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COMMISSIONER ROBERT E. HEALY

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SECTION 11 OF THE PUBLIC UTILITY HOLDING COMPANY ACT

By Robert E. Healy,

Commissioner, Securities and Exchange Commission.

At Boston, in 1936, I had the privilege of addressing this section of The American Bar Association. My subject was the Public Utility Holding Company Act of 1935. At that time the Act had been on the books for about a year. The constitutionality of its principal requirement - registration -- had not been passed upon by the Supreme Court. Opinions on that point differed sharply, as the minutes of the Boston meeting will prove, if proof is needed. I refrained at that time from discussing Section 11 of the Act for several reasons; we had had little experience with it; its principal provision was not operative until 1938; I did not feel that my thoughts on the section were in good order. Since that time the registration requirements has been upheld by the Supreme Court (Electric Bond & Share Company v. Securities and Exchange Commission, 303 U. S. 419). When that case was decided, two justices, Cardozo and Reed, did not participate. Of the remaining seven, one, Justice McReynolds, appointed by President Wilson, dissented. Of the remaining six who concurred, one was appointed by President Roosevelt, one by President Harding, one by President Wilson, one by President Coolidge, and two by President Hoover.

But Section 11 has not been passed on by the Supreme Court or even by lower courts either as to its construction or its constitutional validity. But we have had further experience under that Section. We have instituted so-called integration proceedings under Section 11 (b) (1) against nearly all the large holding companies and simplification proceedings under Section 11 (b) (2) against several. As a result of much discussion, the hearing of arguments and what I assume to designate as thinking, I have come to the point where I want to talk about Section 11 and not much else besides.

For various reasons, one of them political, I shall deliberately refrain from any extensive discussion of the acts and practices which led to the enactment of the statute. My purpose is to discuss Section 11 as a lawyer, to present my views as a lawyer to a group of other lawyers who will understand clearly whatever I am able to state clearly. It should be remembered that what I have to say represents my own personal views and not necessarily those of the other members of the Commission. I plan to canvass several problems which are presented by Section 11 and some of the possible answers. Though I do not propose to constantly repeat such phrases as "it is asserted", "it has been claimed", etc., I do hope to treat the subject objectively. My purpose is to make this a lawyer's paper. It will therefore probably be very dull. I hope it may at least stimulate our thinking, yours and mine, as to what the Section means and also as to another important phase, i.e., what is the proper procedure under the Section? Both problems have the bright face of danger. First, it is always an adventure and often, alas, a misadventure to attempt to say what a statute means. In the end, like the Constitution, it means what the Supreme Court says it means. The meaning of words in statutes is a question of law for the courts. The views of the Securities and Exchange Commission will be given, I believe, great consideration by the Courts. Administrative interpretations and practice may often make or break a statute. Sensible interpretation

and sane administration make for easier constitutional problems. Yet in the end the meaning of words in statutes is a question of law for the courts. This is but another way of repeating that much worn, but fundamental doctrine, essential to our liberties that ours is a government of law and that uncontrolled and undefined discretion in any judicial or quasi-judicial body is at odds with our system of government. In the second place, the way you proceed in a given case can have any important effect on substantive rights. Problems of procedure are not always lawyers' mumbo-jumbo designed to mystify and confuse the layman.

First, as to the constitutionality of Section 11, I wish to say no more than this; that it would be well to have the constitutionality of the section determined; that no valid criticism can be made of any company which seeks such a determination and next, that although I believe the constitutionality of the principal provisions of Section 11 will be upheld, I do not choose to stake my reputation as a lawyer on it for several reasons; One, predicting is a risky business; two, the stake I would risk is too small to make the wager interesting; and three, precedents teach us that when such a wager is lost, the legal reputation staked is not lost, for the loser can not possibly pay up.

As an approach to Section 11 let us consider what an integrated system is. The term is defined in Section 2 (a) (29) of the Act. The definition found in Section 2 (a) (29) is as follows:

"'Integrated public-utility system' means--

"(A) As applied to electric utility companies, a system consisting of one or more units of generating plants and/or transmission lines and/or distributing facilities, whose utility assets, whether owned by one or more electric utility companies, are physically interconnected or capable of physical interconnection and which under normal conditions may be economically operated as a single interconnected and coordinated system confined in its operations to a single area or region, in one or more States, not so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operation, and the effectiveness of regulation; and

"(B) As applied to gas utility companies, a system consisting of one or more gas utility companies which are so located and related that substantial economies may be effectuated by being operated as a single coordinated system confined in its operations to a single area or region, in one or more States, not so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operation, and the effectiveness of regulation: *Provided*, That gas utility companies deriving natural gas from a common source of supply may be deemed to be included in a single area or region."

A mere reading of this definition lends considerable weight to the view that the meaning of this statute, like the meaning of every other statute that the hand of man has written to date, is open to debate. Also that when one comes to decide what utility assets are capable of interconnection, or which ones under normal conditions may be economically operated, etc., or whether a designated one is so large as to impair the advantages of localized management, efficient management, and the effectiveness of regulation, the production of conflicting evidence on these matters should occasion no more surprise than the conflicting evidence which appears in every tribunal in the land dealing with facts. Words are not so completely adequate as to avoid such conflicts. I doubt whether anyone lives who can write a statute presenting no possibilities of substantially plausible differing constructions and no issues of fact.

What do the various paragraphs of Section 11 mean? What should be the procedure in a Section 11 case?

Section 11 (a) provides that it shall be the duty of the Commission to examine the corporate structure of every registered holding company and every subsidiary company thereof, the relationship among them, the character of their interests, the properties owned and controlled by them, and "to determine the extent to which the corporate structure of such holding company system and the companies therein may be simplified, unnecessary complexities therein eliminated, voting powers fairly and equitable distributed among the holders of securities thereof and the properties and business thereof confined to those necessary or appropriate to the operations of an integrated public utility system." Section 11 (a) deals with two general subjects: (1) simplification of corporate structure, including fairness of voting rights; (2) so-called integration.

On the integration aspect it is important to note that Section 11 (a) speaks of the extent to which the properties and business thereof may be confined to those necessary or appropriate to the operations of *an* integrated system which many assert means *one* integrated system.

However, the fact that Section 11 (a) directs the Commission to "determine" the extent to which the corporate structure etc., may be simplified and the business and property thereof confined to those necessary or appropriate to the operations of an integrated system has led several of the large holding companies, and several students of the statute, to contend that the Commission should make a determination as to simplification and integration *before* the Commission launches proceedings under Section 11 (b). The more usual way of administering laws has been generally to make decisions only after hearing the parties involved as to both the law and the facts. Therefore, those opposing the predetermination theory under Section 11 (a) search the statute to learn whether it requires such a radical departure from their preconceptions.

In that search they come at once to Section 11 (b) and say that it is designed to implement Section 11 (a); that is, Section 11 (a) tells us what Congress wants accomplished; Section 11 (b) tells us how to do it; 11 (a) is a statement of objectives; 11 (b) of procedure. They assert that an examination of it discloses that in addition to describing procedure

it substantially modifies even the general objectives set forth in Section 11 (a), that the proceedings authorized by Section 11 (b) (1) are not to be instituted until "as soon as practicable after January 1, 1938", whereas no date at all is mentioned in Section 11 (a). Therefore, it is argued although the Commission was at liberty to make studies under Section 11 (a) before January 1, 1938, it was not at liberty to make any order under Section 11 (b) on the subjects dealt with, i. e., simplification and integration, until after January 1, 1938. It is pointed out that Section 11 (b) deals with the self-same subjects covered by Section 11 (a) and no others, even modifying the substantive provisions of 11 (a), and that Section 11 (a) was not the last word on the subject it covers. Having provided in Section 11 (a) that the Commission should determine the extent to which corporate structures could be simplified, and the business and properties confined to those necessary to the operations of an integrated system, Congress in Section 11 (b)(1) provided that the Commission could require certain action. However, still paraphrasing the arguments of the opponents of the 11 (a) determination doctrine, it is important to note that this action is to be taken by order. But the statute says that the order cannot issue until after notice and opportunity for hearing. The Commission cannot require any action until after notice and opportunity for hearing. In this it is argued there is no support for the view that determinations are to be made *ex parte* and issued prior to hearings. Quite the contrary. This is consistent with Section 20 (c) of the Act which provides that orders of the Commission shall be issued only after opportunity for hearing.

But what is the action that the Commission may thus require by order after notice and opportunity for hearing? It is that the holding company and its subsidiaries take such action as the Commission finds necessary to limit the operations of the holding company system to a "single integrated public utility system and to such other businesses as are reasonably incidental or economically necessary or appropriate to the operations of such integrated public utility system." This is the principal provision and the very heart of Section 11. The general provision is not that companies must integrate. The provision recognizes that the holding companies now control various integrated systems. The great crucial problem posed by Section 11 is: how many integrated utility systems may one holding company own? Viewed from this angle the philosophy of the section substantially resembles that of the Sherman Act which President Benjamin Harrison signed for the Republicans in 1890 and that of Section 7 of the Clayton Act which President Woodrow Wilson signed for the Democrats in 1914. Support for this view is found in the Senate Resolution (Senate Resolution 83 (February 15, 1928) 70 Cong. Rec. 3054) authorizing the Federal Trade Commission's investigation of utility corporations, wherein that Commission was directed "to report particularly whether any of the practices heretofore in this resolution stated tend to create a monopoly or constitute violation of the Federal Antitrust laws".

It is quite evident that Congress was of the opinion that while the operations of operating companies was a matter primarily for the control of the state -- and whether intrastate companies should or should not be permitted by law or practice to maintain virtual monopolies within the state was primarily a matter for state determination -- the broader matter of how many of these companies in how many states should be owned or controlled by a single holding company was a matter in which the national government had a legitimate interest and concern.

However, we find that after expressing the general or primary purpose of reducing the ownership of the holding company to one integrated utility system, the Act then goes on to provide that under certain circumstances the holding company shall have the right to own more than one integrated system, thus modifying Section 11(a) in substance. These circumstances or standards are described in three subparagraphs of 11(b)(1) labelled with the capital letters A, B and C. Thus these provisions are often referred to as the A, C, C standards of Section 11.

The language of the section has given rise to the belief in some quarters that the burden of proving the right to own more than one integrated system, or at least the burden of going forward with evidence on that issue, rests upon the holding company, that the Commission's opening case is made out when the staff has proved that the holding company involved owns more than one integrated system, that thereupon the burden shifts to the holding company to establish its right to more than one by proving the conformity of the additional ones to the A, B, C standards of Section 11. Since the general policy of the Act is to reduce the holdings of particular companies to one integrated system, it is open to serious question whether the Commission can lawfully permit any holding company to own more than one, unless and until the statutory standards are met, just as it seems clear that, if the statutory standards are established, no one can deny the holding company's right to continue to own more than one integrated system. In other words, it is not a matter of Commission discretion, but of statutory right. This is a good point at which to remind ourselves of what the Supreme Court said of another independent agency in *Rathburn* v. *U. S.*, 295 U. S. 602 (1935), "It is charged with the enforcement of no policy except the policy of the law."

Once it is established that the respondent holding company owns more than one integrated system the question has been raised as to who has the right to select or designate the one principal integrated system. The adherents to one school of thought say that this is the prerogative of the holding company, pointing out that in those cases arising under Section 7 of the Clayton Act where holding companies have been found in violation thereof by acquiring two substantially competing corporations, the court's decree of divestiture and the Federal Trade Commission's cease and desist order has invariably left to the holding company the decision as to which company it should retain and which it should release. Assuming that this school is correct, then a further interesting question is posed: What happens if the holding company refuses to make a choice -- to which those of a speculative turn of mind reply that the Commission should make the designation. The other school of thought reasons thus: If a holding company owned one large important integrated system and a number of scattered, rather small and unimportant systems it would be an offense to the objectives of the Act to permit the holding company to designate one of the smaller unimportant systems as its principal *one* for no reason except to gerrymander itself into a position where it could retain under "Big P," if it also proved A and C, that small system, its one really important system and several of the others, whereas if it designated the important one on the principal *one* it could not retain so many.

What are these provisions relating to the ownership of integrated systems in addition to one? First of all (and again this is important in considering how far the Commission can or should go in making determinations under 11 (a)) the right to additional systems can only exist, if (to use the very words of the statute) the Commission finds the A,B,C standards exist "after" -- not before, "notice and opportunity for hearing." Now let us see what the A,B,C standards are:

(A) provides --

"Each of such additional systems cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by such holding company of such system;

(B) (commonly called Big B) provides --

"All of such additional systems are located in one State, or in adjoining States, or in a contiguous foreign country;

(C) provides --

"The continued combination of such systems under the control of such holding company is not so large (considering the state of the art and the area or region affected) as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation."

From the point of view of statutory construction, though not of administrative application, probably the most difficult of these sections is "Big B." At least three constructions of it have been suggested. They are as follows: (1) All additional systems which may be retained must be located in one state or in states adjoining each other, but such state or states need not adjoin the state or states in which the principal system is located; (2) that the location of all additional systems must be in the same state as the principal system or in states adjoining it; and (3) all the additional systems may be in one state which need not adjoin the state of the principal system, or all the additional systems may be in states adjoining the principal one, or in a foreign country contiguous to the principal state.

To date the Commission has not announced its views as to which of these meanings was intended by Congress. The question like any other question of federal statutory construction can never be regarded as settled until the Supreme Court has decided it. In the meantime no company has presented the question to the Commission for decision in a given case on a specific state of facts. In fact one or two of them, which in pending proceedings are in a good position to raise the question or to cooperate in raising it, do not seem at all anxious to learn the Commission's views. For my part, although of necessity I have certain ideas as to how "Big B" should be interpreted, I refrain from expressing them for the following reasons. First, I am much impressed by the view that interpretations of statutes are best made in the course of applying the statute to specific facts and not by abstract pronouncements. Second--and perhaps this should have been first--I have too

often found that my views on the law had to undergo extensive revision after I had heard able counsel argue. I for one am unwilling to join in announcing a construction of "Big B" until I have heard the arguments of counsel representing the companies whose rights and standing might be profoundly affected by our views as to the correct construction. At the same time I regret that such an occasion has not as yet occurred.

My feeling is that the sooner the meaning of "Big B" is settled, the better for everyone involved. For example, it seems quite clear that if the narrow construction of "Big B" is to prevail, a great deal of time and money which would otherwise be spent in trying the A and C issues would be saved. It is even possible that with the meaning of "Big B" settled, the trial of many issues, as to where and what the integrated companies of a given holding company are, can be simplified or wholly avoided. For example, if a holding company's principal integrated system were in the state of Maine, if it owned additional properties in Nevada, if the Commission's staff contended that the Nevada properties constituted two integrated systems, it would be wholly unnecessary to try that issue if the so-called narrow construction (number 2 supra) of "Big B" were adopted. This is so, because since Nevada does not adjoin Maine and since under the narrow construction none of the Nevada properties could be retained by the holding company, it would make no difference in the pending case whether the Nevada properties were two integrated systems or one. On the other hand, it is argued that if a case were decided on "Big B" alone, and no evidence were taken on A and C, were the court to disagree with the Commission interpretation of "Big B", the case would be sent back to try the A and C issues; whereas if the Commission tried the A, B and C issues fully and decided all of them against respondents, a decision by the court upholding either of them would end the case. It should also be pointed out that under the terms of the statute all three of the A, B, C standards must be established; that the non-existence of any one of them defeats the rights of the holding company to retain the additional systems being considered.

If these views are sound, it seems apparent that until the A,B,C issues have been tried and determined, it cannot possibly be known how many integrated systems a holding company may retain, or even that the holding company must reduce itself to the ownership of one integrated system. If this is so, it follows inevitably that at that stage it is waste effort for the Commission to undertake to find what action is necessary in order that the holding company reduce itself to one integrated system. Why undertake how to do something which may not ever have to be done? How under either 11 (a) or 11 (b) (1) can the Commission even make any suggestions as to what to do until it has been decided that the company can or cannot retain more than one, and if so how many more? If we assume that a holding company owns five integrated systems, it may succeed in establishing its right to retain three, or perhaps only two, or perhaps four, or all five. How can we possible know the answer in advance of hearing the company's evidence and claims as to the A,B,C standards? It may be true that we could say to such a company, "In our opinion you cannot possibly establish the A,B,C standards as to any of the four additional systems, but you are welcome to go ahead and try it if you want to." To me this is like saying, "True it's your turn at bat but remember before you step up to the plate we've called two strikes on you."

However, that is what some of the companies seem to desire for several of them have taken a position -- which some others do not seem to favor -- which results in their requesting or perhaps demanding that the Commission state, in advance of trial or even in advance of instituting 11 (b) proceedings, what and where the integrated systems are, what the principal one should be, whether the A,B,C standards are met as to those systems additional to one, and what action the company should take to reduce itself to one or such additional ones as the Commission believes may be retained and to such other business as are properly incidental or appropriate. In the UGI case (Holding Company Act Release No. 2065) the Commission held that a determination need not be made under Section 11 (a) before proceedings were begun under 11 (b), but that since the company had made such a request as I have outlined, there would be no harm in complying with it, and a majority of the Commission said it would be done. Since the burden of proving where and what the integrated systems are seems to rest on the Commission, I thought it was proper if the company desired it, for the Commission to state its wholly tentative views on that subject, but for the present I was unwilling to go further. The compliance with the UGI "request" will take the form of a report, I suspect, and will be ready for delivery before long.

Following A,B,C, Section 11 (b) (1) provides that the Commission may permit as reasonably incidental or economically necessary or appropriate to the operations of one or more integrated public utility systems the retention of an interest in any business (other than the business of a public utility company as such) which the Commission finds necessary or appropriate in the public interest or for the protection of investors or consumers and not detrimental to the proper functioning of such system or systems. This provision is closely, though not precisely, similar to a provision relating to other businesses which is found earlier in Section 11 (b) (1). The question has frequently been asked "Why this repetition?" I think the answer may be that the first provision relates to the retention of such interests in businesses other than utilities as are incidental or economically necessary or appropriate to the operation of a single integrated utility system, whereas the second provision relates to such interests as are necessary or appropriate, the A,B,C standards being established, in connection with the retention of more than one integrated systems. Obviously, there will be cases where additional businesses can appropriately be retained only if more than one integrated system can be retained.

It has been suggested that a holding company can wait and see how it comes out under A,B,C before expressing the preference as to the selection of its principal integrated system. This suggestion gives rise to the question-- How can it be reconciled with the provisions of A,B,C that under the specified circumstances the holding company can retain one or more "additional" systems? Additional to what? How can the geographic test of Big B be applied unless the selection of the principal system has been made? How can the tests of A and C be made if it is not known what systems you are dealing with?

If the views already described as to Section 11 (a) and (b) are sound, then it would seem that an orderly method of procedure might take the following lines:

> The Commission or its staff indicates its tentative views as to what and where the integrated systems owned by the respondent holding company are;

The respondent's counsel indicates how far he agrees and disagrees with this statement;

The trial of the issues, thus joined, proceeds, the Commission counsel taking the burden of going forward. The issues will doubtless present at once a question as to the meaning of "Big B", which can be raised in connection with an offer of evidence;

Before proceeding further with the issues, counsel argue the proper construction of Big B before the Commission;

The Commission states its views as to the meaning of Big B;

The trial of issue as to identity and location of integrated system proceeds;

This issue is argued before the Commission;

The Commission issues interim finding as to what and where the integrated systems are;

The selection or designation of the principal system is made;

The respondents, if they so elect, then undertake to establish the A,B,C standards as to all systems additional to the principal one;

After hearing the parties the Commission decides the A,B,C issues;

At this point it having been decided where and what the integrated systems are, what the principal one is, what additional systems the holding company may retain, the Commission is for the first time in a position to determine what the holding company should do to reduce its ownership to the systems whose retention is proper and what non-utility businesses it may retain as incidental or necessary or appropriate to the integrated utility systems.

From this necessarily technical and, I fear, boring discussion of 11 (b) (1), I move on to 11 (b) (2) which deals with the other topic posed by the masthead, 11 (a) i.e., simplification and equitable distribution of voting rights. This section provides as follows;

"(b) It shall be the duty of the Commission, as soon as practicable after January 1, 1938:

"(2) To require by order, after notice and opportunity for hearing, that such registered holding company, and each subsidiary company thereof, shall take such steps as the Commission shall find necessary to ensure that the corporate structure or continued existence of any company in the holding-company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of such holding-company system. In carrying out the provisions of this paragraph

> the Commission shall require each registered holding company (and any company in the same holding-company system with such holding company) to take such action as the Commission shall find necessary in order that such holding company shall cease to be a holding company with respect to each of its subsidiary companies which itself has a subsidiary company which is a holding company. Except for the purpose of fairly and equitably distributing voting power among the security holders of such company, nothing in this paragraph shall authorize the Commission to require any change in the corporate structure or existence of any company which is not a holding company, or of any company whose principal business is that of a public-utility company. * * * *"

Here again the order expressing the Commission's requirement cannot, by the express provision of the Act be taken until *after* notice and opportunity for hearing, again making weight against the contention that determinations on these very topics can be made under 11 (a) *before* notice and opportunity for hearing. It will be easier to remember the provision of this section dealing with the number of permissible layers of holding companies if we say, as we often do, that this phrase of 11 (b) (2) permits grandfathers but not great-grandfathers. This verbal shorthand has gained for this phrase the nickname "the great-grandfather clause." Its impact will be on those systems with more than two layers or strata of holding companies above the level occupied by the operating companies, and more especially on two or three heavily pyramided systems where the corporate chart resembles the product of a genealogist suffering from dementia.

Continuing with Section 11 (b), it is noted that the section ends with the words: "Any order made under this subsection shall be subject to judicial review as provided in Section 24." This provision as to appeal becomes of additional interest in view of further provisions. Section 11 (c) provides that any order under subsection (b) shall be complied with within one year, but the Commission on a showing of diligence, necessity, etc., may extend the time for not to exceed an additional year. Under Section 11 (d) the Commission may apply to a court to enforce an order under 11 (b). So it is sometimes argued that the Commission cannot apply to a court to enforce its order until a year has elapsed, though it is also argued, no such delay would be necessary were the respondents to announce as soon as an order was entered that they did not intend to obey it. However, under the provision relating to judicial review in Sections 11 (b) and 24, a petition for a court review of an appeal for an order of the Commission must be filed within sixty days of the entry of the order. So in cases where a review is desired, the year's wait for compliance approximates the time often required for a court review. As I have stated, the Commission may apply to a court to enforce compliance with an order issued under 11 (b). There seems to be no other method by which the Commission can enforce compliance with an 11 (b) order. But in certain other agencies such as the Federal Trade Commission, when an application for enforcement of an order is made, the respondents are at liberty to urge all available defenses against the order. So the question is asked: "In view of the right of judicial review provided in Section 11 (b), is not the respondent in a petition for enforcement under 11 (d) prevented from attacking

the Commission order if it has failed to seek the review permitted by Sections 11 (b) and 24?" This question gains in interest from a realization that the review provided by Sections 11 (b) and 24 is by the Circuit Court of Appeals, whereas the application for enforcement under 11 (d) is to the District Court. In the cases where a review has been had in a Circuit Court of Appeals before the application for enforcement is decided in the District Court, it seems safe to assume that all the principal defenses available to the respondents will have been disposed of.

In the enforcement proceedings the court acts as a court of equity. It may take possession of the companies and their assets, it may appoint a trustee, it may make the Commission trustee. The trustee with the approval of the court may dispose of any or all of the assets and may make such disposition in accordance with a "fair and equitable reorganization plan." These last five words are quoted from the 11 (d) and I shall later remind you of their presence. The plan, however, must have been approved by the Commission after opportunity for hearing. The reorganization plan may be proposed in the first instance by the Commission or by any person having a bona fide interest in the reorganization.

Subsection (e) of Section 11 is one of the most important and interesting sections of the Act. It may turn out to be also the most novel in certain respects. It was included in the Act largely at the instance of the holding companies, particularly the New England Power Association. Its general purpose is to permit the companies to file voluntary plans for compliance with Section 11 (b). The existence of huge arrearages of preferred dividends makes this provision of unusual interest and has a similar effect on the provisions of 11 (b) (2). As of December 31, 1938, operating companies, subsidiaries of registered holding companies, had preferred dividend arrearages of $411,737,187 and registered holding companies of $1,168,911,229, not including the amounts of holding companies, such, e.g., as Cities Service Company, claiming exemption as such from the Act. Section 11 (e) provides that any registered holding company and any subsidiary thereof may submit a plan to the Commission for the divestment of control, securities, or assets, or for other action for the purpose of enabling such company or any subsidiary thereof to comply with subsection (b) of 11. The Commission is required to approve the plan under certain conditions: First, there must be notice (obviously to security holders and others with legitimate interest) and opportunity for hearing. Second, the Commission must make two findings (1) that the plan, as submitted or modified, is "necessary to effectuate the provisions of subsection (b)," and (2) that the plan "is fair and equitable to the persons affected" thereby. The Commission *at the request of the company* may apply to a court to enforce and carry out the terms and provisions of the plan. The court too after notice and opportunity for hearing must pass on the same two questions as the Commission, namely, whether it finds the plan "fair and equitable" and appropriate (it does not say "necessary") "to effectuate the provisions of Section 11." Under this section as under 11 (d), which is the enforcement section in non-voluntary cases, the court may take possession of the companies and their assets, may appoint a trustee, may appoint the Commission as trustee to administer the assets in accordance with the plan under the direction of the court.

It is interesting to note that this statute is, in effect, authority for a voluntary reorganization; that so far as the express language discloses, it may come about in the case of a perfectly solvent corporation, indeed in the case of one having no debt. But it does not authorize a reorganization for any purpose but one -- it must be necessary to effectuate the purposes of Section 11 (b). So to be valid a voluntary reorganization must be necessary or appropriate to effectuate the purposes of Section 11 (b). Those purposes, as has been shown, relate first to the number of integrated systems and incidental non-utility businesses a holding company may own, and second to the simplification of the structure and the equitable distribution of voting power. It would seem to follow that a voluntary plan under 11 (e) can be upheld in those instances where the action voluntarily taken could be compelled by the Commission in adversary proceedings under 11 (b). Since the meaning of words in statutes is a question of law for the courts, it may be that various voluntary plans under 11 (e) designed to simplify the structure of a corporation or a system, will have to face a court test as to whether that structure was "unduly and unnecessarily" complicated as a matter of law. It seems equally possible that an adverse proceeding by the Commission against the same company under 11 (b) (2) would have to meet exactly the same test as to legality.

But to be valid under 11 (e) the plan must also be "fair and equitable" to the persons affected by the plan, principally the security holders. The plan must conform to this standard not only in the opinion of the Commission, but Congress was careful to require the court to pass on that question also. It is difficult to read the decision of the Supreme Court in *Case* v. *Los Angeles Lumber Company* (60 Sup. Ct. 1) and escape the conclusion, that the words "fair and equitable" as used in this Act, are words of art, just as the same words were held to be in the section of the Bankruptcy Act before the court in the *Los Angeles* case. In other words, whether the plan is fair and equitable is a question of law. This in turn subjects plans under 11 (e) to the test of the priority doctrine announced in the *Boyd* case (228 U.S. 482), in the *Kansas City Terminals* case and related cases (271 U.S. 445), reaffirmed in the *Los Angeles* case, and explained by obiter in *Securities and Exchange Commission* v. *United States Realty & Improvement* (60 Sup. Ct. 1044), also probably to the doctrine of the *Deep Rock* case (*Taylor* v. *Standard Gas & Electric Co.*, 306 U.S. 307) explained in *Pepper* v. *Litton* (60 Sup. Ct. 238).

A further reading of the *Los Angeles* case leads to the view, that therein the Court held that, under the reorganization statute then before the Court, the plan not only had to be feasible, but it also had to be fair and equitable to the security holders. One was not a substitute for the other. Two tests were presented by the statute. The plan had to meet both of these successfully or be struck down. In the *Los Angeles* case the plan was admittedly feasible. Nevertheless, the court disapproved it. It met one test but not the other and so perished. Likewise under Section 11 (e) it can be plausibly argued that a plan to be valid must meet both of two tests: (1) that it is necessary or perhaps appropriate to effectuate the provisions of subsection (b) of Section 11; (2) that it is fair and equitable. If the plan fails to meet either of these tests, it is invalid. One is not a substitute for the other. The failure to meet either is fatal. Sometime a plan conforms so very well and so desirably to the test of feasibility or to the test of effectuating the purposes of Section 11 (b) that we find it difficult to realize that the

test of "fair and equitable" is of equal vitality and consequent. It was interesting to note the surprise caused by the Supreme Court pointing out in the *Los Angeles* case that a first mortgage is still a first mortgage and that the rights of creditors are superior to those of stockholders, or in other words of debtors, and that contractual rights of this character are protected by our laws.

I have purposely refrained from discussing the bearing of the Los Angeles and U.S. Realty and other decisions on the difference of opinion, which has existed for some time between other commissioners and me, as to whether priorities are lawfully preserved in reorganizations when secured creditors or unsecured creditors or preferred stockholders are required to accept for their old contracts new securities of the same class as those issued to others whose old securities were of lower grade who make no new contribution. (See for example *In the Matter of West Ohio Gas Co.*, 3 S. E. C. 1014, 1029).

One may sensibly ask after considering these provisions of 11 (e), the section for voluntary action, whether similar provisions are found in 11 (b), (c) and (d), the sections for non-voluntary action, adverse action by the Commission. It seems plain that an order of the Commission under 11 (b) (1) or 11 (b) (2) to be valid must be one necessary to effectuate the provisions of 11 (b) (1) and 11 (b) (2). In 11 (b) (2) we find no language expressly stating that the rearrangement ordered by the Commission must be fair and equitable. However, 11 (d) which provides for enforcement of 11 (b) orders and the trustee's power to dispose of assets, also provides that such disposition must be "in accordance with a fair and equitable reorganization plan which shall have been approved by the Commission after opportunity for hearing". So here is plain recognition of the fair and equitable doctrine in connection with adversary proceedings under 11 (b). Besides it may be questioned whether Congress would preserve this doctrine in the 11 (e) cases, and completely neglect it in the 11 (b) cases. It is doubtful whether it has done so. How receptive the Supreme Court would be to a suggestion that this principle be disregarded even in an adversary case, may, in the light of the strong language of the *Los Angeles* case, at least be questioned.

My paper has grown to such a length that I shall devote little time to the further provisions of Section 11. In passing we may note hurriedly that in proceedings in United States courts in which a receiver or trustee is appointed for any registered holding company or subsidiary thereof, the court may make the Commission sole trustee or receiver subject to the orders of the court, that no other person than the Commission shall be named trustee or receiver without notifying the Commission and giving it an opportunity to be heard. A reorganization of such a company shall not become effective unless the plan shall have been approved by the Commission after opportunity for hearing *prior* to its submission to the court. Such a plan may be proposed in the first instance by the Commission or by any person having a bona fide interest. The Commission is authorized by rules or orders to require that all fees and expenses in reorganization and similar cases shall be subject to approval by the Commission. The Commission, however, has enacted a rule, that in cases in which it appears under Chapter X of the Chandler Act, it will not exercise this power, but will present its views to the court, although the rule reserves to the Commission the right to take a different course where circumstances justify it. (Rule U-11F-2).

Section 11 (g) controls the solicitation of proxies, consents and similar documents in respect of any reorganization plan or of divestment of control, securities or assets, or dissolution. The solicitation must have been submitted to the Commission, unless the Commission itself proposed the plan. The solicitation must be accompanied by a report on the plan made by the Commission after opportunity for hearing or by an abstract of such a report. Many investors seem to have found these reports helpful. We do our best to have them written simply. It is often very difficult to do so when the facts are numerous and complicated. To date the Commission has not in these reports advised the security holder how to vote. It does try to see that he gets all the pertinent truth so that he can exercise whatever powers of judgment he has on the basis of fact and not of fancy.

The solicitation must conform to SEC rules. These rules are designed to develop the truth and such of it as is material.

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