BIENNIAL REPORT OF THE ATTORNEY-GENERAL OF THE STATE OF CALIFORNIA, 1904-1906

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OF THE

STATE OF CALIFORNIA

1904-1906

SACRAMENTO
W. W. SHANNON, - - - - - - - - - SUPT. STATE PRINTING
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REPORT OF THE ATTORNEY-GENERAL.

STATE OF CALIFORNIA, OFFICE OF ATTORNEY-GENERAL,
SACRAMENTO, September 15, 1906.

To His Excellency, GEORGE C. PARDEE,
Governor of California.

SIR: I have the honor to transmit to you herewith my biennial report, made pursuant to the provisions of law in that behalf, covering the work of this office for the two years ending September 15, 1906.

It will be observed that, up to the middle of April of the present year, the routine business of the department has shown a constant growth in volume, quite consistent with the growth of the State and its manifold material interests.

Subsequent to the date mentioned, there has been a temporary lull in ordinary routine affairs, owing to the destruction of court records and the interruption of judicial and commercial functions throughout the State by the recent disastrous conflagration in San Francisco. These routine matters have, however, been more than compensated for, during the past six months, by the large number of matters of extraordinary character that have come before me, requiring the closest attention and application of every member of my office force.

Without entering into detail, these matters may be summarized by a reference to the insurance situation; to the governmental questions arising from the long series of holidays necessarily proclaimed by your Excellency; to the confusion arising from lost or destroyed public records; and to the duties attendant upon the special session of the Legislature called to pass laws to meet the abnormal conditions caused by the recent calamity.

The division of the work of the office into three separate channels has been maintained, as far as possible, viz: into civil litigation, criminal appeals, and opinions.

At the date of my last biennial report there were pending before this office one hundred and three civil cases; since that time one hundred and one new cases have been received, as against seventy-two cases for the previous two years; one hundred and six cases of civil litigation have been finally disposed of, so far as the interests of the State are concerned, leaving now pending in the office ninety-seven civil cases.

In addition to the formal report herewith transmitted, I beg to call attention to some of the more important civil matters that have come before me.

CIVIL LITIGATION.

Bond Investment Companies.

In my last report I called attention to the questionable nature of the business being then transacted throughout the State by a large number of so-called "bond investment" companies, and indicated the desirability of action to restrain such as appeared to be doing an illegal business. I pointed out, however, the inadequacy of the law, as it then stood, to protect the interests of the bondholders or creditors of such corporations, and suggested the amendment of the statutes in that respect.

At its session of 1905 the Legislature passed an Act "defining bond investment companies, and regulating and governing corporations * * * and individuals engaged in the business of selling bonds * * * or certificates of investment * * * on the installment plan * * * wherein the holder may be subject to forfeiture for non-payment of installments, * * * *and to protect the holders thereof.*"

This Act requires an initial deposit with the State Treasurer of $5,000 in cash, or in securities to be approved by that officer, and the further deposit, semi-annually, of ten per cent of all payments or installments received. The Act also requires that forty per cent of all payments or installments be set aside as a reserve fund, which "may be invested from time to time within the discretion of the board of directors." The Attorney-General is given authority to at any time examine the affairs of any concern doing business under the Act, and if it be ascertained that the company has not assets equal to the total required reserve, that officer shall at once commence an action to restrain the company from the further transaction of business, and may, in his discretion, institute proceedings to have it declared bankrupt.

There occurs in the Act, however, this remarkable provision:

> "No corporation * * * doing business * * * as an investment company * * * shall hereafter lend to holders of bonds * * * out of its reserve fund, any amount greater than the proportionate share of such bond * * * in said reserve, and whenever such loan is made it shall be evidenced by the note of the borrower and secured by a deposit, as collateral security, of the bond * * * on which the same is made. *Any collateral so taken may be deposited with the treasurer of the State of California as a part of the deposit hereinbefore required.* * * * "

Whatever protection might have been afforded to persistent bondholders by other portions of the Act is completely destroyed by the provision quoted.

I cite, as a concrete instance, the conditions disclosed by an examination of a concern claiming to be perfectly solvent. Its investment bonds each carry a loan value of about sixty per cent of the amount paid in by the bondholder. A number of the bondholders became dissatisfied with their investment and, desiring to withdraw, were paid the loan value of their respective bonds and their notes were taken therefor, their bonds being deposited with the company as collateral for the payment of the notes. These persons had no intention of paying their notes nor of redeeming their bonds. In many other cases a bondholder, temporarily embarrassed financially, was credited upon the books of the company with advance payments to the extent of the loan value of his bond, his note taken therefor, and the bond deposited as collateral, and thereafter the bondholder defaulted in the payment of his note and the bond reverted to the company. These bonds so deposited as collateral were substituted with the State Treasurer for the tangible cash and securities theretofore deposited with that officer. Such collateral, however, had no value except in so far as it was a lien upon the reserve fund of the company, and if the reserve fund, as rapidly as it accumulated, was "within the discretion of the board of directors" loaned to embarrassed or dissatisfied bondholders, the persistent bondholder had absolutely no protection. The concern in question, however, and others of its caliber, promptly availed themselves of the advertising value of the Act, and prominently displayed upon their literature the statement that they were doing business under a law of the State of California passed especially for the "protection" of bondholders in investment companies.

I at once commenced proceedings against this, and other companies whose affairs were in a similar condition, and these proceedings are pending. However, the publicity given to this litigation and to the methods of these concerns as therein disclosed by the public press of the State has had a salutary effect in warning the people against these concerns, with the result that they have practically ceased to attempt business in this State.

Under the law as it now exists, irresponsible persons may commence the business of selling certificates of investment, and my office have no information until complaint is made to me of a repudiation by them of their contract. I then learn, in nearly every instance, that each of such contracts is, in part at least, unlawful. The statute should be so amended as to require these certificates and forms of contract to be submitted to some public officer, designated by the statute, for his approval, as to the legality of their terms, before they may be offered for sale. Statutes of a similar purport exist in other states and are also to be found among the laws enacted by Congress.