

26 S.E.C. 426 (S.E.C. Release No.), 1947 WL 26116

S.E.C. Release No.

SECURITIES AND EXCHANGE COMMISSION (S.E.C.)

IN THE MATTER OF
THE TONOPAH MINING COMPANY OF NEVADA

File No. 812-241

Promulgated July 21, 1947

(Investment Company Act of 1940 Section 3(b)(2))

DEFINITION OF AN INVESTMENT COMPANY

***1 Declaratory Orders**

Application under Section 3(b)(2) of the Investment Company Act of 1940 for an order declaring applicant not to be an investment company denied where applicant falls within the definition of an investment company under Section 3(a)(3) of the Act and does not establish that it is primarily engaged in a business other than that of investing, reinvesting, owning, holding or trading in securities.

APPEARANCES:

McWilliams, Wagoner & Troutman, by J. W. McWilliams, of Philadelphia, Pa., for The Tonopah Mining Company of Nevada.

Charles E. Shreve, for the Corporation Finance Division of the Commission.

FINDINGS AND OPINION OF THE COMMISSION

The Tonopah Mining Company of Nevada has applied for an order under Section 3(b)(2) of the Investment Company Act of 1940 ('the Act'), declaring it not to be an investment company within the meaning of the Act on the ground that it is primarily engaged in the business of metal mining.

After appropriate notice, hearings were held before a trial examiner the trial examiner filed an advisory report recommending denial of the application, exceptions were filed thereto, briefs were filed and oral argument was had before the Commission. Our findings are based upon an independent review of the record.

It is not disputed that over 40 percent of applicant's assets, exclusive of cash and Government securities, are investment securities. Applicant therefore falls within the definition contained in Section 3(a)(3) of the Act, which defines an investment company to include any issuer which

is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis.

However, notwithstanding the quoted provisions of Section 3(a)(3), if the Commission finds that an applicant is 'primarily engaged in a business or businesses other than that of investing, reinvesting, owning, holding or trading in securities,' such applicant may obtain an order declaring it not to be an investment company under the provisions of Section 3(b)(2).¹

The issue raised by a Section 3(b)(2) application is one of fact, and must be resolved by a review of the special circumstances applicable to the particular case.² The principal relevant considerations are 1) the company's historical development; 2) its public representations of policy; 3) the activities of its officers and directors; and, most important, 4) the nature of its present assets; and 5) the sources of its present income. We will consider each of these in turn.

HISTORICAL DEVELOPMENT OF THE COMPANY

*2 Applicant was incorporated in Delaware in 1901. In its early years of existence the company was undoubtedly primarily engaged in the mining business directly and through majority-owned subsidiaries. It regarded its portfolio of investments as a so-called exploration fund for the purpose of exploring and developing mining properties. However, nearly all of the majority-owned mining subsidiaries have now become inactive. The result has been that for a number of years, and as of the present time, the only active mining property in the enterprise has been the gold-silver mine at Tonopah, Nevada. The company has granted leases to miners for exploitation of this property on a royalty basis and supplies certain equipment and services to the lessees.

It has been argued that applicant is also engaged in the mining business through La Luz Mines, Ltd., in Nicaragua. Applicant explored this property in 1936 at a cost of over \$175,000, and had rights to acquire a one-third interest in the corporation to be formed to develop the mine. However, it was not in a position in 1938 to invest the required capital, but reduced its participation to 10 percent. The remaining 90 percent of the stock was acquired by Ventures, Ltd., an affiliate of the applicant.³ In its brief, applicant points to the fact that Ventures and itself have a common president and executive vice-president, and claims that 'as a matter of economic fact' applicant is an operator of the La Luz mining property. The evidence does not support this claim. On the contrary, applicant's secretary-treasurer testified that Ventures and La Luz Mines, Ltd. were not controlled by Tonopah; that La Luz was controlled by Ventures and that Tonopah's interest in La Luz was a stock interest.

This witness further testified that the La Luz and various other investments in mining properties were made because 'Mr. Lindsley (applicant's president) as head of Ventures naturally is very closely informed on them, and is advised that those companies have very good possibilities of developing into active mining ventures, and in that way any investment on our part should have more possibility . . . for the future than merely investing a small amount in Kennecott or something like that, which is an already developed mine.' This testimony appears to indicate that applicant is not investing in these enterprises for the purpose of gaining control or operating the businesses of the companies involved, but rather that its primary interest is that of an investor. As is shown below, applicant's portfolio consists in large part of mining securities, but this circumstance is entirely consistent with a policy of investment rather than engaging in the business of mining. It merely indicates that the company, because of historical reasons and because of the expert knowledge of some of the members of its management, favors concentrating most of its investments in a particular type of industry. This is a well recognized form of investment company activity.

REPRESENTATIONS OF POLICY

*3 The company's charter, as drafted in 1901, stated its principal purpose to be:

To acquire and own and operate mines of gold, silver, copper, coal and other minerals and to conduct any mercantile business in connection with the same.

The purpose clause also provided that 'in furtherance and not in limitation of the general powers conferred by the laws of the State of Delaware, and the objects and purposes herein set forth' the company might, among other things, buy, sell, mortgage or lease real property, manufacture and deal in goods and merchandise of every description, acquire other businesses and pay for the same in securities of the company, acquire or grant licenses, and purchase, hold or sell securities created by any other corporation.

In 1935, the company filed with the Commission an application for registration of its 1,000,000 shares of common stock, par value \$1 per share, on the Philadelphia Stock Exchange.⁴ In the application for registration the general character of the business done by the registrant was described as follows:

Mining property at Tonopah, Nevada, being operated by leasers on a royalty basis; principal metals gold and silver. Its milling plant and tailings at Millers, Nevada, being operated by an outside company—General Metals Recovery Corporation—on a rental and royalty basis. Company maintains a small staff of engineers in field in search for new properties.

The registration statement listed nine majority-owned subsidiaries engaged in mining or related businesses; but of these five were said to be inactive. As to the remaining four, two were stated to be engaged, inter alia, in making 'outside investment' in stocks and bonds of industrial, public utility, railroad and mining companies; one was stated to be engaged in the distribution of electric power to various mining companies; and one was stated to be engaged in hauling supplies and ore to and from various mines in the vicinity of Tonopah.

In a report to stockholders dated April 15, 1935 the management stated:

Your Board has adopted a policy of liquidating securities whenever prices seem to warrant such a course, and not making further investments in other securities, excepting stocks of mining companies which have been investigated and show reasonable prospect of substantial appreciation.

Your Company for some years has operated somewhat in the nature of a holding company, new properties as acquired being operated and financed as independent companies. The proposed legislation regarding holding companies, now before Congress, is being considered by your Board, and when the outcome of this legislation is definitely known, it is quite likely that certain recommendations must be made by the directors as to the future financing of the company. in the event of any large properties being acquired by us.

The subsequent annual reports to stockholders contain few or no direct representations as to the nature of the company with the exception of a report for 1943 dated March 24, 1944, in which it is stated:

*4 There is attached a list of the securities owned by the company, for your information, showing the manner in which the company invests its surplus funds until such time as they may be required for mining purposes.

While the evidence of direct representation is not unequivocal, it does indicate that as early as 1935 the management regarded the enterprise as being 'somewhat in the nature of a holding company' and gave notice to stockholders that the proposed legislation regarding 'holding companies' might affect it.⁵

More important, however, as appears below, the nature of the assets and income of the company, disclosed in the annual reports filed with the Commission and in reports sent to stockholders, was such as to lead investors to believe that the principal activity of the company was trading and investing in securities.⁶

ACTIVITIES OF OFFICERS AND DIRECTORS

The principal offices of the company are in Philadelphia. Applicant asserts that none of the members of its management have ever been engaged in banking, brokerage or the investment business. However, it is stated that the individual directors have had wide experience in investing in mining securities and in mining operations, i. e., that they are experts in the business of mining and are qualified to pass upon the merits of investments in mining stocks in which they may be interested.

Lindsley, applicant's president, is not very active, keeps in contact with company activities through means of reports and copies of minutes of board meetings, and attends such meetings whenever possible. As already stated he is also president of Ventures, Ltd. The superintendent at Tonopah is neither an officer nor a director of applicant.

The record does not show that any members of the corporate management spend any considerable part of their time in connection with the company's mining operations.

NATURE OF ASSETS

As of September 30, 1946, the date of the latest available data, the company's total assets per books were \$1,426,345, of which \$248,150 represented cash and United States Government bonds. Of the remaining \$1,178,195, 'marketable securities' and 'other investment securities' (neither of which items includes securities of controlled subsidiaries accounted for \$1,104,895, or about 94 percent. The portfolio (aside from U. S. Government bonds) contained 21 items of mining and smelting securities carried on the books at \$695,526 and representing about 63 percent of total investment securities. The balance consisted of 35 items including public utility, railroad, aviation, banking, insurance, foreign government, and miscellaneous industrial securities. In addition, 130,000 shares of treasury stock, which had been reacquired at a cost of \$177,950, were carried as a deduction from the capital stock and surplus accounts. Investments in subsidiaries are not carried on the books at all or at only nominal amounts.

A review of the company's balance sheets since December 31, 1934, shows that investment securities have constituted similarly large percentages of assets during the past thirteen years, that mining securities at all times constituted a large portion thereof, and that other securities have been diversified. In short, there has been no substantial change in the general character of the portfolio in recent years.

SOURCES OF INCOME

*5 The following table shows the company's major sources of income and its exploration expenditures by years for the period 1934-1945:

Year	Income from interest and dividends	Profit or (loss) from sales of securities	Exploration expenditures	Profit or (loss) from mining or leasing
1934.....	\$293	\$1,344	\$13,315	\$69,201
1935.....	210	29,302	94,538
1936.....	15,829	16,588	109,587
1937.....	9,777	26,625	114,533
1938.....	10,415	(12,370)	5,359	67,551
1939.....	9,277	(8,251)	7,309	39,661
1940.....	16,594	(27,775)	13,641	41,947

1941.....	19,479	(28,565)	551	36,061
1942.....	32,474	(236,570)	441	18,336
1943.....	48,082	3,421	3,676	2,649
1944.....	58,276	12,285	769	(9,799)
1945.....	56,293	56,498	12	(13,214)

It will be noted that mining income and exploration expenditures have been decreasing very substantially while income from securities has materially increased. Applicant contends that these trends represent an abnormal condition due to the war. However, the table shows that income from mining and exploration expenditures began to drop sharply in 1938. In addition, there is testimony by witnesses for the applicant that the quality of the ore at Tonopah is depreciating and that the possibilities of continued production cannot be projected for any considerable period. It also appears that there has been a substantial reduction in the number of leases under which ore is being extracted.

*6 There can be no question that as of the present time the company's only source of net income consists of interest, dividends and profits on the sale of securities; and we find nothing to indicate that this situation will be changed substantially in the foreseeable future.

CONCLUSIONS

At organization the applicant was undoubtedly primarily engaged in the mining business. It has since changed its character and it has become in large part a company engaged in the business of holding and trading in securities. In recent years its holdings of investment securities have been such as to bring it within the definition of an investment company contained in Section 3(a)(3) of the Act. While it has specialized in the securities of mining enterprises, it has not done so with a view to exercising control or engaging in the business of mining; on the contrary it has assumed the position of an investor. Approximately 94 percent of its total assets (exclusive of cash and United States Government bonds) are represented by investment securities and all of its net income is derived from interest, dividends or trading profits in such securities.

While it may be true that the management hopes some day to acquire controlling interests and exercise control in existing or new mining enterprises in which it is interested, we cannot find that applicant is at present primarily engaged in the business of metal mining. Accordingly the application must be denied.⁷

An appropriate order will issue.

By the Commission: (Commissioners McConnaughey, McEntire, Hanrahan, and McDonald), Chairman Caffrey being absent and not participating.

Footnotes

1 Section 3(b) provides in part:
 'Notwithstanding paragraph (3) of subsection (a), none of the following persons is an investment company within the meaning of this title:

'(2) Any issuer which the Commission, upon application by such issuer, finds and by order declares to be primarily engaged in a business or businesses other than that of investing, reinvesting, owning, holding, or trading in securities either directly or (A) through majority-owned subsidiaries or (B) through controlled companies conducting similar types of businesses . . . ?

- 2 See for example *International Mining Corporation*, 12 S. E. C. 174 (1942); *Tobacco Products Export Corporation*, 12 S. E. C. 743 (1943); *Bankers Securities Corporation*, 15 S. E. C. 695 (1944), affirmed sub nom. *Bankers Securities Corporation v. S. E. C.*, 146 F. 2d 88 (1944).
- 3 *Ventures, Ltd.* owns over 5 percent of the stock of the applicant. According to its annual report for 1945 the applicant owns 10,000 shares of *Ventures, Ltd.*, but the record does not show what percentage of voting power the block represents. In the annual reports filed with the Commission pursuant to Section 13 of the Securities Exchange Act of 1934, applicant's holdings in *Ventures* are listed under marketable securities rather than as an investment in securities of an affiliate.
- 4 Registration is still in effect. At the present time there are outstanding 870,000 shares in the hands of about 3,250 shareholders.
- 5 The reference was apparently to Section 30 of the Public Utility Holding Company Act of 1935 which directed the Commission to 'make a study of the functions and activities of investment trusts and investment companies' and to report the results of its study to Congress on or before January 4, 1937.
- 6 In addition to a balance sheet and profit and loss statement, an itemized list of the security holdings was attached to each of the annual reports sent to stockholders.
- 7 Applicant has not attempted to show that any undue burden would be imposed on its mining operations by reason of registration under the Act; if such a showing were to be made, our action herein would not, of course, preclude applicant from requesting exemption from the provisions asserted to created such burdents.

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