10-1976

E.I. du Pont de Nemours & Co. v. Collins

Lewis F. Powell Jr.
SUMMARY: Petrs urge that CA 8 improperly reversed an order of the SEC. This order would have allowed a merger
between E. I. Du Pont De Nemours and Co. ("Du Pont") and Christiana Securities Co. ("Christiana") by finding it exempt from Section 17 of the Investment Company Act of 1940.

II. FACTS: Christiana is a holding company whose asset portfolio consists mainly (98%) of Du Pont stock. This stock held by Christiana accounts for approximately 28% of the total amount of Du Pont stock outstanding. Christiana is a registered investment company under the Investment Company Act of 1940.

Christiana was initially formed as a control device to ensure that the Du Pont family continued to control Du Pont. At the present time, Christiana is traded on the over-the-counter market; however, ownership in Christiana stock is still highly concentrated. Those who control Christiana (and control Du Pont as well) have concluded that Christiana has outlived its usefulness, and wish to have Christiana disgorge its Du Pont stock. Due to the very low income tax basis of the Du Pont stock held by Christiana, a taxable transaction would be unacceptable due to the very large capital gains tax generated thereby.

Thus it was determined that Christiana should merge tax-free into Du Pont. The net effect of the transaction would be that Christiana stockholders would surrender their Christiana stock, and receive Du Pont common stock in return. Essentially, Christiana shareholders would receive pro rata,
one share of Du Pont stock for every share of Du Pont stock which Christiana now holds. 1/

Although this appears straightforward, a problem arises from the fact that Christiana common stock sells over the counter at a substantial (approximately 28.5%) discount from the market value of the common stock which Christiana owns. In other words, for a $100 investment in Christiana common stock an investor could acquire a $128.50 indirect ownership of Du Pont stock. This phenomenon is common for closed-end investment companies, and evidently springs from the corporate ownership of the investment stock. For example, Christiana must pay a tax of effectively 7.2% upon any dividend which Du Pont pays. Then if the dividend is distributed, the Christiana shareholders also have to pay their personal income tax thereon. Therefore, there is an added tax burden in that such dividends are subject to double taxation when the holding companies pass the dividends through. Furthermore, in the instant case, the income tax basis of Christiana's

1/Actually, Du Pont was to issue shares of its own common stock equal in value to 97.5% of the net asset value of all Christiana's assets (approximately 98% of which consisted of Du Pont common stock). Thus, DuPont would receive a 2.5% "discount" on its common shares received by it.

2/Essentially, a closed-end mutual fund (or investment company) is one whose shares trade at whatever price the market will bear. On the other hand, an open-end mutual is one which trades at net asset value per share -- the market value of the fund's portfolio, less liabilities, divided by the number of shares of the fund outstanding. An open-end fund buys and sells its shares at net asset value; a closed-end company is sold from one investor to another at whatever price is agreed upon.
portfolio is so low that the potential capital gains liability inhering in the Du Pont stock upon sale reduces the value of the Du Pont stock.

Section 17(a) of the 1940 Act proscribes mergers between two affiliated corporations. However, Section 17(b) allows the SEC to issue an order exempting the transaction from Section 17(a) upon a finding that:

"(1) the terms of the proposed transaction, including the consideration to be paid or received, are reasonable and fair and do not involve overreaching on the part of any person concerned. . . ."

The SEC made such a finding exempting the transaction. However, certain minority shareholders of Du Pont sought review of this order, pursuant to Section 43(a) of the Act. (Sections 17 & 43 (a) are appended hereto.)

III. DECISIONS BELOW: The SEC, by unanimous vote, found the terms of the proposed merger to be fair and reasonable and to involve no overreaching. The Commission recognized that the merger dealt with an exchange of stock substantially equivalent in value. However, it also recognized the substantial benefits that the merger would confer upon the Christiana stockholders in that Christiana stockholders would receive Du Pont stock based upon the market value of stock, rather than upon the market value of Christiana's stock itself.
Crucial to the SEC's determination of fairness was its finding that an investment company should be valued at the net asset value of its portfolio, rather than at the market price at which its stock is currently selling. Appendix at 32 A. Thus, the SEC viewed the fact that Christiana's shareholders were to receive value in excess of that which they could then currently realize upon the market by sale of their shares as a benefit to them without corresponding detriment to Du Pont. Thus the substantial inequality between the market value of Christiana shares and Du Pont shares, on a pro rata basis, did not lead the SEC to conclude that the merger terms were not fair and reasonable.

Having thus found that Du Pont shareholders did not have a right to share in the tax benefits accruing to Christiana's shareholders via the merger, and further that the increased number of Du Pont shares available for sale after the merger would not significantly depress the price of Du Pont stock, the SEC concluded that the merger was within the realm of fairness.

With a divided panel, CA 8 reversed. The essence of CA 8's disagreement with the SEC was based upon the SEC's valuation of Christiana at the net asset value of its portfolio. CA 8 found that the SEC erred in deciding as a matter of law that net asset value is the proper valuation technique. CA 8, citing income
In tax cases, felt that the market value of the Christiana's shares was the relevant value to be used. CA 8 found that the merger negotiation was not at arms-length, and that, valuing Christiana at its market value, the benefits to Christiana shareholders far outweighed those to Du Pont shareholders. CA 8 concluded that "there is no substantial evidence on the basis of this record to support the Commission's finding."

In attempting to analyze the case, CA 8 appointed Professor Roger Upson, Associate Dean of the University of Minnesota, College of Business Administration, to serve as consultant to assist the court "in understanding the record in this case and to prepare reports and memoranda for this Court in connection with that function." Appendix at 91 A.

Judge Stephenson, dissenting, accorded great weight to the findings of the SEC below, and concluded that "'the Commission's action is based upon substantial evidence and is consistent with the authority granted by Congress.' Securities and Exchange Commission v. Chenery Corp., 332 U.S. 194, 207 (1946)."

Petrs' petn for rehearing en banc were denied by an equally divided court.

**IV. CONTENTIONS:** The SEC and the corporations contend that CA 8 was wrong in rejecting the SEC's use of net asset value, and in finding the merger not fair. They argue that CA 8 should have been guided by this Court's pronouncement in

"The Commission's conclusion here rests squarely in that area where administrative judgments are entitled to the greatest amount of weight by appellate courts. It is the product of administrative experience, appreciation of the complexities of the problem, realization of the statutory policies, and responsible treatment of the uncontested facts. It is the type of judgment which administrative agencies are best equipped to make and which justifies the use of the administrative process. See Republic Aviation Corp. v. Labor Board, 324 U.S. 793, 800. Whether we agree or disagree with the result reached, it is an allowable judgment which we cannot disturb."

Under this standard, petrs urge, the SEC's findings of fairness should not have been disturbed.

The SEC also argues that CA 8's opinion will create substantial uncertainty regarding the standards of fairness for Section 17 transactions; the SEC has heretofore consistently used the net asset value approach. SEC petn at 15.

The corporate petrs also object to CA 8's going "outside of the record" by its employment of Dean Upson as a consultant.

V. DISCUSSION: The issue of whether the transaction is "fair" is a difficult one. On the one hand, Du Pont would suffer no ostensible detriment from the exchange of its shares for a greater number of its shares; on the other hand, Du Pont would never agree to an arm's-length transaction which benefits it so
slightly and the other side so greatly without attempting to negotiate a portion of the "benefits" for itself. In effect, the affiliation of Du Pont and Christiana caused the shareholders to bear an opportunity cost equal to the amount that an arm's-length merger partner would "pay" Du Pont to induce it to enter into the transaction.

CA 8 rested heavily upon the fact that, using the market value of Christiana stock as the measurement standard, Du Pont would have received far less than would the Christiana shareholders, who would have received a 28.5% premium -- about a half billion dollars -- for their stock. One of the most significant factors causing this 28.5% discount is the unrealized capital gains tax liability inherent in Christiana's Du Pont stock. However, in a tax free reorganization, Christiana shareholders would get a carry-over basis. See I.R.C. § 358. Since the basis of the Christiana stock in the hands of its shareholders is also quite low -- see appendix at 88a -- there would also be a very substantial unrealized capital gains tax inhering in the "new" Du Pont stock. Hence, the "bonanza" to these shareholders is not as large as CA 8 would have us believe. To a large extent the effect of unrealized capital gains will depress the

3 There may still be significant tax advantages since this transaction does erase the potential for double taxation, i.e., due to the disparities (1) between the basis of Christiana's Du Pont stock and Du Pont market value, and (2) between the basis of Christiana's shares in the hands of its shareholders and Christiana's market value.
intrinsic value of the new Du Pont shares to the same extent that it did the market value of Christiana shares.

At any rate, the issue of whether, in fact, the merger terms were "fair" under section 17 is intriguing, although perhaps not certworthy per se.

Although the SEC attempts to urge otherwise, the proper standard for valuation of investment companies for purposes of section 17 does not appear, standing alone, to be important enough, recurrent enough, or confused enough to command this Court's attention.

The primary impetus for cert must flow from the approach used by CA 8 in reversing the SEC. CA 8 characterized the SEC as holding, as a matter of law, that the net asset value standard is the appropriate standard under which to measure value. CA 8 thus found the SEC "wrong on the law."

This approach strikes me as a rather thinly veiled attempt at evading the review standards set forth in Chenery and in section 43(a) of the 1940 Act. I do not read the SEC's opinion as "holding" the net asset value standard necessary as a matter of law. Valuation is the key to fairness; value is a factual question and the SEC's use of net asset value in the case of an

4/Section 43(a) provides, inter alia: "the findings of the Commission as to the facts, if supported by substantial evidence, shall be conclusive."
investment company is supportable, and not an error of law (at least until CA 8 found it to be so.) Thus, the SEC's conclusions do seem to be supported by substantial evidence, and by the SEC's factual analysis, and should have been protected on appeal.

The mere fact that CA 8 had to hire the consultant to help it "understand the record" only illustrates the deference that CA 8 should have given, but did not give, to the SEC determinations. Moreover, this Court has only recently warned courts of appeal to stay within the record on review. FPC v. Transcontinental Gas Pipe Line Corp., 44 U.S.L.W. 3413 (January 19, 1976).

The fact that CA 8 arguably disregarded the proper standard review argues for some action by this Court. However, there is no argument below about what that standard is; the only real issue therein is whether CA 8 effectively circumnavigated the deferential standard of review by casting the SEC's employment of net asset value as an error of law. Thus, if cert were to be granted, what this Court might really end up doing is addressing the question of law/question of fact issue, or making the difficult determination of whether, on the merits, the merger was fair.

There is a response.

8/10/76
Eagan
Op. in SEC appx.
§ 17 (a) It shall be unlawful for any affiliated person or promoter of or principal underwriter for a registered investment company (other than a company of the character described in section 80a-12(d)(3)(A) and (B) of this title), or any affiliated person of such a person, promoter, or principal underwriter, acting as principal—

(1) knowingly to sell any security or other property to such registered company or to any company controlled by such registered company, ...

(b) Notwithstanding subsection (a) of this section, any person may file with the Commission an application for an order exempting a proposed transaction of the applicant from one or more provisions of said subsection. The Commission shall grant such application and issue such order of exemption if evidence establishes that—

(1) the terms of the proposed transaction, including the consideration to be paid or received, are reasonable and fair and do not involve overreaching on the part of any person concerned;

(2) the proposed transaction is consistent with the policy of each registered investment company concerned, as recited in its registration statement and reports filed under this subchapter; and

(3) the proposed transaction is consistent with the general purposes of this subchapter.
days after the entry of such order, a written petition praying that the order of the Commission be modified or set aside in whole or in part. * * * Upon the filing of such petition such court shall have the jurisdiction, which upon the filing of the record shall be exclusive, to affirm, modify, or set aside such order, in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission or unless there were reasonable grounds for failure so to do. The findings of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If application is made to the court for leave to adduce additional evidence, and it is shown to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceeding before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. * * *
SECURITIES AND EXCHANGE COMMISSION, Petitioner

vs.

RICHARD J. COLLINS, ET AL.

5/26/76 - Cert.

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Rehnquist, J.
Powell, J.
Blackmun, J.
Marshall, J.
White, J.
Stewart, J.
Brennan, J.
Burger, Ch. J.
This is the Christiana/ Du Pont merger that SEC approved as "fair", as it was authorized to do under §17(b) of Investment Co Act 1940.

CA 8 (2.6.61) reversed SEC, holding that SEC had erred in adopting "net asset" rather than "market value" of Christiana stock. This holding is contrary to long practice of SEC & in probably wrong.

Preliminary Memo

Summer List 11, Sheet 3

No. 75-1872

SECURITIES AND EXCHANGE COMMISSION

v.

COLLINS

Federal/Civil

Please see memo in No. 75-1870.

8/10/76

Eagan

This suit was brought by minority stockholders of Du Pont.

Although the merger (merely exchanging shares for shares - Du Pont stock stock held by Christiana for shares of Du Pont) caused tax free loss, treatment favoring different...
E. I. Du Pont De Nemours and Company, et al., Petitioners

v.

Richard J. Collins, Jr., et al.

6/25/76 - Cert.

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John Marshall's note: "I see no great possibility."

Grant's note: "John's thinking was wrong."

Probable vote: Join 3.
75-1870 E.I. duPont v. Collins

Argued 3/2/77

517 b of Inv. Co. Act - S.E.C. formula
term of merger "paid" & involving no
"over-reaching;"

The intrinsic value of the stock
transformed to DuPont was its net
asset value. § 17 was intended
to assure that
David Ferber (Solomon of SEC)  
Relax on Central States case

Goldman (for DuPont)  
The vagueness of Tax Code makes this case complex. Add,Benefits to DuPont.  
1. Dispersion of its stock—so that DuPont would no longer be a "holding-c.0." subsidiary.

[Redemption similar merger  
Ten prior cases under $.17—  
all involved net asset value.  
SEC would not have approved  
term of merger significantly different—Ahh to SEC Ref. 35a, 36a.]
Further (cont.)

Even if there might have been a different "deal" at some length, SEC found their fees reasonable under Act.

3. Independent Investment Bankers found fees fair & reasonable.

No "control premium" was given Chevronian block of DuPont stock.

Posters are only two of more than 200,000 DuPont stock.

SEC gave special attention to claim that merger would have adverse effect on market value of DuPont.

(The G.M. case, relied on by Kerns, was different because by court order real was required, selling each year.)
Collins (for Rafer)
SEC didn't have to make a choice bet. market & net asset value. It should have considered both.

Merr (ftaugh) (for Rafer)
SEC consistently has used net asset value - Br 15

After merger terms are favorable to shareholders of C, they are not detrimental to DuPont. Indeed, DuPont acquires its own stock at a 2½% discount.

Also, DuPont - over long term - may benefit from not appearing to be subject to holding C.

Moreover, shareholders of C "carry-over" tax basis. "Bonanza" not as great as may appear.
Argued that DuPont - in answer-length deal - would have bargained for some of C's shareholders gain.

But SEC thought this would have been "over-reaching" within statute.

What considerations of fairness would embelle DuPont to claim a share in tax benefits derived by C's shareholders?

SEC consistently has used net asset value - Br 15

Also, merger terms are favorable to shareholders of C, they are not detrimental to DuPont.

Indeed DuPont acquires its own stock at a 2 1/2% discount.

Also, DuPont-o-very
TO: MR. JUSTICE POWELL
FROM: Gene Corney
RE: Nos. 75-1870 & 75-1872, SEC v. Collins

BOBTAIL BENCH MEMO

When the petitions for cert first came before the Conference, I recommended that you vote to grant in these two cases. I was then of the view that CA8 failed to give appropriate deference to the SEC's interpretation of the statute (which the SEC was charged to enforce). After considering this matter carefully on the merits, I am now of the view that the SEC is wrong and CA8 is right: net asset value is not the determinative factor with respect to the "fairness" of mergers of this sort.

A. BACKGROUND

Under section 17 of the Act, mergers between investment companies and their affiliates can be consummated only if the SEC finds that they are "reasonable and fair and do not involve overreaching on the part of any person concerned." The SEC has generally not required as a precondition to its approval that the parties to the merger apportion the benefits generated by the merger. The issue is whether this is the correct approach to the statute.

Christiana's only alternative to a merger with du Pont would have been liquidation under section 333 of the IRC, which could have resulted in a tax liability of between 8.5% and 17.2% of Christiana's assets measured by their market value. The SEC approved the tax free merger between du Pont and Christiana, even though it recognized the
clear "imbalance of benefit" in the terms of the merger. As the SEC viewed the transaction, the merger with the 2.5% discount would not injure the du Pont shareholders. And it is clear that it would help the Christiana shareholders by maintaining substantially the entire value of their investment. The SEC thus found the merger to be within the "range of fairness" mandated by the statute. CAB reversed, finding significant the gross disparity in benefits between the two groups of shareholders.

B. THE CONCEPT OF FAIRNESS

I gather from the briefs that we are not going to get much help from the legislative history with respect to whether Congress thought this type of merger was fair or unfair. As an economist, I find it easiest to treat the concept of "fairness" with respect to deals in terms of what the market will bear. If for now we put to one side the problems involved when the transaction is, for one reason or another, not an arm's length bargain, a "fair" price is the market price. When two parties negotiate a transaction, it is usually because there are benefits to be gained by both sides. The distribution of those benefits will depend on relative bargaining strength: how badly do you need what the other fellow has to offer. In other words, the terms of the bargain depend on what each party brings to the bargain and how badly the other party needs it.

This view finds support in some of our cases dealing with the concept of a "just and reasonable" standard. For example, in Schwabacher v. United States, 334 U.S. 182, 199, we interpreted the "just and reasonable" standard of the Transportation Act of 1940...
as requiring that it is not what a stockholder "once put into a constituent company but what value he is contributing to the merger that is to be made good."

It is of course possible to argue that Christiana is bringing to this merger its assets--primarily du Pont stock--since the effect of the proposed merger is a transfer of those assets. Under that view, one could then argue that Christiana's compensation should be valued not on the market value of its stock, but on the market value of its assets. The problem with that approach is that it takes only a superficial look at the transaction. The purpose of this transaction is not to bring to du Pont Christiana's assets; standing alone, there is no economic incentive for du Pont to purchase from Christiana its own shares and then reissue new shares in their place. The real purpose behind this transaction is to realize the substantial tax benefits that flow from this type of tax free merger. From this view, what Christiana brings to du Pont is an opportunity for the two to get together and accomplish a tax savings that will be unavailable to Christiana if it pursued any of its other options. Christiana needs du Pont badly in this transaction, since du Pont is the only available party which can accomplish tax free status. And Christiana brings with it an opportunity for a huge tax savings. Du Pont of course brings to the bargain the other side of the coin: it brings the opportunity for tax free status and is no doubt willing to accept part of the tax "bounty" in exchange for its role in the deal.

If these two parties got together and worked out an arrangement at arm's length, I am certain that the terms of the deal would have been far different than those approved by the SEC.
C. THE OPPORTUNITY FOR "UNFAIRNESS"

The SEC enters this case precisely because Congress recognized that certain transactions involved a significant opportunity for unfairness. With respect to affiliated companies, Congress wanted to deal with the possibility that the "dominant" firm would force unfair terms upon, and thereby injure, the "minor" firm. Thus, Congress required that the SEC give prior approval only to those mergers between affiliated companies that were "fair and reasonable and did not involve overreaching on the part of any person concerned."

If one presented the facts of this case to a group of economists and asked them to explain the factors influencing the terms of this bargain now before us, I am absolutely certain that the consensus would be that Christiana controlled or influenced the du Pont decision to accept the terms through something other than the legitimate exercise of bargaining power at arm's length. Here, Christiana is the dominant party, the merger provides an opportunity for it to obtain terms more favorable than it would otherwise obtain, and the terms in fact turn out to exhibit a clear imbalance. Why then should the merger be approved as fair and reasonable?

The only reason I can think of is that it is important to preserve the net asset value of shares in investment companies. This may well be part of the purpose of the provisions of the statute at issue. But the very provision under scrutiny at this time requires fairness to ALL parties to the bargain, which means du Pont as well as Christiana. Moreover, here it is Christiana which is the dominant party, and if either party is to be preferred it should be du Pont.
It might nonetheless be contended that the du Pont shareholders should not complain that the deal is unfair, since there is likely to be no effect on the price of their shares and the value of their investment. But that is a rather odd concept of fairness: your present position remains unchanged. In a very meaningful du Pont shareholders are injured—they have missed a good corporate opportunity. Take the following hypothetical, which probably sounds familiar. Suppose Christiana's assets consisted solely of IBM stock. Also assume that du Pont had ten shares of common outstanding, with ten shareholders each holding one share. Two of the du Pont shareholders also happen to be two shareholders of Christiana. Indeed, we can even assume that they are the two only shareholders of Christiana. Now let's suppose that due to some quirk in the tax laws the Christiana shareholders can merge with du Pont and only du Pont to realize the same tax savings as is at issue in this case. So the two Christiana shareholders go to du Pont management and say: look, if we merge with you in this fashion the value of du Pont shares will remain unchanged, and we can ourselves realize this huge tax savings. Since we also happen to be du Pont shareholders, why don't you do us this favor and let us reap this 100,000 tax benefit. The du Pont management would be crazy if it didn't insist on sharing the tax savings with the Christiana people. The fact that the Christiana shareholders also happen to be du Pont shareholders, and that du Pont shares would not decrease in value is irrelevant. If du Pont insists on a 50/50 split of the tax savings, each du Pont shareholder would "get" 1/10 th of 50,000, or 5,000. This is true as well of the two Christiana shareholders who are du Pont shareholders.
But if du Pont instead insists on no share of the benefit, or as here only a marginal share, the full value goes to the two Christiana shareholders—who are also du Pont shareholders—at $50,000 each. What reason is there for such a result?

Du Pont management would never enter into such a deal knowingly and voluntarily. If the deal went through under the terms proposed in the instant case, the presumption would be that du Pont management was negligent, that it had been coerced by the controlling influence of Christiana, or that du Pont management had colluded with the Christiana shareholders for an under-the-table share of the tax savings. With management as sophisticated as it is today, I think we can reject the first possible inference as unrealistic. With respect to either of the other two possibilities, the deal is inherently unfair and unreasonable to du Pont stockholders.

D. THE ROOT PROBLEM

A good deal of confusion can be caused by looking at this case in terms of whether Christiana shareholders are "entitled" to the tax benefits in the first place, and whether it is unfair to deprive them of the benefits to which they are entitled. In my view, the Christiana shareholders long ago attached certain restrictions and limitations on their shares by putting them into this holding company. They did so for good reason: they wanted to use Christiana as a control device. The fact that that control device has outlived its usefulness does not mean that they should be able to avoid the restrictions placed on their shares without paying for the fact those restrictions brought them benefits for a number of years. The very purpose of the
Act seems to be to keep Christiana from forcing a "bad deal" on du Pont. To say that the deal is "fair" since it does not injure du Pont stops at a superficial level. The deal is fair since you didn't get hurt in terms of a decline in present value. But the deal is appropriately characterized as a "bad deal"--and thus in my view as an unfair deal--because du Pont shareholders lost the opportunity to increase the value of what they owned.

I realize that we normally give considerable deference to the interpretation of a statute offered by the agency charged with enforcement of the statute. But this interpretation makes no economic sense, and I would reject the agency's interpretation.
The Chief Justice

This merger weakened control of Du Pont family.
SEC clearly right.

Agree with Stevens's dissent.

CAG had no business engaging a professor.

Every case.

Reverie

Two issues:
1. Look at what Du Pont acquired it acquired.
   "net assets." This is correct basis.
2. If case is judged on "arms length," it may merit
close scrutiny. But benefits to C's stockholders
   in net really concern of Du Pont if deal was fair to it.

Brennan, J.
Affirm

(No discussion.)

Stewart, J.

Revers

No statement to Du Pont.
Test under statute is not whether a
terms could have
bees negotiated.
Test is whether
terms were fair
SEC right.
Revere

Tax advantage $ is irrelevant.
Statutory test is fairness.

Blackmun, J. Revere

Agree tax advantage of some (that vary with each individual) are irrelevant.
Good registered at

Rehnquist, J. Absent

Powell, J. Revere

Chemical could have merged with other companies — some probably willing to pay a premium for the control of the greatest chemical company in world.
No. 75-1870  Du Pont v. Collins
No. 75-1872  Securities and Exchange Commission v. Collins

MR. CHIEF JUSTICE BURGER announced the opinion of the Court.

We granted certiorari in this case to determine whether the Securities and Exchange Commission, in approving the merger of a closed-end investment company into an affiliate company, reasonably exercised its discretion under the Investment Company Act of 1940, 54 STAT 789, as amended, 15 U.S.C. §80a-1 et seq. The Commission valued the investment company essentially on the basis of the market value of the securities which constituted substantially all of its assets rather than on the lower basis of its own outstanding stock.

The statutory scheme here is relatively straightforward. Section 17 of the Investment Company Act of 1940, 15 U.S.C. 80(a)-17, forbids an "affiliated person," as defined in the

1/ 429 U.S. 815 (1976)
Act, to purchase any securities or other property from a registered investment company unless the Commission finds, inter alia, that the "evidence establishes that ... the terms of the proposed transaction, including the consideration to be paid or received, are reasonable and fair and do not involve overreaching on the part of any person concerned. ...".

2/ 15 U.S.C. 80a-2(a)(3) defines an "affiliated person" as follows:

(3) "Affiliated person" of another person means (A) any person directly or indirectly owning, controlling, or holding with power to vote, 5 per centum or more of the outstanding voting securities of such other person; (B) any person 5 per centum or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by such other person; (C) any person directly or indirectly controlling, controlled by, or under common control with, such other person; (D) any officer, director, partner, copartner, or employee of such other person; (E) if such other person is an investment company, any investment adviser thereof or any member of an advisory board thereof; and (F) if such other person is an unincorporated investment company not having a board of directors, the depositor thereof.

3/ Section 17(b) also requires that: i - the proposed transaction be consistent with the policy of each registered investment company concerned, and ii - consistent with "the general purposes of this subchapter." 15 U.S.C. 80a-17(b)(2)(3). These criteria are not contested here.
The merger in this case involves Christiana Securities Company, a closed-end, non-diversified management investment company, and E. I. Du Pont de Nemours and Company, a large industrial operating company engaged principally in the manufacture of chemical products. Christiana was formed in 1915 in order to preserve family control of the Du Pont Corporation. At the time the present merger negotiations were announced in April 1972, 98% of Christiana's assets consisted of Du Pont common stock. This block of Du Pont stock in turn comprised approximately 28.3% of the outstanding common stock of the Du Pont Corporation. For purposes of this litigation, Christiana has been presumed to have at least the potential to control Du Pont, although it submits that "this potential lies dormant and unexercised and that there is no actual control relationship." Investment Company Act Release No. 8615/December 13, 1974, 5 S.E.C. Docket 745, 747 (1974).

Christiana owns 13,417,120 shares of Du Pont. It also holds a relatively small amount of Du Pont preferred stock. Its other assets consist of two daily newspapers in Wilmington, Delaware and 3.5% of the stock of the Wilmington Trust Company which, in turn, holds more than one half of Christiana's common stock as trustee. Investment Company Act Release No. 8615/December 13, 1974.

According to the applicants' "Notice of Filing of Application", Investment Company Act Release No. 7402, Du Pont has 47,566,694 shares of common stock outstanding held by approximately 224,984 shareholders.
Christiana itself has 11,710,103 shares of common stock outstanding and has about eight thousand shareholders. Unlike Du Pont stock, which is traded actively on the New York and other national stock exchanges, Christiana shares are traded in the over-the-counter market. Since virtually all of its assets are Du Pont common stock, the market price of Christiana shares reflects the market price of Du Pont stock. However, as is often the case with closed-end investment companies, Christiana's own stock has historically sold at a discount from the market value of its Du Pont holdings. Apparently, this discount is primarily tax-related since Christiana pays a federal intercorporate tax on dividends. Its stockholders are also subject to potential capital gains tax on the unrealized appreciation of Christiana's Du Pont stock which has a very low tax base. Additionally, the relatively limited market for Christiana stock likely influences the discount.

In 1972, Christiana's management concluded that, because of the tax disadvantages and the discount at which its shares

6/ 95.5% of these shares are held by 338 people. Investment Company Act Release No. 8615/December 13, 1974.

7/ In the two years preceding the date of the announcement of the merger negotiations, this discount was generally in the range of 20-25%. Investment Company Act Release No. 8615, December 13, 1974.
sold, Christiana should be liquidated and its stockholders become direct owners of Du Pont stock. Christiana's board of directors proposed liquidation of Christiana by means of a tax-free merger into Du Pont Corporation. Du Pont would purchase Christiana's assets by issuing to Christiana shareholders new certificates of Du Pont stock. In more concrete terms, Du Pont would acquire Christiana's $2.2 billion assets and assume its liabilities of approximately $300,000. In so doing, Du Pont would acquire from Christiana 13,417,120 shares of its own common stock. Du Pont would then issue 13,228,620 of its shares directly to Christiana holders. This would be 188,500 shares less than Du Pont would receive from Christiana - a ratio of 1.123 shares of Du Pont for each share of Christiana. This ratio was ascertained by taking the market price of Christiana's Du Pont stock and its other assets, subtracting Christiana's relatively nominal liabilities, and making certain other minor adjustments. Direct ownership of Du Pont shares would increase the market value of the Christiana shareholders' holdings and Du Pont would have acquired Christiana's assets at a 2.5% discount from their net value. The Internal Revenue Service ruled the merger would be tax-free.

(2) Du Pont and Christiana filed a joint application with the Commission for exemption under §17 of the Investment Company
Act. Administrative proceedings followed. The Commission's Division of Investment Management Regulation supported the application. A relatively small number of Du Pont shareholders, including the respondents in this case, opposed the transaction. Their basic argument was that, since Christiana was valued on the basis of its assets, Du Pont stock, rather than the much lower market price of its own outstanding stock, the proposed merger would be unfair to the shareholders of Du Pont since it provides relatively greater benefits to Christiana shareholders than to shareholders of Du Pont. The objecting stockholders argued that Du Pont Corporation should receive a substantial share of the benefit realized by Christiana shareholders from the elimination of the 23% discount from net asset value at which Christiana stock was selling. They also argued that the merger would depress the market price of Du Pont stock because it would place more than 13 million marketable Du Pont shares directly in the hands of Christiana shareholders.

After the hearing, the parties waived the initial administrative recommendations and the record was submitted directly to the Commission. The Commission unanimously granted the application. Basically, it viewed the proposed transaction as an exchange of equivalents - Christiana's Du Pont stock to be acquired by Du Pont in exchange for Du Pont stock issued directly to Christiana shareholders. It held that, for purposes
of §17(b), the proper guide for evaluating Christiana was the market price of Christiana's holdings of Du Pont stock:

"Here justice requires no ventures into the unknown and the unknowable. An investment company, whose assets consist entirely or almost entirely of securities, the prices of which are determined in active and continuous markets, can normally be presumed to be worth its net asset value. . . . The simple, readily usable tool of net asset value does the job much better than an accurate gauge of market impact (were there one) could." 5 S.E.C. Docket, at 751.

The fact that Du Pont might have obtained more favorable terms because of its strategic bargaining position or by use of alternative methods of liquidating Christiana was considered not relevant by the Commission. In its view, the purpose of §17 was to prevent persons in a strategic position from getting more than fair value. The Commission found no detriment in the transaction to Du Pont or to the value of its outstanding shares. Any depressing effects on the price of Du Pont would be brief in duration and the intrinsic value of an investment in Du Pont would not be altered by the merger. Moreover, in the Commission's view, any valuation involving a significant departure from net asset value would "run afoul of §17(b)(1) of the Act"; it would strip long-term investors in companies like Christiana of the intrinsic worth of the securities which underlie their holdings.

A panel of the United States Court of Appeals for the Eighth Circuit divided in setting aside the Commission's
determination. 532 F.2d 584 (1976). The majority held that the Securities and Exchange Commission had erred, as a matter of law, in determining that Christiana should be presumptively valued on the basis of the market value of its principal asset, common stock of Du Pont. "[I]n judging transactions between dominant and subserviant parties, the test is 'whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain' Pepper v. Litton, 308 U.S. 295, 306-307 (1939) (footnote omitted)," 532 F.2d, at 592. Employing this standard, the Court of Appeals majority concluded the record did not support the Commission's finding that the terms of the merger were "reasonable and fair" since the "economic benefits to Christiana shareholders from the merger are immediate and substantial," 532 F.2d, at 601, while "benefits to present Du Pont shareholders are minimal." Id., at 602. The court concluded that, from Du Pont's viewpoint, "the degree of [control] dispersion attained . . . does not justify the substantial premium paid for the Christiana stock," id., at 603. The panel also held that the Commission had erred in failing to give weight to the "occasional detriment to Du Pont shareholders," id., at 605, caused by the increase of available Du Pont stock in the market.

8/ A petition for rehearing en banc was denied by an equally divided court.
In determining whether the Court of Appeals correctly set aside the order of the Commission, we begin by examining the nature of the regulatory process whose decision that court was required to review. In *United States v. National Assn. of Securities Dealers*, 422 U.S. 694 (1975), we noted that the Investment Company Act of 1940, 15 U.S.C. §80a-1 et seq. "vests in the SEC broad regulatory authority over the business practices of the investment companies." 422 U.S., at 704-705. The Act was the product of Congressional concern that existing legislation in the securities field did not afford adequate protection to the purchasers of investment company securities. Prior to the enactment of the legislation, Congress mandated an intensive study of the investment company industry. One of the problems specifically identified was the numerous transactions between investment companies and persons affiliated with them which resulted in a distinct advantage to the "insiders" over the public investors. Section 17 was the

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specific Congressional response to this problem. Congress therefore charged the Commission, in scrutinizing a merger such as this, to take into account the peculiar characteristics of such a transaction in the investment company industry. Recognizing that an "arm's length bargain," cf. Pepper v. Litton, 308 U.S. 295 (1939), is rarely a realistic possibility in transactions between an affiliate and an investment company, Congress substituted, in effect, the informed judgment of the Commission to determine, inter alia, whether the transaction was "reasonable and fair and did not involve overreaching on the part of any person concerned."

Given the wide variety of possible transactions between an investment company and its affiliates, Congress, quite understandably, made no attempt to define this standard with any greater precision. Instead, it followed the practice frequently employed in other administrative schemes. The language of the statute was cast in broad terms and designed to encompass all situations falling within the scope of the statute; an agency with great experience in the industry was

11/ While the House and Senate Reports indicate that the Congress' chief concern was protection of the public investors of the investment company, S. Rep. No. 1775, 76th Cong., 3d Sess. 14 (1940); H. R. Rep. No. 2639, 76th Cong., 3d Sess. 9 (1940), the statute has been construed to afford protection to the stockholders of the affiliate as well. See Fifth Avenue Coach Lines, Inc., 43 S.E.C. 635, 639 (1967).

given the task of applying those criteria to particular business situations in a manner consistent with the legislative intent. 13/

C

In this case, a judgment as to whether the terms of the merger were "fair and reasonable" turned upon the value assigned to Christiana. In making such an evaluation, the Commission concluded that "[t]he single, readily usable tool of net asset value does the job much better than an accurate guage of market impact. . . ." 5 S.E.C. Docket, at 751. Investment companies, it reasoned, are essentially a portfolio of securities whose individual prices are determined by the forces of the securities marketplace. In determining value in merger situations, "asset value" is thus much more applicable to investment companies than to other corporate entities. The value of the securities surrendered is, basically, the real value received by the transferee.

13/ This situation is quite different from that which confronted the Court earlier this Term in Piper v. Chris-Craft Industries, U.S. ___ (1977). There, the Court held that "the narrow legal issue" of implying a private right of action under the securities laws was "one peculiarly reserved for judicial resolution" and that the experience of the Commission on such a question was of "limited value." U.S. ___ n. 27. Moreover, the Commission's Chairman, in testimony before Congress on the relevant legislation, had taken a position opposed to that asserted by the Commission's amicus brief in Piper. By contrast, this case does not involve a purely legal determination but, rather, an assessment as to whether a given business arrangement is compatible with the regulatory scheme which the agency is charged by Congress to administer.
In reviewing a decision of the Commission, a court must consider both the facts found and the application of the relevant statute by the agency. Congress has mandated that, in review of §17 proceedings, "[t]he findings of the Commission as to facts, if supported by substantial evidence, shall be conclusive." 15 U.S.C. §80a-42. A reviewing court is also to be guided by the "venerable principle that the construction of a statute by those charged with its execution should be followed unless there are compelling indications that it is wrong. . . ." Red Lion Broadcasting v. FCC, 395 U.S. 367, 381 (1969). "[C]ontemporaneous construction is entitled to great weight . . . even though it was applied in cases settled by consent rather than by litigation." FTC v. Mandel Bros., 359 U.S. 385 (1959). Here, however, the Court of Appeals held, as a matter of law, that the Commission erred in the method applied in passing on the merger, thus all but ignoring the Congressional limitations on judicial review of agency action.

The Commission has long recognized that the key factor in the valuation of the assets of a closed-end investment company should be the market price of the underlying securities. This method of setting the value of investment companies is, as Congress contemplated, the product of the agency's long and intimate familiarity with the investment company industry. For instance, in issuing an advisory report to the United States
District Court pursuant to Section 1703 of Chapter X of the Bankruptcy Act, the Commission advised that "it is natural that net asset value based upon market prices should be the fundamental valuation criterion used by and large in the investment company field." Central States Electric Corporation, 30 S.E.C. 680, 700 (1949), approved, sub nom Central States Electric Corp. v. Austrian, 183 F.2d 879, 884 (CA 4, 1950), cert. denied, 340 U.S. 917 (1951). Similarly, in mergers like the one presented in this case, the Commission has used "net asset value" as a touchstone in its analysis. See, e.g. Delaware Realty and Investment Company, 40 S.E.C. 469, 473 (1961); Harbor Plywood Corp. and Hunt Foods and Industries, Inc., 40 S.E.C. 1002 (1962); Eastern States Corporation, Investment Company Act Releases Nos. 5693 and 5711 (1969).

Moreover, despite the characterization of the Court of Appeals to the contrary, the Commission did not employ a mechanical application of a rule or "presumption". It considered carefully the contentions of the respondents that a departure from the use of net asset value was warranted in this case. Upon analysis, it concluded that the central and controlling aspect of the merger remained the fact that it consisted of an exchange of Du Pont common stock for Du Pont common stock; it was not Christiana stock but Du Pont stock which Du Pont was receiving in the merger. As to the claim that Du Pont stock would be adversely affected over an extended period of time by volume selling, the Commission concluded there was no indication of a long-term adverse market impact. It noted that Christiana stock was held principally by long-term investors. There was no evidence that Christiana stockholders, who for years had been indirect investors in Du Pont, would now change the essential nature of their investment.

The Commission's reliance on "net asset value" in this particular case and its consequent determination that the proposed merger met the statutory standards thus rested "squarely in that area where administrative judgments are entitled to the greatest amount of weight by the appellate courts. It is the product of administrative experience, appreciation of the complexities of the problem, realization
of the statutory policies, and reasonable treatment of the uncontested facts." SEC v. Chenery Corp., 332 U.S. 194, 209 (1947). In rejecting the conclusion of the Commission, the Court of Appeals substituted its own judgment for that of the agency charged by Congress with that responsibility. Indeed, after receiving briefs in oral argument, the Court of Appeals — over the objection of the Commission, Christiana and Du Pont — undertook the unique appellate procedure of employing a university professor to assist the court in understanding the record in this case and to prepare reports and memoranda for the court. Thus, the reports relied upon by that court included a variety of data and economic observations which had not been examined and tested by the traditional methods of the adversary process. We are not cited to any statute, rule, or decision authorizing the procedure employed by the Court of Appeals. Cf. Fed. Rule App. Proc. 16.

In our view, the Court of Appeals clearly departed from its statutory appellate function and applied an erroneous standard in its review of the decision of the Commission. The record made by the parties before the Commission was in accord with traditional procedures and that record clearly reveals substantial evidence to support the findings of the Commission. Moreover, the agency conclusions of law were based on a construction of the statute consistent with the legislative intent. Accordingly, the judgment of the Court of Appeals is reversed.

REVERSED
June 1, 1977

No. 75-1870 DuPont v. Collins
No. 75-1872 SEC v. Collins

Dear Chief:

Please join me.

Sincerely,

The Chief Justice

lfp/ss

cc: The Conference
June 1, 1977

Re: Nos. 75-1870 & 75-1872, DuPont v. Collins

Dear Chief:

Please join me.

Sincerely,

The Chief Justice

Copies to Conference
Re: No. 75-1870, du Pont v. Collins

Dear Chief,

I am glad to join your opinion for the Court in this case.

Sincerely yours,

The Chief Justice

Copies to the Conference
June 7, 1977

Re: No. 75-1870, Du Pont v. Collins
No. 75-1872, Securities and Exchange Commission v. Collins

Dear Chief:

Please join me.

Sincerely,

T. M.

The Chief Justice

cc: The Conference
Mr. CHIEF JUSTICE BURGER delivered the opinion of the Court.

We granted certiorari to this case to determine whether the Securities and Exchange Commission, in approving the merger of a closed end investment company into an affiliate company, reasonably exercised its discretion under the Investment Company Act of 1940, 15 U.S.C. § 80a-1 et seq. The Commission valued the investment company essentially on the basis of the market value of the securities which constituted substantially all of its assets rather than on the lower basis of its own outstanding stock.

The statutory scheme here is relatively straightforward. Section 17 of the Investment Company Act of 1940, 15 U.S.C. § 80a-17, forbids an "affiliated person," as defined in the Act, from owning, controlling, or holding with power to vote, 5 per...
to purchase any securities or other property from a registered investment company unless the Commission finds, \textit{inter alia}, that the "evidence establishes that... the terms of the proposed transaction, including the consideration to be paid or received, are reasonable and fair and do not involve over-reaching on the part of any person concerned. . . ."

A

(1) The merger in this case involves Christiana Securities Company, a closed end, nondiversified management investment company, and E. I. du Pont de Nemours and Company, a large industrial operating company engaged principally in the manufacture of chemical products. Christiana was formed in 1915 in order to preserve family control of the Du Pont Corporation. At the time the present merger negotiations were announced in April 1972, 98\% of Christiana's assets consisted of Du Pont common stock.\textsuperscript{4} This block of Du Pont stock in turn comprised approximately 28.3\% of the outstanding common stock of the Du Pont Corporation.\textsuperscript{5} For

\begin{itemize}
\item [(B)] any person 5 per centum or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by such other person;
\item [(C)] any person directly or indirectly controlling, controlled by, or under common control with, such other person;
\item [(D)] any officer, director, partner, copartner, or employee of such other person;
\item [(E)] if such other person is an investment company, any investment adviser thereof or any member of an advisory board thereof; and
\item [(F)] if such other person is an unincorporated investment company not having a board of directors, the depositor thereof.
\end{itemize}

\textsuperscript{8} Section 17(b) also requires that: i— the proposed transaction be consistent with the policy of each registered investment company concerned; and ii—consistent with "the general purposes of this subchapter." 15 U.S.C. § 80a-17(b)(2)(3). These criteria are not contested here.

\textsuperscript{4} Christiana owns 13,417,120 shares of Du Pont. It also holds a relatively small amount of Du Pont preferred stock. Its other assets consist of two daily newspapers in Wilmington, Del., and 3.5\% of the stock of the Wilmington Trust Company which, in turn, holds more than
purposes of this litigation, Christiana has been presumed to have at least the potential to control Du Pont, although it submits that "this potential lies dormant and unexercised and that there is no actual control relationship." Investment Company Act Release No. 8615/December 13, 1974, 5 S. E. C. Docket 745, 747 (1974).

Christiana itself has 11,710,103 shares of common stock outstanding and has about 8,000 shareholders. Unlike Du Pont stock, which is traded actively on the New York and other national stock exchanges, Christiana shares are traded in the over-the-counter market. Since virtually all of its assets are Du Pont common stock, the market price of Christiana shares reflects the market price of Du Pont stock. However, as is often the case with closed end investment companies, Christiana's own stock has historically sold at a discount from the market value of its Du Pont holdings. Apparently, this discount is primarily tax related since Christiana pays a federal intercorporate tax on dividends. Its stockholders are also subject to potential capital gains tax on the unrealized appreciation of Christiana's Du Pont stock which has a very low tax base. Additionally, the relatively limited market for Christiana stock likely influences the discount.

In 1972, Christiana's management concluded that, because of the tax disadvantages and the discount at which its shares sold, Christiana should be liquidated and its stockholders become direct owners of Du Pont stock. Christiana's board one-half of Christiana's common stock as trustee. Investment Company Act Release No. 8615/December 13, 1974.

5 According to the applicants' "Notice of Filing of Application," Investment Company Act Release No. 7402, Du Pont has 47,566,694 shares of common stock outstanding held by approximately 224,964 shareholders.

6 In the two years preceding the date of the announcement of the merger negotiations, this discount was generally in the range of 20-25%. Investment Company Act Release No. 8615, December 13, 1974.
of directors proposed liquidation of Christiana by means of a tax-free merger into Du Pont Corporation. Du Pont would purchase Christiana’s assets by issuing to Christiana shareholders new certificates of Du Pont stock. In more concrete terms, Du Pont would acquire Christiana’s $2.2 billion assets and assume its liabilities of approximately $300,000. In so doing, Du Pont would acquire from Christiana 13,417,120 shares of its own common stock. Du Pont would then issue 13,228,820 of its shares directly to Christiana holders. This would be 188,500 shares less than Du Pont would receive from Christiana—a ratio of 1.123 shares of Du Pont for each share of Christiana. This ratio was ascertained by taking the market price of Christiana’s Du Pont stock and its other assets, subtracting Christiana’s relatively nominal liabilities, and making certain other minor adjustments. Direct ownership of Du Pont shares would increase the market value of the Christiana shareholders’ holdings and Du Pont would have acquired Christiana’s assets at a 2.5% discount from their net value. The Internal Revenue Service ruled the merger would be tax free.

(2) Du Pont and Christiana filed a joint application with the Commission for exemption under § 17 of the Investment Company Act. Administrative proceedings followed. The Commission’s Division of Investment Management Regulation supported the application. A relatively small number of Du Pont shareholders, including the respondents in this case, opposed the transaction. Their basic argument was that, since Christiana was valued on the basis of its assets, Du Pont stock, rather than the much lower market price of its own outstanding stock, the proposed merger would be unfair to the shareholders of Du Pont since it provides relatively greater benefits to Christiana shareholders than to shareholders of Du Pont. The objecting stockholders argued that Du Pont Corporation should receive a substantial share of the benefit realized by Christiana shareholders from the elimination of
the 23% discount from net asset value at which Christiana stock was selling. They also argued that the merger would depress the market price of Du Pont stock because it would place more than 13 million marketable Du Pont shares directly in the hands of Christiana shareholders.

After the hearing, the parties waived the initial administrative recommendations and the record was submitted directly to the Commission. The Commission unanimously granted the application. Basically, it viewed the proposed transaction as an exchange of equivalents—Christiana's Du Pont stock to be acquired by Du Pont in exchange for Du Pont stock issued directly to Christiana shareholders. It held that, for purposes of § 17(b), the proper guide for evaluating Christiana was the market price of Christiana's holdings of Du Pont stock:

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The fact that Du Pont might have obtained more favorable terms because of its strategic bargaining position or by use of alternative methods of liquidating Christiana was considered not relevant by the Commission. In its view, the purpose of § 17 was to prevent persons in a strategic position from getting more than fair value. The Commission found no detriment in the transaction to Du Pont or to the value of its outstanding shares. Any depressing effects on the price of Du Pont would be brief in duration and the intrinsic value of an investment in Du Pont would not be altered by the merger. Moreover, in the Commission's view, any valuation involving a
significant departure from net asset value would "run afoul of § 17 (b) (1) of the Act"; it would strip long-term investors in companies like Christiana of the intrinsic worth of the securities which underlie their holdings.

A panel of the United States Court of Appeals for the Eighth Circuit divided in setting aside the Commission's determination, 523 F. 2d 584 (1976). The majority held that the Securities and Exchange Commission had erred, as a matter of law, in determining that Christiana should be presumptively valued on the basis of the market value of its principal asset, common stock of Du Pont. "[I]n judging transactions between dominant and subservient parties, the test is 'whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain' Pepper v. Litton, 308 U. S. 295, 306-307 (1939) (footnote omitted)." 532 F. 2d, at 592. Employing this standard, the Court of Appeals majority concluded the record did not support the Commission's finding that the terms of the merger were "reasonable and fair" since the "economic benefits to Christiana shareholders from the merger are immediate and substantial." 532 F. 2d, at 601, while "benefits to present Du Pont shareholders are minimal." Id., at 602. The court concluded that, from Du Pont's viewpoint, "the degree of [control] dispersion attained ... does not justify the substantial premium paid for the Christiana stock," id., at 603. The panel also held that the Commission had erred in failing to give weight to the "occasional detriment to Du Pont shareholders," id., at 605, caused by the increase of available Du Pont stock in the market.

B

In determining whether the Court of Appeals correctly set aside the order of the Commission, we begin by examining the nature of the regulatory process whose decision that court was

A petition for rehearing en banc was denied by an equally divided court.
required to review. In United States v. National Assn. of Securities Dealers, 422 U. S. 694 (1975), we noted that the Investment Company Act of 1940, 15 U. S. C. § 80a-1 et seq., "vests in the SEC broad regulatory authority over the business practices of the investment companies." 422 U. S., at 704-705. The Act was the product of congressional concern that existing legislation in the securities field did not afford adequate protection to the purchasers of investment company securities. Prior to the enactment of the legislation, Congress mandated an intensive study of the investment company industry. One of the problems specifically identified was the numerous transactions between investment companies and persons affiliated with them which resulted in a distinct advantage to the "insiders" over the public investors. Section 17 was the specific congressional response to this problem.

Congress therefore charged the Commission, in scrutinizing a merger such as this, to take into account the peculiar characteristics of such a transaction in the investment company industry. Recognizing that an "arm's length bargain," cf. Pepper v. Litton, 308 U. S. 295 (1939), is rarely a realistic possibility in transactions between an affiliate and an investment company, Congress substituted, in effect, the informed judgment of the Commission to determine, inter alia,
whether the transaction was "reasonable and fair and did not involve overreaching on the part of any person concerned." 12

Given the wide variety of possible transactions between an investment company and its affiliates, Congress, quite understandably, made no attempt to define this standard with any greater precision. Instead, it followed the practice frequently employed in other administrative schemes. The language of the statute was cast in broad terms and designed to encompass all situations falling within the scope of the statute; an agency with great experience in the industry was given the task of applying those criteria to particular business situations in a manner consistent with the legislative intent. 13

C

In this case, a judgment as to whether the terms of the merger were "fair and reasonable" turned upon the value assigned to Christiana. In making such an evaluation, the Commission concluded that "[t]he single, readily usable tool of net asset value does the job much better than an accurate gauge of market impact. . . ." 5 S. E. C. Docket, at 751. Investment companies, it reasoned, are essentially a portfolio of securities whose individual prices are determined by the forces of the securities marketplace. In determining value in merger situations, "asset value" is thus much more applicable

12 15 U. S. C. 80a-17 (b) (1).
13 This situation is quite different from that which confronted the Court earlier this Term in Piper v. Chris-Craft Industries, — U. S. — (1977). There, the Court held that "the narrow legal issue" of implying a private right of action under the securities laws was "one peculiarly reserved for judicial resolution" and that the experience of the Commission on such a question was of "limited value." — U. S. — n. 27. Moreover, the Commission's Chairman, in testimony before Congress on the relevant legislation, had taken a position opposed to that asserted by the Commission's amicus brief in Piper. By contrast, this case does not involve a purely legal determination but, rather, an assessment as to whether a given business arrangement is compatible with the regulatory scheme which the agency is charged by Congress to administer.
to investment companies than to other corporate entities. The value of the securities surrendered is, basically, the real value received by the transferee.

In reviewing a decision of the Commission, a court must consider both the facts found and the application of the relevant statute by the agency. Congress has mandated that, in review of §17 proceedings, "[t]he findings of the Commission as to facts, if supported by substantial evidence, shall be conclusive." 15 U. S. C. §80a-42. A reviewing court is also to be guided by the "venerable principle that the construction of a statute by those charged with its execution should be followed unless there are compelling indications that it is wrong . . ." Red Lion Broadcasting v. FCC, 395 U. S. 367, 381 (1969). "[C]ontemporaneous construction is entitled to great weight . . . even though it was applied in cases settled by consent rather than by litigation." FTC v. Mandel Bros., 359 U. S. 385 (1959). Here, however, the Court of Appeals held, as a matter of law, that the Commission erred in the method applied in passing on the merger, thus all but ignoring the congressional limitations on judicial review of agency action.

The Commission has long recognized that the key factor in the valuation of the assets of a closed end investment company should be the market price of the underlying securities. This method of setting the value of investment companies is, as Congress contemplated, the product of the agency's long and intimate familiarity with the investment company industry. For instance, in issuing an advisory report to the United States District Court pursuant to §1703 of Chapter X of the Bankruptcy Act, the Commission advised that "it is natural that net asset value based upon market prices should be the fundamental valuation criterion used by and large in the investment company field." Central States Electric Corporation, 30 S. E. C, 660, 700 (1949), approved, sub nom. Central States Electric Corp. v. Austrian, 183 F. 2d
Similarly, in mergers like the one presented in this case, the Commission has used "net asset value" as a touchstone in its analysis. See, e.g., Delaware Realty and Investment Company, 40 S. E. C. 469, 473 (1961); Harbor Plywood Corp. and Hunt Foods and Industries, Inc., 40 S. E. C. 1002 (1962); Eastern States Corporation, Investment Company Act Releases Nos. 5693 and 5711 (1966)."14

Moreover, despite the characterization of the Court of Appeals to the contrary, the Commission did not employ a mechanical application of a rule or "presumption." It considered carefully the contentions of the respondents that a departure from the use of net asset value was warranted in this case. Upon analysis, it concluded that the central and controlling aspect of the merger remained the fact that it consisted of an exchange of Du Pont common stock for Du Pont common stock; it was not Christiana stock but Du Pont stock which Du Pont was receiving in the merger. As to the claim that Du Pont stock would be adversely affected over an extended period of time by volume selling, the Commission concluded there was no indication of a long term adverse market impact. It noted that Christiana stock

14 This method of valuation of closed end investment companies was similarly employed in 8th, Inc., Investment Company Act Release Nos. 8773 and 8714; Chemical Fund, Inc., Investment Company Act Release No. 8773, The Citizens and Southern Capital Corp., Investment Company Act Release Nos. 7755 and 7892, Detroit and Cleveland Navigation Company, Investment Company Act Release Nos. 2692 and 3099, Cheapside Dollar Fund Limited, Investment Company Act Release Nos. 7064 and 7084. The Commission has, of course, required that such valuations be adjusted to reflect such factors as expenses of the merger and tax considerations. Tally Industries, Inc., Investment Company Act Release No. 5623 and Electric Bond and Share Company, Investment Company Act Release No. 8216, cited by the Court of Appeals, did not rely on net asset value since the companies held substantial assets other than securities. While Christiana also had some assets other than Du Pont stock, they amounted to only 2% of its assets.
was held principally by long term investors. There was no evidence that Christiana stockholders, who for years had been indirect investors in Du Pont, would now change the essential nature of their investment.

The Commission’s reliance on “net asset value” in this particular case and its consequent determination that the proposed merger met the statutory standards thus rested “squarely in that area where administrative judgments are entitled to the greatest amount of weight by the appellate courts. It is the product of administrative experience, appreciation of the complexities of the problem, realization of the statutory policies, and reasonable treatment of the uncontested facts.” *SEC v. Chenery Corp.*, 332 U. S. 194, 209 (1947). In rejecting the conclusion of the Commission, the Court of Appeals substituted its own judgment for that of the agency charged by Congress with that responsibility. Indeed, after receiving briefs in oral argument, the Court of Appeals—over the objection of the Commission, Christiana and Du Pont—undertook the unique appellate procedure of employing a university professor to assist the court in understanding the record in this case and to prepare reports and memoranda for the court. Thus, the reports relied upon by that court included a variety of data and economic observations which had not been examined and tested by the traditional methods of the adversary process. We are not cited to any statute, rule, or decision authorizing the procedure employed by the Court of Appeals. Cf. Fed. Rule App. Proc. 16.

In our view, the Court of Appeals clearly departed from its statutory appellate function and applied an erroneous standard in its review of the decision of the Commission. The record made by the parties before the Commission was in accord with traditional procedures and that record clearly reveals substantial evidence to support the findings of the Commission. Moreover, the agency conclusions of law were
based on a construction of the statute consistent with the legislative intent. Accordingly, the judgment of the Court of Appeals is reversed. 

Reversed.

Mr. Justice Rehnquist took no part in the consideration or decision of this case.
June 9, 1977

RE: 75-1870 - DuPont v. Collins

Dear Chief:

Please join me.

Respectfully,

The Chief Justice

Copies to the Conference
June 9, 1977

Chambers of
Justice Harry A. Blackmun

Re: No. 75-1870 - du Pont v. Collins
No. 75-1872 - S.E.C. v. Collins

Dear Chief:

Please join me.

Sincerely,

[Signature]

The Chief Justice

cc: The Conference