

Complaint.

FEDERAL TRADE COMMISSION

v.

NON-DERRICK DRILLING MACHINE CO., INC.

COMPLAINT IN THE MATTER OF THE ALLEGED VIOLATION OF SECTION 5 OF
AN ACT OF CONGRESS APPROVED SEPTEMBER 26, 1914.

Docket 293—March 14, 1923.

SYLLABUS.

Where a corporation organized for the purpose of manufacturing and operating a new type of drilling machine; in promoting the sale of its stock, published, circulated, and distributed advertising matter wherein it

- (a) Misrepresented the construction, costs, capacity, and success achieved by said machine;
 - (b) Grossly misrepresented the prospects of the company as reflected by alleged progress made, and alleged profits in sight;
 - (c) Misrepresented the financial history of the enterprise, the reasons for a general solicitation of the public, and the business the corporation was claimed to be primarily engaged in; and
 - (d) Otherwise misrepresented the advantages of its stock as an investment:
- Held*, That such practices, under the circumstances set forth, constituted unfair methods of competition.

COMPLAINT.

The Federal Trade Commission, having reason to believe from a preliminary investigation made by it that the Non-Derrick Drilling Machine Company, Inc., hereinafter referred to as the respondent, has been and now is using unfair methods of competition in interstate commerce in violation of the provisions of Section 5 of an Act of Congress approved September 26, 1914, entitled "An Act to create a Federal Trade Commission, to define its powers and duties, and for other purposes," and it appearing that a proceeding by it in respect thereof would be to the interest of the public, issues this complaint stating its charges in that respect on information and belief as follows:

PARAGRAPH 1. That the respondent, Non-Derrick Drilling Machine Company, Inc., is a corporation, existing and doing business under and by virtue of the laws of the State of Delaware, having its principal office in the city of Pittsburgh, State of Pennsylvania; that the said respondent was incorporated the 22d day of June, 1917, and has an authorized capital of \$200,000, divided into shares of the par value of \$1 each.

PAR. 2. That 123,630 shares of the capital stock of the respondent have been issued, of which 101,000 shares have been issued to one W. A. McCausland for certain patents.

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PAR. 3. That from the 22d day of June, 1917, the respondent, through its officers and agents, has sold respondent's capital stock and solicited subscriptions therefor throughout various States of the United States by means of advertisements, circular letters, pamphlets, and personal solicitation; but respondent has not yet engaged in actual business.

PAR. 4. That the respondent, Non-Derrick Drilling Machine Company, Inc., was organized and incorporated ostensibly for the purpose of manufacturing a certain device or apparatus for drilling holes for oil, gas, salt, and water, but the respondent has never manufactured any such device or apparatus.

PAR. 5. That since the 22d day of June, 1917, the stock of respondent, Non-Derrick Drilling Machine Company, Inc., has been offered and sold in interstate commerce in competition with divers other persons, firms, copartnerships, and corporations.

PAR. 6. That in connection with the sale and offering for sale of said stock, in the course of said commerce, the respondent has practiced certain unfair methods of competition hereinafter set forth in paragraphs 7 to 9, inclusive.

PAR. 7. That during the period of two years last past and for the purposes of selling said stock and obtaining subscriptions therefor, and with the effect of deceiving and misleading the public, including those who might and did subscribe for said stock, the respondent, at divers times, has made, published, advertised, and circulated false, misleading, unfair, and extravagant statements, reports, promises, and predictions concerning the business, progress, capital stock, financial standing, and prospective profits of respondent, and has suppressed and concealed from the public material facts relating to and effecting the plans, organization, business, and capital stock of said company; and respondent continues so to do.

PAR. 8. That during said period, and with like purposes and effect, the respondent at divers times has made, advertised, published, and circulated false, unfair, and misleading statements, predictions, and promises concerning the existence, character, value, durability, strength, efficiency, and operation of the aforesaid drilling device or apparatus; and respondent continues so to do.

PAR. 9. That during said period and with like purpose and effect the respondent at divers times has falsely stated, represented, advertised, and published that it was engaged in business as a drilling contractor and continues so to do; whereas the only business transacted by the respondent since the date of its incorporation, namely, June 22, 1917, has been the sale of its capital stock to the public and the soliciting of subscriptions therefor.

REPORT, FINDINGS AS TO THE FACTS, AND ORDER.

Pursuant to the provisions of an Act of Congress approved September 26, 1914, entitled "An Act to create a Federal Trade Commission, to define its powers and duties, and for other purposes," the Federal Trade Commission issued and served a complaint upon the respondent, Non-Derrick Drilling Machine Company, Inc., charging it with the use of unfair methods of competition in violation of the provisions of said act.

The respondent, Non-Derrick Drilling Machine Company, Inc., having filed its answer, hearings were had and evidence was introduced in support of the complaint and on behalf of the respondent before Edward M. Averill, a trial examiner of the Federal Trade Commission theretofore duly appointed, at which hearings the respondent appeared and was represented by counsel.

And thereupon this cause came on for final hearing upon the complaint and the answer thereto, the report of the trial examiner, and was argued by counsel, and the Commission, having duly considered the record and being now fully advised in the premises, makes this its findings as to the facts and conclusion.

FINDINGS AS TO THE FACTS.

PARAGRAPH 1. The Non-Derrick Drilling Machine Company, Inc., the respondent, is a corporation, incorporated June 22, 1917, under the laws of the State of Delaware, with its statutory office in Dover, in the State of Delaware, and its principal office in Pittsburgh, in the State of Pennsylvania. Authorized capital stock of \$200,000 is divided into 200,000 shares of a par value of \$1 each, and since the 22d day of June, 1917, the stock of respondent has been offered for sale, and sold and transported in interstate commerce in competition with the stocks and investment securities of other corporations.

PAR. 2. Of this authorized capital stock 173,200 shares have been issued, 153,115 shares being issued to W. A. McCausland for the purchasing of the rights to certain patents covering parts of the drilling machine which the company was organized to build, W. A. McCausland being at the time of organization the inventor of the machine and owner of the said patents.

PAR. 3. The respondent company was organized for the purpose of manufacturing a certain type of nonderrick drilling machine for use in drilling holes for oil, gas, salt, and water, and it was the further intention of the company to operate said nonderrick drilling machine as contractors in drilling holes for oil, gas, or water. History of the inception and organization of the company is as follows:

W. A. McCausland had been for 15 or 20 years prior to 1917 engaged in the drilling business, and during that period the recognized

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and standard machinery for drilling consisted of a high derrick ranging from 60 to 80 feet, which required for its construction a large amount of timber, and by reason of its height, was unstable. A long stem was required for the drilling operation, and by reason of these and other technical features, the cost of construction was great and the cost of operation heavy. McCausland became interested in the study of ways and means of decreasing these costs and increasing the efficiency, and after devoting a considerable part of his time and some money, he devised a means whereby the derrick could be dispensed with, the drilling being done from a height of approximately 30 feet by use of a cable device running longitudinally of a walking beam operating the loaded tool, and a new style jar working with a piston. He devised several other improvements, all of which new features he patented, application being made January, 1915, and May, 1916, and letters patent granted January 2, 1917. McCausland had no money with which to develop these inventions, and in order to obtain the necessary funds decided to organize a stock company for the development, manufacture, and sale of the new style nonderrick drilling machines. Shortly after the organization of the respondent company, W. A. McCausland was elected president and J. B. Chalmers secretary and treasurer. McCausland then endeavored to secure subscriptions to the stock of the company in order to raise money with which to get the device upon the market. His efforts to interest men of means met with no success, and late in 1917, or early in 1918, the company decided to appeal to the public generally, issuing and circulating various pamphlets (Coms. Exs. 5, 6, 7).¹ These pamphlets were distributed by hand and also by use of the mails, being sent from Pittsburgh, Pa., into Ohio, Kentucky, Illinois, Indiana, Missouri, and New York. The company also advertised in the St. Louis Dispatch, a newspaper published in St. Louis, Mo., and a Buffalo, N. Y., paper (Coms. Ex. 1).¹ The company also issued and mailed to prospects in various States other than Pennsylvania, circular letters (Coms. Exs. 9, 10, 11, 13, 14, 15).¹

PAR. 4. \$35,075 were collected in cash from the sale of stock. Of this amount \$6,256.45 was expended upon the construction and erection of one machine and in making the parts for another, the balance being expended in salaries, office expenses, advertising, and other expenses.

PAR. 5. Approximately two years were consumed in building the first and only machine ever put out by the company. This delay is attributed to want of capital and to difficulty in getting work done, owing to the demands of the period 1917 to 1919 on every

¹ Not published.

class of labor and material entering into machine work. The \$35,075 which was collected from sale of stock did not come in all at once. It was collected in small sums extending over the entire period of two years.

PAR. 6. The nonderrick drilling machine was first set up at Tionesta, Pa., in the fall of 1919. It developed certain defects and accomplished nothing there. In August, 1920, the machine was taken to Corry, Pa., under a contract between respondent and the Beech Oil Company of Pittsburgh, to drill a well at \$2.35 per foot. Actual drilling operations at Corry did not begin until October, 1920, the intervening time being spent in remedying the defects which developed at Tionesta, and in assembling and erecting the machine. From the time actual drilling operations were begun at Corry, in October, 1920, until February 16, 1921, a period of four months, the machine had only drilled to a depth of 170 to 180 feet. During this period constant changes and alterations were being made in the machine, as drilling operations showed the defects; other delays were occasioned by the breaking of parts of the machine. Some of the delay was caused by difficulty in getting coal, labor, and supplies. The machine is not a complete practical drilling machine, and is still in the experimental stage, as shown by the two attempts made to drill with it at Tionesta and Corry. It is necessary in the country around Corry to drill to a depth of at least 700 feet to reach the oil sand. A standard drilling machine will drill a hole 700 feet deep in a period of a week or two weeks.

PAR. 7. The respondent company in the course of its advertising campaign to secure subscriptions to its stock, printed, or caused to be printed, and circulated in interstate commerce in and among the various States of the United States certain circulars and pamphlets in which said circulars and pamphlets the respondent made statements that:

The non-derrick drilling machine requires about 15 tons less material, is constructed for much less money and will greatly increase the capacity over the old style rig. (Coms. Ex. 5.)¹

The profits in our machine will be enormous. (Coms. Ex. 5.)¹

But it is not often that you are offered big profits combined with such a large element of safety as that offered by the Non-Derrick Drilling Machine Company. (Coms. Ex. 6.)¹

We are Drilling Contractors and not oil speculators. (Coms. Ex. 6.)¹

Every single piece and part of this drilling machine has been designed and tested as to strength and possible desirability and can be demonstrated to do the work effectively and cheaply. (Coms. Ex. 5.)¹

¹ Not published.

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These statements are false and misleading. At the time these circulars and pamphlets were circulated by respondent company no machine had been built nor had any contracts been made for the building of a machine. It was, therefore, obviously impossible for respondent company to state how much it would cost to build a machine or how much the profits would be. The cost of building the only machine ever constructed greatly exceeded the estimates made by the president of the company, and there have been no profits of any kind made by respondent company. The capacity of the respondent company's machine was not equal to the capacity of a standard drilling machine and would not drill as deep or as fast as the old style rig. The operations of respondent company were all an experiment, and there was no "element of safety" connected with it. Respondent company's advertising literature made no mention of the fact that no machines had been constructed, but gave the impression to purchasers and prospective purchasers that the nonderick machine was a success.

Respondent company at the time of circulating the pamphlets and circulars quoted above were not drilling contractors and had no contracts for drilling wells, nor did it ever have more than one such contract. The first operation in which the machine was tried and found defective, at Tionesta, Pa., was not under a contract to drill, but was a speculative operation undertaken by respondent, which was abandoned because respondent could not get a lease on the land. No drilling machine had been built when the statements quoted above were made and circulated, and the statement that the various parts of the machine had been tested for strength and durability were false. Until the machine was finally erected and put into operation, no tests of the strength of its various constituent parts had been made. Certain parts of the machine were standard parts used on the standard drilling machine, and the strength of those parts as used on the latter machine was known. In a circular letter, dated January 16, 1919, and distributed through the mails, the following statements were made:

Your inquiry to our "AD" received, for which please accept thanks. We have decided to offer you an opportunity which is both exceptional and unusual. By paying \$2.00 per week, you can become an owner in this company and see your \$100 grow into thousands.

* * * * *

The reason we have changed our plan is simply because we believe we can raise the money quicker with which to start actual business. We believe a person can part with \$2.00 per week (without asking any questions) after reading our literature much easier and without

feeling it than he could to lay out \$100 or more in cash. We could have this company financed and going now, if we would submit to the big fellows and hand them the control, which we have refused to do. We are raising a small amount so the number of people who become owners in this company will be limited. We do not want over 200 subscribers, besides the present stock holders who paid cash, and if the public does not avail themselves of this opportunity at once, we intend going back to the first system where we started, just a few months ago. This is a new company and just started, now is the time to get in on the ground floor. * * *. A person who would not invest in a sure winner like this would not buy gold dollars for 50 cents. (Coms. Ex. 8.)¹

These statements are false and misleading. The respondent, during 18 months, had exhausted every means to interest persons with capital in the venture. They could not finance the scheme. They had done little, if anything, toward building even one machine. They did not limit the amount of subscriptions or the number of subscribers. They had no "first system" to which they could "go back."

In a circular letter distributed to prospective customers styled Financial Exhibit or Manufacturing Department (Coms. Ex. 13),¹ the respondent estimates the cost of 500 machines at \$412,500, or \$825 each, and at the bottom of the so-called Financial Exhibit, states:

YEARLY RETURNS.—It is estimated that the yearly returns on each \$100 invested in the shares of the Non-Derrick Drilling Machine Company will yield \$250 and that the original investment will have been returned the very first year of actual operation and that the shares will be worth many times their original cost.

While in truth and in fact it cost the respondent company more than \$3,200 for one machine; which would make 500 machines cost \$1,600,000, wiping out entirely the \$500,000 estimated dividends on the stock. These facts were known, or should have been known to the respondent, and the statements made in the said alleged financial exhibit were untrue, grossly exaggerated, and misleading, and calculated to deceive the public.

On November 5, 1920, in answer to an inquiry from a stockholder, the respondent company wrote a letter containing the following:

* * * The machine is a great success and the public will hear from us later. * * *

This statement was false, for in the fall of 1919 respondent had set up its only machine at Tionesta, Pa., where it had not proved a success, and at the time the letter was written the machine was being operated at Corry, Pa., and was not proving practicable.

¹ Not published.

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No stock was sold after August 1, 1919, although a few shares were issued after that date to purchasers who were paying for their shares on the deferred-payment plan. As of February 16, 1921, a total of \$35,075 cash had been received for stock, of which \$29,177.76 was expended, the principal amount being applied to salaries and commissions account and drilling machine and tool account, the remainder being used for miscellaneous items. A balance of \$5,897.24 remained in the treasury of the company at that time.

CONCLUSION.

That the practices of the respondent as described in the foregoing findings as to the facts are unfair methods of competition in interstate commerce, and are a violation of the provisions of Section 5 of an Act of Congress, approved September 26, 1914, entitled "An Act to create a Federal Trade Commission, to define its powers and duties, and for other purposes."

ORDER TO CEASE AND DESIST.

This proceeding having been heard by the Federal Trade Commission upon the complaint of the Commission, the answer of the respondent, the testimony and evidence, the trial examiner's report upon the facts, and the Commission having made its findings as to the facts and its conclusion that the respondent has violated the provisions of Section 5 of an Act of Congress approved September 26, 1914, entitled "An Act to create a Federal Trade Commission, to define its powers and duties, and for other purposes,"

Now, therefore, it is ordered, That the respondent, Non-Derrick Drilling Machine Company, Inc., its officers, directors, agents, and servants, cease and desist from publishing, circulating, or distributing, or causing to be published, circulated, or distributed, in or among the various States of the United States, pamphlets, circulars, post cards, letters, or any other printed or written matter whatsoever in connection with the sale or offering for sale in interstate commerce of stock or securities, wherein it is printed or set forth any false or misleading statement, representations, promises, or reports concerning the business, progress, capital stock, organization, resources, financial standing, and prospects of the respondent company.

And it is further ordered, That the respondent shall file with the Federal Trade Commission, within sixty (60) days from the date of this order, its report in writing stating the manner and form in which this order has been conformed to, and shall attach to such report two copies of all circulars, pamphlets, post cards, or other advertising matter distributed or displayed to the public by respondent in connection with the sale of its stock in interstate commerce subsequent to the date of this order.

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