

ADMINISTRATIVE PROCEEDING  
FILE NO. 3-1246

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

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In the Matter of  
AMERICAN STEEL AND PUMP CORPORATION  
(812-2141)

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**FILED**

MAR 18 1968

SECURITIES & EXCHANGE COMMISSION

INITIAL DECISION

Irving Schiller  
Hearing Examiner

Washington, D. C.  
March 18, 1968

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BEFORE: Irving Schiller, Hearing Examiner

APPEARANCES: Lewis Sandler of Saxe, Bacon & Bolan,  
for American Steel and Pump Corporation

Hugh P. Mullen, for Victor Muscat

William J. Kenney of Gadsby, Maguire & Hannah,  
for Edward Krock

Lawrence M. Powers of Bermen and Powers,  
for A. W. Benkert and Company and certain  
holders of the common stock and 4% income  
bonds series A of American Steel and  
Pump Corporation

Sydney H. Mendelsohn, David M. Butowsky,  
Gerald J. Beyer and Theodore Altman,  
for the Division of Corporate Regulation  
of the Commission

American Steel and Pump Corporation ("American") has filed an application for an order pursuant to Section 17(b) of the Investment Company Act of 1940 ("Act") exempting certain transactions from the provisions of Section 17(a) of the Act. These transactions include a tender offer by Victor Muscat ("Muscat") and Edward Krock ("Krock") for the outstanding common stock and 4% Income Bonds Series A, due December 1, 1994 ("Bonds") of American and for the resale of the common stock to BSF Company ("BSF"), a registered investment company, and the resale of the said Bonds to American, a company controlled by BSF. Though the application requests that the Commission exempt the aforesaid transactions solely from the provisions of Section 17(a) of the Act, the order for hearing directs that consideration also be given to determining whether the proposed transactions, if consummated, would be contrary to Section 17(d) of the Act and Rule 17d-1 thereunder.

After appropriate notice, including notice to security holders of American, a public hearing was held before the undersigned hearing examiner. At such hearing Muscat, Krock and A. W. Benkert & Co. ("Benkert") were granted leave to be heard, pursuant to Rule 9 of the Commission's Rules of Practice. Such leave permitted these persons to participate in the proceedings affording them the right to offer evidence, cross examine witnesses and at the conclusion of the hearings submit proposed findings and a brief. Proposed findings of fact, conclusions of law and briefs

were filed by American, Krock, Benkert and the Division of Corporate Regulation ("Division"). Muscat filed a statement adopting the proposed findings submitted by Krock.

The following findings and conclusions are based on the record, the documents and exhibits therein.

Description of Companies and Affiliated Persons

American has issued and outstanding 326,968 shares of 47¢ par value common stock and approximately \$1,947,000 of Bonds. BSF, a registered management closed-end investment company, owns approximately 57% of the outstanding common stock of American by virtue of which BSF controls American. Muscat is chairman of the board of directors of American and is president and chairman of the board of BSF. Muscat is also president and chairman of the board of directors of Defiance Industries, Inc., which owns approximately 30% of the capital stock of BSF. Muscat is a substantial stockholder of both BSF and Defiance Industries, Inc. Krock is president, treasurer and a director of American and was vice president and treasurer of BSF between August 23, 1962 and May 18, 1967. Muscat and Krock each have options to purchase from American 20,000 shares of its common stock. Messrs. Muscat and Krock, who directly and indirectly control American, are affiliated persons of American within the meaning of Section 2(a)(3) of the Act and American is an affiliated person of BSF within that section since the latter owns more than 5% of American's voting securities. In addition Muscat is an affiliated person of BSF

as defined in Section 2(a)(3) of the Act.

Background of Application

In the latter part of 1963 or early in 1964 BSF purchased from The First National City Bank ("Bank"), as Executor of the Estate of Ambrose W. Benkert, a total of 162,332 shares of American, constituting 51% of its outstanding stock, at a price of \$16.32 per share. In 1964 certain holders of the common stock of American commenced an action in the Supreme Court of the State of New York against BSF, Muscat, the Bank and others for damages allegedly suffered by all the holders of American's common stock who claimed that they were entitled to receive the same price as that paid by BSF to the Bank for the control stock. The plaintiffs in that action were employees and customers of Benkert, which firm acted as underwriter of the Bonds issued by American in 1955. In the latter part of 1966 or early 1967 as a result of negotiations commenced between the parties to the lawsuit a settlement was reached pursuant to which Muscat and Krock were to make an offer to purchase for cash all the outstanding Bonds of American at \$61 for each \$100 principal amount of Bonds and all the outstanding common stock of the said company at \$15.50 per share. Accordingly, on or about April 14, 1967 Muscat and Krock made a written offer to purchase American's outstanding Bonds and common stock upon terms and conditions mentioned below.

This offer to purchase (hereafter referred to as the "tender offer") which was to expire at the end of April as to the

common stock and the middle of May as to the Bonds was extended to June 15, 1967<sup>1/</sup> and during the extended period security holders were furnished certified financial statements consisting of a "Consolidated Balance Sheet" and "Consolidated Statement of Income and Earned Surplus" of American and subsidiary companies together with an accompanying letter which, among other things, described the relationship of Muscat and Krock with American, BSF, Fifth Avenue Coach Lines, Inc., Defiance Industries and other affiliated companies and explained certain inter-company loans and transactions reflected in the financial statements. The letter also afforded a security holder, who had accepted the offer prior to the receipt of the foregoing material, an opportunity to withdraw his prior acceptance or if he had not accepted to do so before the above-mentioned June date. The letter, in addition, informed security holders that Muscat and Krock proposed to resell the securities they acquired pursuant to the tender offer and that the proposed transactions set forth in the tender offer require an application to, and an order by, the Commission pursuant to the Act.

#### The Application

American in its application discloses that Muscat and

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1/ The record shows that on April 21, 1967, shortly after the commencement of the tender offer, trading in the securities of American was suspended by the Commission for failure of the company to file audited financial statements for the fiscal year ended November 30, 1966. The suspension was terminated on June 2, 1967 after the company filed appropriate financial statements, copies of which were required to be furnished securities holders of American who were being solicited under the tender offer, which offer was extended as noted in the text.

Krock offered to purchase the common stock of American at a price of \$15.50 per share and informed stockholders that by their acceptance of the offer they assigned all claims which they had arising out of the ownership of such stock except rights and claims against the Bank and one of its officers. As noted earlier these claims were the subject matter of a pending lawsuit by common stockholders against American, BSF, Muscat, the Bank and others. BSF, which did not propose to tender its shares of American common stock, was to be given the right of first refusal, for a period of one year from the closing date of the tender offer, to purchase the shares of common stock which Muscat and Krock acquired under the tender offer at an undisclosed price but upon terms identical with the terms of bona fide offer of a third person to purchase the stock. The record fails to identify any third person who made or proposed to make the bona fide offer for the common stock of American nor is there any evidence of the price at which such stock would be sold to BSF.

The tender offer relating to the Bonds states that Muscat and Krock will purchase them at \$61 for each \$100 principal amount of Bonds and that the holders of the Bonds who accept must consent to the execution by Sterling National Bank, the trustee under the Indenture and Deed of Trust ("Indenture") dated December 1, 1954, of a supplemental indenture modifying certain provisions in the Indenture so as to eliminate fixed ratio requirements which had to

be met by American before it could declare a dividend on its common stock. <sup>2/</sup> The tender offer specifically identified the indenture provisions relating to ratio requirements together with the provisions proposed to effect the elimination of such requirements to which bondholders would consent upon acceptance of the tender offer. Bondholders were also informed that American received a commitment from an insurance company to loan American \$2,500,000 subject to certain conditions precedent. <sup>3/</sup> If the loan materialized American

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<sup>2/</sup> Under the Indenture, American could not declare or pay any dividends (other than stock dividends) on its common stock unless interest shall have been paid on the bonds to the end of the most recent fiscal year, there shall be no unpaid accumulated sinking fund installments and the company maintain a current asset ratio of at least 2-1/2 to 1 and quick asset ratio of at least 1-1/2 to 1.

<sup>3/</sup> The record discloses that the insurance company commitment is for a term of 12 years at 7% interest. The security under the proposed loan is to be a first mortgage on all the plant and equipment of American. There are no sinking fund requirements for the first two years. After such period, the company will be required to make equal semi-annual payments of \$125,000 to retire the loan in ten years. The loan agreement will require American to maintain working capital of \$5 million dollars as well as tangible net worth of \$6,500,000. It will also provide that permission must be obtained from the insurance company for any new long-term debt and on short-term bank loans of two million dollars. Dividends are limited to 25% of net income after taxes after November 30, 1966. Under the contemplated loan, the insurance company will receive warrants to purchase 35,000 shares of American's common stock at \$15 per share for 12 years. The insurance company has agreed to take up its commitment by June 1968, provided that the 1967 earnings of American are at least \$700,000 and that the bonds will first have been freed from the covenants against pledges of stock and fixed assets, and that the appropriate portion of the insurance company loan will then be used to retire said Bonds at a maximum price of \$75 per \$100 par value. To obtain this financing, assets now restricted by the indenture must be pledged to the insurance company. To accomplish this Messrs. Muscat and Krock have agreed to endeavor to obtain the consent of the holders of the Bonds, to the removal of the restriction on the pledge of assets or otherwise make possible the loan.



would make an offer to Messrs. Muscat and Krock and all other bondholders to purchase their Bonds at a price not exceeding \$75 per \$100 principal amount of Bonds and that in fixing the exact differential the company (American) would take into consideration the use by Muscat and Krock of "their personal funds and their expenses." However, it is clear from the application that there may be a modification of the maximum price in which event the price will not exceed the modified maximum. The application further states that Muscat and Krock intend to accept the offer of American to purchase the Bonds.

The record discloses that as of October 1967 the holders of approximately 34,212 shares of common stock and the holders of approximately \$1,307,000 principal amount of Bonds had accepted the tender offer. The record further discloses that Benkert was designated as the Tender Agent and as such would be entitled to receive from Muskat and Krock a fee of \$1 per share for each share of common stock tendered and \$50 for each \$1000 principal amount of Bonds, plus an additional 11.1 cent per day after April 30 for each \$1000 principal amount of Bonds tendered. Out of these commissions Benkert would pay its legal fees and other expenses. The record discloses that Benkert's fees are dependent on the consummation of the tender offer and that as of November 15, 1967 such fees amounted to \$128,000, less expenses which had not been calculated.

Section 17(b) Exemption

As noted earlier Muscat is an affiliated person of BSF and Muscat and Krock are affiliated persons of American which is a controlled company and an affiliated person of BSF. The proposed sales by Muscat and Krock of the securities of American therefore comes within the prohibition of Section 17(a) of the Act which, in pertinent part, makes it unlawful for an affiliated person (Muscat) or an affiliated person (Muscat and Krock) of an affiliated person (American) of a registered investment company (BSF) to sell any security to such investment company or any company controlled by such registered company. Section 17(b) provides, in relevant part, for the granting of an exemption from such prohibition if 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."

The burden of proving the availability of the exemption under Section 17(b) of the Act is upon American, the applicant.<sup>4/</sup> American, after requesting the Commission to enter an order pursuant to the foregoing section, appeared at the hearings but offered no proof to substantiate the conclusory statements in its application that the terms of the proposed transactions are fair. Thus, the record relating to the proposed sale of the common stock to BSF

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<sup>4/</sup> North River Securities Co., Inc., 37 SEC 465, 476 (1956); Transit Investment Corporation, 23 SEC 415, 427 (1946)

reflects that Muscat and Krock will give BSF the right of first refusal to purchase the stock at an undisclosed price but upon the same terms as those of a bona fide offer of a third person to purchase the stock. The record fails to identify such third person or the price at which such securities are to be sold to BSF. It is evident from the record, however, that the price to BSF will be in excess of the \$15.50 per share which Muscat and Krock propose to pay for the common stock under the tender offer. The application states that the price to BSF will take into consideration the "expenses and risks" in connection with the tender offer. There is no evidence concerning such expenses or any elaboration of the so-called risks. Accordingly, the hearing examiner finds that the record fails to contain any evidence as to the consideration proposed to be paid by BSF for the purchase of American common stock. The hearing examiner further finds that American has failed to sustain the burden of establishing that the terms of the proposed sale of the common stock of American to BSF are fair and reasonable and do not involve overreaching.

Turning now to the proposed sale of the Bonds the record discloses that Messrs. Muscat and Krock will, pursuant to the tender offer, purchase such Bonds at \$61 for each \$100 principal amount of Bonds and intend to sell them to American at a price not to exceed \$75 per \$100 principal amount of Bonds. The application however, states that the sale price to American is not specifically fixed and that such price is subject to subsequent modification in

which event the price to be paid by American will not exceed the price as modified. The record does not reflect any limitation concerning such possible modification other than a statement that "In fixing the exact differential, the company will consider the expenses and interest during the period Messrs. Muscat and Krock will have had their personal funds at risk." There is no indication in the record as to the nature of such "expenses" nor any evidence that any amount of "expenses" have already been or will be incurred nor is the word "interest" further defined. Thus, it is entirely possible that any modification could increase the price substantially in excess of the \$75 referred to previously. Moreover, no attempt was made in the record to warrant that any price over and above the \$61 for each \$100 principal amount of Bonds which Muscat and Krock propose to pay bondholders is a reasonable and fair price to be paid by American to its controlling persons. The hearing examiner finds that the record is devoid of any evidence to establish what consideration will, in fact, be paid by American to Muscat and Krock or that any effort made to establish a justifiable range of prices which American would propose to pay to them for the purchase of the Bonds. The hearing examiner concludes that American failed to sustain the burden of establishing that the terms of the proposed sale of the Bonds including the consideration to be paid are reasonable and fair and do not involve overreaching. The exemption requested pursuant to Section 17(b) of the Act must therefore be denied.

The only evidence in the record relating to the fairness and reasonableness of any of the transactions was submitted by Benkert representing security holders who accepted the tender offer. Such evidence is confined solely to the tender offer. Benkert maintains the tender offer should be considered a separate transaction as to which a Section 17(b) exemption is available, or, in the alternative, an order entered declaring that the tender offer is not within the purview of the Act since it "is essentially an open market purchase by two individuals outside the registered investment company (BSF) and its affiliates." The argument that the tender offer should be considered as a separate transaction unrelated to the other transactions is not supported by the evidence. The record discloses that the soliciting material furnished security holders in connection with the tender offer clearly reveals that Muscat and Krock formulated a plan designed to settle a lawsuit pending against them and that such plan involved both the purchase of the common stock and Bonds of American and the sale of such securities to BSF and American. Each of the transactions forms an integral part of the entire plan. Thus, the tender offer is one of the essential components of an integrated series of transactions which ultimately was intended to result in the sale of the very securities acquired under the said offer. It is also noted that American requests an exemption for all the transactions involved and not for any isolated transaction.

In addition no exemption is available under Section 17(b)

for the tender offer. Benkert's evidence of the fairness of the tender offer is comprised of the testimony of Mr. Harry C. Wood who testified that although he knew that American's sales and net earnings increased substantially during the period from 1962 through 1966 and he was aware of the price earnings ratio and book value of the company's securities he discounted such criteria because of what he described as an unhealthy situation concerning management stemming from the fact that American failed to furnish financial and other reports to security holders and engaged in intercompany loans and other transactions with its affiliated companies. It was Wood's opinion that a valuation of American's securities would have to include an appraisal of future management and that he has no faith in the Muscat management. Under all the circumstances Wood believed it best to sell his securities in American and that this was a substantial reason for his willingness to accept the price offered under the tender offer. He concluded that thus the tender offer price was fair and reasonable. These criteria admittedly did not take into consideration the relationship of the prices to be paid for the securities under the tender offer as against the prices at which they were proposed

to be resold. The hearing examiner finds that the terms of the tender offer fails to meet the standards of fairness and reasonableness under the Act.

There is no substance to Benkert's argument that the tender offer is not within the purview of the Act since it is merely a purchase outside an investment company or its affiliates. We have noted above the affiliations between Muscat and Krock and the investment company (BSF) and American, its controlled company. The transactions in question relate both to a purchase by affiliated persons of an investment company and the sale of the same securities to such company and its controlled company and well within the type of affiliated transactions proscribed by Section 17 of the Act.

Section 17(d)

The order for hearing directs that consideration be given to whether the proposed transactions, if consummated, would be contrary to Section 17(d) of the Act and Rule 17d-1 thereunder. The Section and Rule prohibit an affiliated person of an investment company or an affiliated person of such person, acting as principal, from participating in or effecting any transaction in which such investment company, or a company controlled by such investment company is a joint or joint and several participant unless an

application concerning such arrangement is filed with the Commission and approved by it.<sup>5/</sup> Under the Rule the Commission in passing upon such application will consider the extent to which such participation is on a basis different from or less advantageous than that of other participants and whether the participation of the investment company or the controlled company in such arrangement, is consistent with the provisions, policies and purposes of the Act. Taken together these provisions are designed to regulate transactions where the persons making the investment decisions for the investment or controlled company may have a possible conflict of interest and the danger exists that the investment company or its controlled company may be overreached by such affiliated persons.<sup>6/</sup> The situation in the instant case is fraught with just such a danger. Muscat and Krock, by virtue of their control of both the investment company and American, obviously made the investment decision for both companies to purchase the securities at prices higher than that paid by them under their tender offer. Such an arrangement was devised in a manner calculated to be profitable to them and to the possible detriment of the security holders of the investment and controlled companies.

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<sup>5/</sup> These provisions, as applicable here, would prohibit Muscat and Krock, affiliated persons of an affiliated person of BSF from effecting any transaction in connection with a joint arrangement in which BSF or its controlled company, American, is a joint participant unless the Commission grants an application pursuant to the above-mentioned rule.

<sup>6/</sup> Cf. Securities and Exchange Commission v. Midwest Technical Development Corporation, et al (D.C. Minn. 1963) CCH Fed. Sec. L. Rep. Par 91,252.



The Bond transaction is a clear example of such a profitable arrangement. The Bonds which were to be bought at \$61 for each \$100 principal amount of bonds were to be sold by Muscat and Krock to their controlled company at a price not to exceed \$75 for each \$100 principal amount of bonds or possibly higher if so determined between them and the insurance company which had committed itself to loan the necessary funds. Although the transaction relating to the sale of the common stock to BSF is not as evident, since the price at which the stock is to be sold to the investment company is not reflected in the record, it is clear that Muscat and Krock intend that the sale price will exceed their purchase price for it is proposed that such sale price will take into consideration "their expenses and risks in connection with the tender offer."

Despite the arrant conflict of interest in which Muscat and Krock became enmeshed no attempt was made by either of them to offer any evidence to justify the arrangement whereby the investment and its controlled company should be permitted to participate in these transactions on a basis different from and obviously less advantageous than that of Muscat and Krock. The hearing examiner finds that on the basis of the record the tender offer for American's securities by Muscat and Krock and the proposed sale of such securities to their controlled companies, constitute a participation by Muscat and Krock in a joint arrangement with BSF and American and that such participation by both companies appears to be on a basis different from and less advantageous than that of Muscat and Krock the other

participants, contrary to the provisions of Section 17(d) of the Act and Rule 17d-1 thereunder. The hearing examiner further finds that in view of his findings that no exemption is available under Section 17(a) of the Act for the proposed sale of American's common stock and bonds to FSF and American respectively it would also be necessary to deny any order under Rule 17d-1 since granting an order of approval would be inconsistent with the provisions of the Act.

American at the hearing asserted that due to three events "the subject matter of the application presently before the Commission no longer exists and there are no issues to be considered by the Commission." <sup>7/</sup> American was thereupon offered the opportunity to withdraw its application but refused to do so, claiming that despite its steadfast refusal to offer proof to support its application it still believes that the transactions are reasonable and fair. The

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<sup>7/</sup> The three events are (a) Muscat and Krock's intention not to consummate the tender offer. Since Muscat and Krock control American the latter's intentions are in reality the intentions of its two controlling individuals and the so-called event lacks substance. (b) Another event is the withdrawal of the financing commitment by the insurance company. No explanation was given for such withdrawal by either American, Muscat and Krock or the insurance company and there is no evidence that such withdrawal is warranted nor that other financing cannot be obtained. (c) The final event is a pendente lite injunction enjoining American from purchasing its Bonds. The record shows that on September 22, 1967 the Hon. Harold J. McLaughlen, a justice of the Supreme Court of the State of New York, in an action entitled Harry Rebell et al v. Victor Muscat et al (Index No. 4421/66), issued an injunction pendente lite enjoining American from purchasing its Bonds. Such injunction clearly does not bar American from offering proof in connection with the instant application.

refusal to withdraw the application or submit proof to support the allegations therein leads the hearing examiner to conclude that the contention that the transactions are reasonable and fair is not made in good faith.

In addition, the record discloses that in November 1967 counsel for American requested the Supreme Court of the State of New York to adjourn the trial of a derivative action brought by a stockholder against Muscat, Krock, American, BSF and others<sup>8/</sup> until Commission "approval" is obtained for the tender offer.<sup>9/</sup> American's counsel represented to such Court that the Commission "is required to look into the entire transaction to determine its fairness, reasonableness and the absence of overreaching on the part of any of the defendants" and that this Commission has expressly taken jurisdiction thereof. However, in October 1967, one month earlier, American's counsel in these proceedings had requested the hearing examiner to declare the hearing "moot" stating ". . .we should wait for the determination of the civil court as to 'whether or not the tender offer can be consummated.'" These antithetical positions when coupled with the refusal to

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8/ Rebell v. Muscat referred to in footnote 7.

9/ The State court suit included, among other things, an allegation that the Muscat Krock tender offer was "improper."

withdraw the instant application while at the same time arguing there are no issues to be considered indicates the employment of tactics inimical to the Commission's processes and evinces a lack of good faith not only on behalf of American but also on behalf of its controlling persons Muscat and Krock who participated in these proceedings.<sup>10/</sup> Accordingly,

IT IS ORDERED that the application filed by American for an order pursuant to Section 17(b) of the Investment Company Act of 1940 exempting from the provisions of Section 17(a) of the Act a tender offer by Muscat and Krock for the outstanding common stock and Bonds of American and resale of the common stock to BSF and the Bonds to American be, and it hereby is, denied; and

IT IS FURTHER ORDERED that the proposed transactions, if consummated, would be contrary to Section 17(d) of the Act and Rule 17d-1 thereunder.

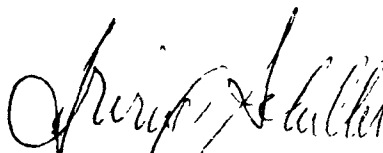
This order shall become effective in accordance with and subject to the provisions of Rule 17(f) of the Commission's Rules of Practice.

Pursuant to Rule 17(b) of the Commission's Rules of Practice any person seeking Commission review of this initial decision may file a petition for such review within 15 days after

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<sup>10/</sup> To the extent that the proposed findings and conclusions submitted to the hearing examiner are in accord with the views set forth herein they are accepted, and to the extent they are inconsistent therewith they are rejected.

service thereof on him. Pursuant to Rule 17(f) this initial decision shall become the final decision of the Commission as to each party or other person entitled to seek review unless such party or person files a petition for review pursuant to Rule 17(b) or the Commission, pursuant to Rule 17(c), determines on its own initiative to review this initial decision as to such person. If a party timely files a petition for review or the Commission takes action to review as to a party this initial decision shall not become final with respect to that party.



Irving Schiller  
Hearing Examiner

Washington, D. C.  
March 18, 1968