ADDRESS

of

ABE FORTAS

Assistant Director of the Public Utilities Division
Securities and Exchange Commission

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THE PUBLIC UTILITY ACT AND THE SECURITIES AND EXCHANGE COMMISSION*

It is not yet three years since the Public Utility Act of 1935 became effective; and only about seven months have passed since the Supreme Court, in the *Electric Bond and Share* case, broke the rebellion of most of the utilities. But in this brief period, many things have happened in the public utility industry. Not the least important of these, has been a change in the attitude of the leaders of the industry towards the Holding Company Act -- due partly to the natural cooling of the hot passions engendered by the legislative battle over the Act, and partly, I believe, to the quality of its administration.

Thus the greatest hazard in the administration of the Act has been overcome, I think. The thing that we have had most to fear was not our problems, large as they are; but the attitudes of those whom we were seeking to regulate in an orderly and reasonable fashion.

We are well over this stage of our affairs; but even now we must occasionally face the peril of utility companies which are advised by lawyers who are bellicose by nature. Some of these lawyers might well emulate the man in the well-known verse who "though he saw an argument that proved that he was pope; he looked again and saw it was a bar of mottled soap".

I hope tonight to present to you a brief survey of some aspects of the Holding Company Act, and to describe briefly to you some of the things we are trying to accomplish, and how we are going about them. My purpose will be served if some of you begin to feel as I do, that administration of the statute, along the lines which the Securities and Exchange Commission is now pursuing, carries promise of much benefit to the electric and gas industry and to the nation as a whole.

The practices, conditions and events which gave rise to the Act are too well known to need mention here. Many utility operators ran wild in the decade from 1920 to 1930. An essential industry became a financial pawn; its life was a matter of no great concern; its sole function was to increase the power and position of its rulers. Corporation was pyramided upon corporation; and security upon security, until a paper labelled a "bond" or "debenture" was sometimes no more than an equity in an equity in an equity. Enormous sums were siphoned from utility companies in the form of charges for unnecessary and duplicating services; enormous profits were made by intra-system dealings -- the right hand profiting from the left; and securities were sold and rates were fixed partly upon the basis of fictitious values -- arrived at by simple or complex addition. All of this led to tremendous concentration of power in the hands of a few individuals; and this concentration of power led in turn to forsaking that quality which is the essence of democracy -- humility. Power led to lust for power; and lust for power led to propaganda.

These things could not endure in a democratic society; and the Holding Company Act represents that society's attempt to control and regulate them. Perhaps it is merely my own great interest in the administration of the Act which leads me to suggest that this Act is a significant test of our way of life; it is a test of government's ability to

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* The views expressed in this paper are the writer's personal opinions.

regulate private enterprise in a crucial field, without destroying it; and of private enterprise's ability to adjust itself to a new world -- and to live productively and peacefully -- without destroying itself.

Roughly speaking, the principal provisions of the Act may be divided into six parts: First, definition and determination of persons and companies which are subject to the regulatory scheme; second, regulation of service contracts and charges; third, control over acquisitions and dispositions of property and securities; fourth, control over the issuance of securities; fifth, control over reorganizations; and sixth, the "death sentence" or "health sentence" provisions, including the requirements for engineering and operating integration of properties, for simplification of capital and corporate structures, and for equitable distribution of voting control.

In this paper, I shall attempt to discuss only a few of these matters: regulation of the issuance of securities; control over reorganizations; and the provisions relating to integration and simplification. Before discussing any of these, however, let me give you an over-all sketch of the machinery of the Act. Holding companies -- that is, broadly speaking, companies which control or exert a controlling influence over one or more operating gas or electric companies -- must register under the Act, and file certain information and reports. When the holding company registers, it and its subsidiaries become subject to the regulatory provisions of the Act, unless the Act itself or the Commission's rules and regulations provide an exemption for the particular type of company or the particular activity. Generally speaking, the enforcement machinery of the Act is quite similar to that of other federal regulatory agencies. The Commission has investigatory powers; it may apply for injunctions; and it may refer appropriate cases of violation to the Attorney General of the United States for criminal prosecution. Persons aggrieved by an order of the Commission may appeal directly to a federal Court of Appeals in a proper circuit.

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If a registered holding company or one of its subsidiaries wishes to issue securities, it must file a declaration with the Commission under Section 6 of the Act. Many subsidiaries are also subject to the regulation of state public utility commissions and such companies may have to get the consent of the state commission to the issue. If the issue has been approved by a state commission, the jurisdiction of the Securities and Exchange Commission is limited. It cannot disapprove the issue; it can merely prescribe terms and conditions upon which the securities may be issued and sold. The authority of the Commission is so limited, however, only if the utility whose securities have been approved by the state commission is organized and doing business in that state, and only if the purpose of the issue is to finance the company's business.

In a number of cases, the Commission has found it necessary to exercise its power to impose terms and conditions upon the issue of securities in this category, which had been approved by state commissions. For example, in a Cumberland County Power & Light Company case (Release 1016) the Commission conditioned its order allowing the issue

and sale of preferred shares by requiring (1) that no dividends on common stock should be paid out of earnings subsequent to December 31, 1937, until the company's uncapitalized expenditures reached a specified amount, and (2) that no common dividends should be paid until certain reserves had been set aside in a specified amount. The purpose of these restrictions was to provide some assurance that the company would be able to meet certain obligations under a lease of traction property.

Discussion of this case may have raised a question in your minds about the relations of the Securities and Exchange Commission and state commissions in cases of this sort. It is the Commission's practice in every case where a difference arises between it and a local commission, to communicate with that Commission and discuss the problem. Sometimes, the two agencies have somewhat different information; sometimes, in their separate deliberations, they have emphasized different aspects of the problem. But I think I am correct in saying that in every single case where a difference of opinion has arisen between the federal and state agencies, it has been worked out cooperatively and to their mutual satisfaction. -- Indeed, I may say in passing, and without pausing to elaborate, that the relations and operations of national and state utility commissions have seemed to me to present an interesting and valuable lesson in the orderly functioning of the federal system.

If the securities to be issued have not been passed upon by a state commission, or if, for some other reason, they are not entitled to the qualified exemption provided by Section 6(b) of the Act, the Commission must pass upon them under Section 7. Section 7 provides, generally speaking, that the securities must be of certain permitted types, and that they must conform to certain standards. More specifically, Section 7(c)(1) requires (that unless issued for certain limited purposes which I shall presently describe) the security be a common stock with par value or a bond secured by a first lien on physical property, or its substantial equivalent. This provision reflects several interesting ideas. The dominant objective which it indicates is simplicity of capital structure. Preferred stocks, preference stocks, unsecured debentures, some types of collateral trust bonds, and warrants are not permitted. The basic purpose of this, of course, is to eliminate deceptive and illusory securities, which seem to investors to promise more than they really give in the way of protection of assets and a call upon earnings, and to make it possible for investors more easily to evaluate their rights and the worth of the securities which they purchase or own. Another objective of the provision is to discourage pyramiding -- the piling of equity upon equity, supported more by fancy nomenclature than by assets -- a practice which, as I have mentioned, has been a major curse of the industry. Still another purpose of this limitation of types of securities is to prevent juggling. This is apparent in the prohibition of no-par stock which has been a favorite instrument of accounting magic, and of unsecured debentures which have sometimes been abused by the simple device of pledging the assets upon which they rest.

It is obvious, however, that if these provisions of Section 7(c)(1) were made immediately applicable to all issues, without exception, chaos would result. Companies faced with a refunding of a debenture issue, for example, might be forced into reorganization if they were restricted to the issuance of bonds or par value common stock; and companies with a

large amount of no-par stock outstanding might be unable to obtain funds for urgent corporate purposes by the sale of equity securities if they could not issue additional no-par stock. Consequently, in Section 7(c)(2) of the Act, Congress authorized the Commission to permit the issuance of securities other than bonds or par value common stock (I roughly summarize the statutory provisions) where necessary to refund, extend, exchange or discharge an outstanding security, or for urgent and necessary corporate purposes where the requirements of Section 7(c)(1) would impose an unneccessary and unreasonable burden.

These are, of course, rather broad exceptions; so broad, in fact, that the published opinions of the Commission show no issue which has been disapproved because of section 7(c)(1). But the requirements that new issues should be either bonds or par value common stock may be expected to play an increasingly important part in utility financing; and certainly, they present an objective towards which the program of rehabilitating the security structure of companies must be directed--they offer a standard for the ideal security structure.

The provisions of section 7(d) of the Act have already had a profound influence upon utility financing. This section provides, in brief, that the Commission shall permit securities to be issued unless it finds that:

"(1) the security is not reasonably adapted to the security structure of the declarant and other companies in the same holding company system;

(2) the security is not reasonably adapted to the earning power of the declarant;

(3) financing by the issue and sale of the particular security is not necessary or appropriate to the economical and efficient operation of a business in which the applicant lawfully is engaged or has an interest;

(4) the fees, commissions, or other remuneration, to whomsoever paid, directly or indirectly, in connection with the issue, sale, or distribution of the security are not reasonable; or *****

(6) the terms and conditions of the issue or sale of the security are detrimental to the public interest or the interest of investors or consumers."

These provisions with particular clarity illustrate the point that interpretation and application of the statute is a job requiring accounting, engineering, and specific public utility knowledge, as well as legal skill. One cannot determine whether an issue of securities is justified by the issuer's earning capacity by consulting Blackstone or Coke. This is a matter primarily dependent upon standards derived from the field of finance, applied to the facts of the particular case as shown by detailed financial analysis and judgment. Nevertheless, the standards are sufficiently precise; and the facts of particular cases -

both the evidentiary and the ultimate facts - can be determined with reasonable precision.

I shall not attempt to summarize the action which has been taken by the Commission under these sections of the Act, or to analyze the philosophy, approach and criteria which the decisions of the Commission may disclose. A few observations must suffice for present purposes.

The Commission does not approach these cases with a rigid set of measurements. For example, in one case the Commission might allow bonds to be issued even though the company's past earnings indicate that interest is covered only, let us say, 1.7 times; and in another case where the earnings coverage appeared to be the same, the Commission might not permit the issuance. There are many possible bases for this difference in results. For example, in one case, the company's maintenance may be excellent and its depreciation reserve adequate; in the other, the company's maintenance and its depreciation reserve may be grossly deficient. Obviously, such factors as these must be taken into account in determining whether the securities to be issued are reasonably adapted to the issuer's *earning power* and to its security structure.

There are many other factors of importance in making a determination of these issues, such as the ratio of the value of the company's assets to its debt and total capitalization; and the composition of the company's earnings, and the terms and nature of its other outstanding securities and claims.

Another important and interesting factor in determining whether securities meet the standards of section 7(d) are the specific, detailed provisions of those securities. In this connection, the Commission has done a great deal in the way of raising financial standards and gradually improving the condition of many companies. Dozens of instances of this sort could be mentioned. Most of them -- like a great many of the Commission's accomplishments -- never receive general public attention, because they are worked out in the conference room, in cooperation with utility executives, their bankers and lawyers. For example, provisions of indentures receive our close scrutiny; and in several instances, we have worked out provisions respecting sinking funds, maintenance and depreciation charges, withdrawal of additional bonds, dividend restrictions, and similar matters, which may put a weak company on the road to health, and convert a second grade issue into a conservative, non-speculative issue. Similarly, we have attempted to make certain that trustees for bond issues are qualified to furnish loyal and disinterested protection to bondholders, and are free from interests which would act as a deterrent to their rendering such service.

Finally, let me comment briefly upon the provision which requires the Commission to withhold permission to issue securities if it finds that the fees and commissions to be paid in connection therewith are unreasonable. Of course, this is not a prohibition of reasonable fees and commissions. Bankers may and do continue to take a spread on utility issues; and bankers and lawyers may charge for beneficial services rendered to the company. But the statute clearly prohibits fees which are not justified by services rendered or risks assumed. Parenthetically, let me reassure you by saying that to date the Commission has not

refused to permit any securities to be issued because of excessive lawyers' fees. This should not be taken as an indication of lawyers' self-restraint or of their modest appraisal of the value of their own efforts. It means merely that to date our lawyers have not produced for the Commission's consideration a record establishing that the fees to be paid by the issuer to its lawyers are unreasonable. -- This, I believe, conclusively demonstrates that government lawyers, poorly paid as they are, are free from sin.

One of the difficult problems that we have had to face in this connection has been in respect of finders fees. For example, in one case a banker claimed a sizeable fee because, so he alleged, he had "found" property which it was to the company's advantage to purchase; in other cases, bankers have claimed fees because they have "found" commercial banks or insurance companies which purchased the company's securities.

Sometimes it is difficult to judge whether any substantial services were rendered in these cases, and whether the services rendered deserve the claimed compensation. The law, common sense, and various indications in the Act warn the Commission to cultivate a healthy skepticism of finders' fees charged by affiliates of the issuing company - that is, by persons in a position to exercise influence upon the company, or by persons who, because they are officers or directors of the company, or otherwise occupy a relationship of trust to it, or owe the company a duty to use their best efforts on its behalf. Even though the finder is not affiliated with the company, he must be prepared to show that he has rendered services worth what he seeks to recover. "Finding" the Guaranty Trust Company or the Chase National Bank in this great city does not, without more, establish a claim to compensation. On the other hand, the laborer is worth his hire - and this is true even though he be a banker.

These cases - the issuance of securities - form the grist of the mill under the Holding Company Act. Perhaps some of what I have heretofore said has already given you the notion that the Commission, in dealing with the security issues, is far from a "bureaucratic" agency in the sense that some commentators use the term. In the true sense of the word, it is an administrative agency; an agency which tries to see not black and white, but all the colors of the spectrum; and which realizes the values of the conference room over the hearing chamber; but which, at the same time, recognizes the difference between cooperation and compromise, and between compromise and surrender, and is thoroughly aware of its responsibilities under the law.

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Some months ago I had the pleasure of speaking to the Bankruptcy Law group of this institution on the subject of Reorganizations under the Public Utility Act; and I then developed at some length the application of this same technique of administration and this approach, to the reorganization problems which we must deal with under the Act. Tonight I propose merely to summarize the provisions of the Act and briefly to relate some of the problems which have arisen under them.

In summary, the Commission's approval of a plan of reorganization for a registered holding company or a subsidiary thereof is necessary before the plan can be effected. This applies to so-called voluntary

reorganizations as well as to reorganizations under 77B (or Chapter X of the new Chandler Act). No specific provision of the Act requires Commission approval of voluntary reorganizations; but every series of corporate acts which lawyers are accustomed to think of as a voluntary reorganization involves either the issuance of new securities, or the exercise of a privilege to alter preferences, priorities or other rights of outstanding securities. Commission approval of such matters is necessary; approval of the issuance of securities being necessary under sections 6 and 7, as I have discussed; and of the alteration of rights of outstanding securities, under section 6(a)(2). One of the statutory standards governing approval of either of these matters is that the issuance or the alteration of rights must not be detrimental to the public interest or the interest of investors or consumers. Pursuant to this and other statutory standards, the Commission has felt that in considering whether to approve the issuance of securities or the alteration of rights, it must take into account the provisions of the plan of reorganization and determine its fairness or unfairness to security holders.

The same situation does not exist with respect to plans of reorganization to be effected in the federal district courts. In such cases, section 11(f) of the Act affirmatively requires that the plan be approved by the Commission before it is "submitted" to the Court. Parenthetically, it may interest you to hear of an issue which has been raised in connection with the construction of this provision. Various plans have been filed with the court and with the Securities and Exchange Commission to reorganize Utilities Power and Light Corporation, a large holding company which is in 77B proceedings in the United States District Court for the Northern District of Illinois. It was apparent that the reorganization proceedings would be bitterly contested, and that they would be lengthy and expensive. The Commission was anxious to avoid the necessity of two proceedings - one before the Commission and another before the court's Special Master. The court shared the Commission's solicitude; and a procedure was worked out whereby the Commission's Trial Examiner and the court's Special Master were designated to sit and take evidence, each, of course, retaining the power to make separate rulings. Appropriate orders were entered by the court and the Commission authorizing this procedure.

To my knowledge this was the first time that such procedure has ever been attempted. Its wisdom is unquestionable, I think; the savings in time and costs are enormous; and it is a tribute to the vision of the federal judge concerned that he was willing to authorize the procedure. However, one of the parties to the proceedings apparently felt that this scheme violated the provision of section 11(f) which, as I have said, requires Commission approval of a plan of reorganization before it can be "submitted" to the court. This party therefore asked the Circuit Court of Appeals for the 7th circuit for leave to appeal from the court's order. Such leave was denied; and I believe that a valuable landmark in the administrative conduct of reorganization hearings, and in the relations of administrative agencies and courts in reorganization proceedings under their dual jurisdiction has been established.

In connection with both voluntary and judicial reorganizations, the Commission has extensive control over the solicitation of proxies and

consents. Section 11(g) of the Act provides that no consents to a plan may be solicited unless the solicitation is accompanied by a report of the Commission on the plan. Generally speaking, this report is an analysis of the plan prepared by the Commission in which the Commission seeks to call the attention of security holders to the important features of the plan and matters relating thereto, in as simple language as possible. Further, under sections 11(g) and 12(e) of the Act, the Commission has adopted rules and regulations governing solicitation methods and practices.

I shall not attempt to describe these rules in any detail. Roughly, their purpose is to prohibit the solicitation of deposits of securities - a needless, dangerous and expensive practice which has characterized reorganizations for many years - unless unusual circumstances have produced a clear necessity for such deposits; and to require that anyone soliciting proxies or consents make full disclosures of his interests; agree to submit all fees and expenses to review and determination by a disinterested person; and agree to refrain from buying or selling any securities affected by the reorganization. Any proxies or consents must be unconditionally revocable at the option of the security holder, without expense.

There is nothing that I can add at this time to what I said here some months ago concerning the Commission's theory and practice in exercising its jurisdiction over reorganization plans. Perhaps I can best summarize this aspect of the Commission's work by describing the Commission's procedure and recent decision in connection with the reorganization of the West Ohio Gas Company under section 77B of the Bankruptcy Act. This is a comparatively small gas company, distributing natural gas (which it purchases from another company) in the city of Lima, Ohio, and neighboring towns. It is a subsidiary of Midland Utilities Company, a registered holding company now in 77B proceedings.

West Ohio's difficulties were brought on partly because of adverse economic conditions; but in large part because it was grossly overcapitalized and overburdened with funded debt and fixed charges. It had outstanding $1,353,000 of first mortgage bonds; $719,800 of preferred stock; and $1,716,381 of common stock. All of its common and 52.1% of its preferred were owned by its parent company, Midland Utilities Company. West Ohio also owed Midland $65,633 on account of advances made to it, this debt being represented by notes. Thus the total capitalization of West Ohio, including bonds and notes, was $3,854,814.

On the asset side of its balance sheet at the close of 1937, Midland showed total assets of $4,585,416. It carried its property account at $4,080,802. Its gross revenues had shown a steady decline from 1931 to 1936, going down-hill in this period from $704,630 to $547,037. In 1937, this downward trend was reversed, its revenues climbing to $577,521. Even in this year, however, West Ohio failed to earn its fixed charges of $93,383 by $57,939. Accrued and unpaid interest on the company's bonds amounted to $318,500, at the close of 1937, and unpaid interest on the note to Midland totaled $12,933. Preferred stock dividends were in arrears, dividends to the aggregate extent of $243,465, or $33.83 per share, having accumulated.

Thus, the company's books themselves showed a sufficiently bad picture. But when the Commission's staff, in accordance with its usual practice, completed an investigation of the company's affairs, the situation appeared to be much worse. Instead of the company's fixed assets having a value of $4,080,802 as shown on the books, it appeared that the property had very little, if any, value in excess of the aggregate amount of the claims of the bondholders which totaled about $1,700,000. Obviously this value could not support the company's capitalization of $3,854,314.--A drastic cut in debt and total capitalization was necessary.

The company itself filed a plan of reorganization with the Commission. This plan was withdrawn when a bondholders' committee (representing institutions holding about 30% of the outstanding bonds) filed a plan which had been worked out to the apparent satisfaction of the company's representatives. This plan provided for a 50% cut in the principal amount of the bonds, and a reduction in coupon rate from 6% to 5%. To compensate for this sacrifice the bondholders as a class were to receive around 65% of the new common stock.

It appeared to the Commission's staff that this plan was unfair to the bondholders, and it so advised the parties and held numerous conferences with them in an endeavor to work out an acceptable scheme. Thereafter, however, the bondholders committee submitted an amended plan which provided for a net property valuation of $2,225,000, and for the issuance of $676,500 of new 5% bonds (or ½ of the principal amount of those outstanding), and 151,437 shares of $10 par common stock of which the bondholders were to get 70.29%, the note holders 5.95%, preferred stockholders 23.76%. The old common stock was not to participate.

A hearing was held on this amended plan at which time evidence was received relating to value of the property, its past and prospective earnings, and other matters relevant to the plan. After the conclusion of this hearing the staff was still unsatisfied with the plan. It felt that although the plan was basically sound with respect to the amount of funded debt and fixed charges, it was unfair in that it did not accord the bondholders a large enough percentage of new common stock to compensate for their scale-down.

Counsel for a holder of $10,000 principal amount of West Ohio bonds objected to the plan because it required bondholders to accept common stock in part exchange for their bonds. His affirmative suggestion was that the difference between the new first mortgage bonds to be issued under the bondholder's committee plan and the total amount of their claims should be recognized by the issuance of income bonds. He argued his contention orally before the Commission. The Commission's staff agreed with him that the plan did not give adequate recognition to the bondholders, but disagreed with his suggestion that income bonds be issued. The Commission's discussion of this point may be of interest to you:

> "The issuance of new bonds in the principal amount of the outstanding bonds, part of which would bear contingent interest, would indeed preserve for the present bondholders

their lien upon the Company's property for the full principal amount of the bonds they now hold and might also require the payment of more interest to the bondholders than would be payable on the bonds provided by the plan. It would also preserve the bondholders' rights to payment of the full principal amount of their bonds at the new maturity date. The realization of such rights is not, however, predictable and they might well prove to be illusory.

"This Company has a high operating ratio, and its earnings are subject to the exigencies of competition from other utilities. If a plan of reorganization is to be sound, new securities ought not to be issued in an amount in excess of that on which specified interest payments and some protective margin of earnings appear to be a reasonable prospect. Similarly, the amount of the funded debt should not be excessive in relation to the value of assets and the Company's total capitalization and should not be so high as to constitute a source of danger to the Company at maturity. Securities conforming with such standards may also be expected, under normal conditions, to be more marketable than securities which fall short of such standards. The issuance of a substantial amount of income bonds in this reorganization would conflict squarely with the standards required by the Act to be observed in such cases."

Subsequent to this oral argument, the bondholders committee revised its plan to provide for a net property value of $1,300,000 and a total capitalization of $1,156,500 consisting of $676,500 principal amount of first mortgage 5% bonds and 240,000 shares of $2 par common stock. This new common would be distributed 90.2% to the bondholders, 6.8% to the noteholder, and 3% to the preferred stockholders.

In its findings and opinion dated October 22, 1938, the Commission approved this revised plan as fair and equitable, and as complying with the standards of the Act. The plan must now be submitted to the court for approval, and the consent of the requisite number of security holders must be obtained under section 77B. Solicitation of such consents must be accomplished by a copy of a Report to be drafted by the Commission under section 11(g) of the Act, and must conform with the requirements of the Commission's rules.

This brief discussion of the West Ohio case may illustrate, better than any abstract discussion, the procedure of the Commission and its staff, and the theory of the Commission, in dealing with plans of reorganization. Perhaps what I have said about the case evidences these significant features:

(1) Thorough analysis of each case by the Commission's staff, sometimes including (as was true in the West Ohio case) a field study of the company's property and business;

(2) Informal staff procedure in which positive assistance as well as negative criticism is offered to parties;

(3) Thorough consideration of each case by the Commission itself;

(4) Adherence in reorganization cases to the theory that each class of security holders is entitled to "completely compensatory" treatment before anything is given to a junior class -- the theory which has developed from the Boyd case; and

(5) A reasonable application of the *Boyd* case theory. (Thus, in the *West Ohio* case the Commission found that the property had "very little, if any" value in excess of the claims of bondholders. Nevertheless, in view of all the circumstances, it felt that the allocation of 3.5% of the total new capitalization to junior claimants and security holders did not render the plan unfair.)

What I have said about the Commission's practice and theory in judicial reorganizations applies equally to voluntary reorganizations, as I discussed in my former paper before this group. I said then, and I now reiterate, that a pressing need of many companies in the public utility industry is to clean up their capital structures and to put their houses in order. Until this is done, financing for many of them may be difficult and expensive; and certainly equity financing will be most unlikely. No one can expect investors to buy common stocks of a company which is already overloaded with debt, fixed charges and stock, and which has large arrearages on its preferred stock. That is precisely the condition of some public utility companies; and until this situation is corrected, informed persons will justly regard as nonsensical propaganda the complaint of some of the industry's executives that they cannot raise equity money because of the New Deal's power policy. The real reason, in most cases, is that the companies are over-bonded and over-stocked -- conditions which generally arose in the roaring twenties.

It may be of interest to you to note that some holding company systems have embarked upon a program of cleaning house by use of accounting devices which lawyers do not customarily think of as reorganizations. For example, several companies have made extensive studies of the value of their assets; and they have begun to restate their assets and their capital securities in light of present day realities. The importance of such program is indeed great, and the benefits to be derived from them are unmistakable. Great credit is due to the executives of these companies for their realistic leadership in taking such action.

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Perhaps the phase of the Commission's work under the Act which has attracted most attention is its administration of the provisions of sections 11(b) and 11(e) of the Act, which relate to integration and simplification of holding company systems and to the redistribution of voting power. Unquestionably, these sections raise difficult practical and legal problems, but considerable progress has been made towards solving them in an efficient, sensible fashion. Two comprehensive voluntary

plans filed under section 11(e) of the Act have been approved by the Commission. One was the American Waterworks & Electric Company plan, and the other was the plan of Republic Electric Power Company, recently approved by the Commission. There are reliable indications, including the recent, notable statement of Mr. Groesbeck, Chairman of the Electric Bond & Share Corporation (the largest utility holding company in the country), that all or virtually all holding companies will have notified the Commission of their plans for complying with the requirements of section 11(b) by December 1 of this year. The Commission has itself instituted only one proceeding to compel compliance with the provisions of section 11(b). This was in respect of Utilities Power & Light Corporation which is in 77B proceedings, as I have already mentioned.

I shall not attempt to discuss these provisions of the statute or their administration. It is too early to give you a progress report; and the argumentative and theoretical considerations have been ably presented in a number of available documents -- particularly in a speech delivered by Chairman Douglas before the American Bar Association in July of this year. A brief comment will suffice for present purposes.

Section 11(b)(1) provides, in substance, that every registered holding company must confine its utility operations to properties which can be operated as a single interconnected and coordinated system, located in a single area, plus such other (non-utility) businesses as are reasonably incidental or economically necessary to its utility business. If justification can be shown for it pursuant to the provisions of the statute, the holding company may continue to control, in addition to this single system, additional systems located in the same state or in adjoining states. In brief, the purposes of this section of the Act may be summarized as follows:

(1) To compel economical use and operation of generating facilities and transmission lines, and thereby to improve the national power supply and make it possible to furnish power at rates which will benefit both consumers and investors;

(2) To reduce operating waste, and to eliminate the lack of appreciation of and reasonable responsiveness to local opinion which may be incident to absentee management;

(3) To limit the concentration of control in the industry;

(4) To facilitate regulation of electric and gas utilities by state as well as federal authorities;

(5) To make the gas and electric industry more attractive to investment capital (This would result from the improvements in efficiency, service, and management and from the reduction of local opposition, which I have described; and also from the stability which follows as a result of concentration of activities in one carefully selected, economically balanced area--a point fully developed in Chairman Douglas' speech of July, 1938).

Section 11(b)(2) requires, in brief, simplification of corporate structures and equitable distribution of voting power. Little question has been raised as to the desirability of these reforms. The perpetuation of corporations which serve no purpose -- or at most are useful to confuse investors, dismay regulatory agencies, or serve as convenient instruments for accounting legerdemain or financial deception -- is obviously contrary to the public interest; and the needless pyramiding of corporation upon corporation so as to increase leverage; to make it possible for a few thousand dollars at the top to control millions of other peoples money; and to facilitate remote control, is clearly a national danger.

Similarly, few people today will quarrel with the proposition that persons who have money invested in equity securities should have a voice in the affairs of their corporation commensurate with their interest therein. Otherwise, they have no means of safeguarding their interests. Let me give you an example of what I mean by this. Let us suppose a holding company which has a large capital deficit. There is clearly no value for the common stock, and there has been no value for it for a number of years. Let us also suppose that for many years there have been no earnings available for the common; that there are huge accumulations of unpaid dividends on the preferred stock; and that there is no prospect of earnings available for common in the reasonably forseeable future. Nevertheless, let us assume, the common has sole voting rights. Obviously, natural self-interest will indicate to the directors elected by and responsible to the common that they should do everything possible to build up the equity of the company to a point where it is possible for the common to salvage something. In short, there is, in this sort of situation, a terrible temptation to the common's directors to take flyers with money which rightfully belongs not to the common, but to the preferred. -- There is only one way to prevent this sort of thing, and other undesirable incidents of inequitable distribution of voting powers, and that is to redistribute the privilege to vote.

In conclusion, let me make a general observation about the importance of the Holding Company Act to lawyers interested in the development of financial law and practice. The economic and social significance of the Act has been frequently commented upon; and the administrative techniques which we are developing under the Act are of great interest and perhaps of considerable importance. But to the financial lawyer a matter of absorbing interest is the degree to which the Act reflects the best critical thought concerning financial practices in the public utility field, and the manner in which it directs that the standards of public utility finance shall be maintained upon a level consonant with the great national importance of the industry. And in the daily work of the Commission under the Act, lawyers will see that there is gradually emerging, tested and tempered by a common law process, an ever clearer set of detailed principles under the Act. We are, I think, on our way to a happier day in finance; to a stage where the marshalling of capital for the country's needs will be a sober, orderly process; and on this road, perhaps the Holding Company Act is a milestone.

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