In accordance with published SEC policy and with the Commission's specific approval, the Fort Worth regional office told FHI's attorney of the violations. FHI voluntarily suspended sales of its securities and filed for reorganization under chapter X of the Bankruptcy Act, stating it could not meet its current obligations. The court appointed a trustee to assume management operations during the reorganization, which is still in progress. In a separate administrative proceeding brought by SEC, members of the former management of FHI consented to findings of violations of various provisions of the Federal securities laws and accepted sanctions barring them from the securities industry.

SEC's role in a chapter X reorganization is to (1) provide the district courts expert advice on the legal and financial problems involved in reorganization and (2) protect the legitimate interests of public investors holding securities of companies being reorganized. SEC has the status of a "party in interest" with the right to be heard on all matters but no right to initiate an appeal. Court records indicate that SEC has been active as a party in interest and has assisted the court-appointed trustee.

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The FHI reorganization has now been in process about 15 months, and SEC estimates it will continue at least 6 more months. The costs of such a proceeding include fees charged by the trustee, his lawyer, and any other court-approved costs. Such costs are offset by the reduced cost of management the trustee replaced. According to a financial report prepared for the trustee, FHI paid about \$39,600 a month for management services during the 10 months preceeding its declaration of bankruptcy; expenses approved by the court for management services during the chapter X proceeding have been about \$48,000 a month. The total cost of the bankruptcy cannot be predicted.

Although the hardships on individual stockholders in a corporation undergoing chapter X reorganization cannot be denied, the process is designed to serve their long-term benefit. The reduced market value of a company's stock is usually of as much concern to stockholders as the administrative cost of the proceeding. Because few buyers are willing to speculate in the stock of a corporation in bankruptcy, stockholders who wish to sell must do so at a greatly reduced price, if at all. However, the trustee's investigation revealed FHI's assets are intact, and on December 31, 1973, the estimated book value per share of stock was more than \$4. The trustee believes the corporation has good prospects for successful reorganization.

With regard to the delay that has been experienced in the FHI case, SEC told us the case was moving at an average rate and that it is often advantageous for the trustee to operate the company long enough to become familiar with its problems and opportunities. We have no basis to question this judgment by SEC.

The Commission on Bankruptcy Laws of the United States issued a report in 1973 (H. DOC. 93-137) that outlined problems with existing bankruptcy laws and recommended possible remedies. The report was based on an extensive investigation of bankruptcy laws and court practices and addresses some of the specific issues that surfaced in the FHI case.

We are sending this report to you and Senators Bartlett, Bellmon, and Pearson as you requested. We will not distribute the report further unless you agree or publicly announce its contents.

Sincerely yours,

*Victor L. Lowe*

Victor L. Lowe  
Director