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"What Has the Public Utility Holding Company Act Contributed to the Utility Industry?"

An Address By

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As a long-time resident of Michigan, attuned to the problems and the thinking of the people in this State, it is a real pleasure to come and talk to you about some of our common interests. It is like a homecoming.

Many of you know my background and my associations in Michigan -- as a manufacturer, as an investment banker, and more recently with the Securities and Exchange Commission in Washington. I have always been interested in the financial aspects of business. It is my good fortune to be on a Commission whose chief concern is with finance, and my years at the Commission have been stimulating indeed.

As I looked about for material on the subject assigned to me, I came across an item in The Wall Street Journal, about two weeks ago, quoting a prediction by Mr. George Woods, Chairman of the Board of The First Boston Corporation, that the electric utility industry will sell $4,700,000,000 of securities for new capital requirements over the next three years, of which some $3 billion will be bonds, $1 billion common stocks and $700 million preferred stocks.

As I read these figures (which do not differ materially from our own estimates at the S.E.C.) and observed Mr. Woods' confidence that the amounts would be raised as needed, I could not help thinking of the influence the Public Utility Holding Company Act has had and will have upon the success of these offerings. That statute has contributed to a resurgence of investor confidence in utility securities which to a large extent is making possible the tremendous expansion currently taking place in the industry.

For the next few minutes I want to summarize for you some of the accomplishments of the Holding Company Act -- what it has meant to investors, what it has meant to consumers, and what it has meant to you as officers and managers of utility companies.

Many of you, of course, have had personal experience with the statute, and probably have formulated opinions of your own. My viewpoint is naturally that of an administrator, who has had occasion -- over four years -- to observe every section of the Act in operation in a multitude of situations.

The Public Utility Holding Company Act has remained unamended in the 16 years of its existence. This is particularly worthy of note. The act was perhaps one of the most controversial pieces of domestic legislation ever enacted. There were dire predictions by its many very vocal critics of the terrible consequences which would follow its passage. None of these predictions, practically speaking, has come true.

I attribute this remarkable record to three things: first, to the wisdom of its authors -- who drafted a statute on a most complex subject which was simple, comprehensive, and workable; second, to the administration of the act by the S.E.C.--which, among other things, refrained from using the compulsory powers of the act in favor of voluntary and cooperative effort; and finally, and by no means least, to the fundamental strength of the utility industry at the operating level--which enabled it to prosper and more than double in size, even while it was undergoing nothing less than a financial revolution.

Many of you here can take credit for your contribution on that last point. I am glad to give voice to the recognition you deserve. Congress was confirmed in its belief that the utility industry was fundamentally healthy, that the trouble was a financial one, and primarily at the holding company level.

It is unnecessary for me to recount again the condition of the utility industry in the 30's which produced passage of the act -- the concentration of ownership in a few large holding companies, the heavily pyramided capital structures, absentee management, competition in bidding for properties leading to excessive write-ups, huge dividend arrears, the deterioration of credit, the abuse of the service company device and of the parent-subsidiary relationship, the loss of public confidence in both utility securities and utility management, and many other things -- all brought to light in a most thorough study initiated by the Congress during the administration of President Herbert Hoover.

The holding companies originally had served a necessary function in the development of the utility industry. They brought together the thousands of individual isolated generating companies into large consolidated units incorporating the latest in technological developments. Some were formed by engineering firms. Some, like Electric Bond & Share, with the securities taken in return for equipment. But it was not long before the holding company acquired attractive potentialities as a device for financial mischief.

These practices adversely affected the interests of consumers and investors in many cases. Operating companies, essentially healthy, were prevented from expanding normally or from passing on operational savings to consumers because of the persistent pressure for more and more income to support top structures.

Those of us who remember those days also remember that they added up to a serious doubt whether private ownership of the electric and gas public utility services would be permitted to continue in this country.

How different is the pattern today, after a decade and a half of the Holding Company Act! The concept of private ownership in my opinion was never more firmly accepted by the American people than it is today. The privately owned utility industry was never more prosperous or better able to render to the public the service it requires promptly and at reasonable rates. Its credit is sound. Its securities enjoy a good market and have broad public acceptance.

I feel that the Public Utility Holding Company Act has been instrumental in this accomplishment.

How has this been brought about? Let us briefly review the record.

Integration of Properties

First, the integration requirements of the act--what were they aimed at? What has been accomplished?

When the act was passed, 16 holding company systems controlled three-quarters of the privately owned electric generating capacity in the United States. Four groups controlled over half of all natural gas transmission lines.

Right here in Michigan, for example, twenty-five operating utilities within its borders were controlled by no less than fourteen holding company systems, including such names as Electric Bond and Share, Cities Service, Commonwealth & Southern, Middle West, North American, Standard Power & Light, and United Light & Power.

One primary objective of the statute was to free the nation's utilities from remote control. The Congress decreed that only those holding companies could remain in existence which serve a useful economic function, which control integrated systems limited to a single area or region and which were not so large as to impair the effectiveness of local management and local regulation. All others would have to disappear from the utility field.

The job accomplished under the act in eliminating unnecessary holding company control and in achieving better integration of utility properties has been monumental.

At the close of 1950, 759 companies -- with gross assets of over $10 billion -- had been divested by holding company systems, and are no longer subject to our jurisdiction. Included in this total are 249 electric companies and 147 gas utilities. Most of these have been released from holding company control and have become wholly independent. A substantial number have been acquired by other independent utilities, thus strengthening the over-all pattern of integration.

Also included in the total of divestments to date are 363 other enterprises, ranging from street railways to amusement parks, hotels, real estate development companies, paper mills, warehouses, laundries, brick works and even a baseball club -- businesses which have little or no place in a utility operation, but which had been swept up in the pell-mell growth of the holding systems.

In addition, 225 companies with assets of over $6 billion have been divested by their original parents, but continue subject to the act because of their relationship to other holding companies. Most of these divested companies are emerging as components of about 20 streamlined and integrated holding company systems which will have achieved complete compliance with Section 11. For the most part, these groups of companies represent the integrated segments of the widely scattered systems of the '20s. These new systems have also rounded out their service areas by the acquisition of properties formerly controlled by holding companies since dissolved or now on the road to that end. A recent example was the purchase of Birmingham Electric Company by Southern Company from the Electric Bond and Share system. Another was the acquisition by American Gas and Electric Company of Indiana Service Corporation from the former Midland United system.

In the aggregate these changes in ownership and control under the integration provisions of Section 11 reflect that realignment of properties which Justice Douglas envisioned in 1938, when, speaking as a commissioner, he said, "The pink spots of one system which are now scattered amorphously over the nation's map will tend to draw themselves together into a solid mass -- a symbol of economic and geographic integration for the better service of consumers and the greater security of invested capital."

The over-all results from a geographical standpoint are also illustrated by a comparison of the scope of system operations before and after the application of Section 11. As of December 1938, 14 registered holding company systems were rendering gas or electric service in 10 or more states, and 14 other systems were serving five or more states. We no longer have any utility systems covering a ten-state area. The number of systems operating in five or more states has declined to eight.

Of the original 14 holding company systems which I mentioned as owning properties in the State of Michigan, only four remain in this area. Of these, American Natural Gas Company and American Gas and Electric Company are expected to continue as registered systems, while Standard Gas and Electric Company and Wisconsin Electric Power Company remain with unresolved problems under Section 11. The roster of divested independent Michigan companies is a long one, including Consumers Power Company, Detroit Edison Company, Michigan Gas and Electric Company, Upper Peninsula Power Company, Edison Sault Electric Company, Lake Superior District Power Company, National Utilities Company of Michigan, and others. Securities of these companies are widely held; their common stocks in several instances are listed and actively traded on the major exchanges of the country. More important, as Congress envisioned, their management has been returned to local people. Consumers Power is now run from Jackson instead of New York; Michigan Consolidated Gas is run from Detroit; so is Detroit Edison.

This transition has many ramifications. It means that local security dealers have taken a strong interest in the securities of the local utility company, encouraging ownership within the territory served, and giving rise to a strong potential supply of additional capital to the company's needs. It means increasing reliance on local banks for short-term money needs. Last month, for example, a subsidiary of the Milwaukee Gas Light Company borrowed some short-term money from a Milwaukee bank. I mention this not because it is unique, but because it is increasingly typical. If I say I think it is a healthy practice, provided that the local banks can meet the competitive rate for money, I hope I will not be charged with sectionalism, for I recognize the necessary place of the large eastern banks, whose great resources have a definite part to play in all major financing. At the same time, the strength of this country lies in the strength of its individual communities, and I believe the Holding Company Act has definitely reinforced local ownership and participation in utility operations.

During the past 12 years, some 919 different electric and gas utility companies have been subject at one time or other to Commission jurisdiction. Today the number of "still subject" utility companies is down to 214 (at the close of 1950). Only about a third of all Class A and B electric utilities are now subsidiaries of registered holding companies; the proportion of gas utilities still subject is even lower.

Simplification of Corporate Structures

Second, let us consider the changes which have been wrought in the financial structures of these companies under the so-called "simplification" provisions of the act.

In Section 11 (b) (2) covering corporate simplification, Congress sought to eliminate perhaps the most undesirable element of holding company control, the complex pyramiding of corporate structures and corporate securities intended to achieve maximum control with minimum investment.

An early study of holding company system preferred stocks undertaken by the Commission in 1938 demonstrates the effect of these practices. Of some 153 holding company preferred stock issues outstanding at that time, three-fifths (with an involuntary liquidating value of some 1.4 billions of dollars) were in arrears. The arrearages totaled over $360 million. The same pattern was reflected at the operating company level where 121 issues out of a total of 365 suffered from arrearages in dividends, totaling $147 million. The equity of holders of securities below these preferred issues was, in many cases, approaching the vanishing point and the situation precluded many operating utilities from obtaining any new capital.

Of the 14 holding company systems operating in the State of Michigan in December 1938, 11 had outstanding preferred stocks with dividend arrearages.

To bring about compliance with the statute's simplification requirements and restore utility corporate structures to a clean and sound pattern, the Commission has, in some instances, been required to administer strong medicine. Some holding companies serving no useful purpose have had to dissolve, others to recapitalize to achieve a simplified structure. Many operating companies have also undergone major internal changes to achieve equitable distribution of voting rights.

The Commission has instituted 77 separate proceedings under this section. By such action, companies have been spurred to formulate voluntary plans of reorganization and the Commission has had the benefit of management's judgment and initiative in devising the ultimate means of compliance. The resultant reorganizations have often taken a great deal of time in litigation and court appeals. One may regret the delay, but it is the price we have had to pay to assure absolute fairness to security holders. The Commission is proud of its court record in these cases -- we have never finally lost a case on fairness -- because it means that we have shown a proper consideration of the rights of the tens of thousands of investors involved. It has been our purpose to save for everyone his legitimate investment values, and I think we have, in so far as it has been humanly possible.

Sometime ago, in response to an inquiry of the House of Representatives Judiciary Subcommittee on Monopoly Power, the Commission developed some data to reflect the effect of the integration process upon investors in terms of security market values. Three of the larger systems which had undergone drastic reorganization were selected for study. The market values of their securities were compared; first, as of the date the act became effective, August 26, 1935; second, as of the date the holding company registered; and finally, as of the date in 1949 when this report was prepared.

The Commonwealth and Southern Corporation, one of the three holding companies selected, had in its own capital structure bonds, preferred, common stock and warrants, which, in August 1935, had a total market value of $191 million. By March 1938, that market value had declined to $124 million. In the years that followed, Commonwealth and Southern consummated numerous Section 11 (e) plans which resulted in the eventual divestment of its northern properties and the establishment of a new southern holding company to conduct integrated operations in Georgia, Alabama, Florida and Mississippi. The cash or market value of securities received by investors in the parent holding company as a result of these proceedings reached a figure of $415 million by October 11, 1949, an increase of 117 percent compared with the 1935 figure. During this period the Dow-Jones utility average rose only about 49 percent, the Dow-Jones industrial average about 45 percent.

In the case of Electric Power & Light Corporation, which had bonds, debentures, preferred, second preferred, common stock and option warrants outstanding, the change is even more striking. The trend in market values shows the following pattern: August 26, 1935, $54 million; December 1, 1938, $92 million; September 28, 1949, $294 million. The value indicated in 1949 was up 439 percent from the 1935 figure. Values ascribed as of the latter date included cash received upon the retirement of securities outstanding or cash plus the market value of securities received in exchange transactions.

The third holding company, Engineers Public Service Company, has also disappeared from the utility scene. The final Section 11 (e) plan effected the distribution of its interest in three sound operating companies; Virginia Electric & Power Company, Gulf States Utilities Company and El Paso Electric Company. In 1935, the parent company had outstanding three classes of preferred as well as common stock with an aggregate market value of $22 million. This value increased to $27 million in 1938 and, as of October 1, 1949, in terms of cash or market value of securities received, the figure reached $126 million, an increase of 479 percent over the earliest date.

While these changes in value necessarily include the factor of general market movement between the various dates, the substantial up-trend serves to demonstrate that the integration program did not result in the forced liquidation or "dumping" of securities which some critics had anticipated with alarm.

Elimination of Write-Ups and Excessive Charges

Third, let us consider the elimination of write-ups and other inflationary items which has taken the water out of balance sheets.

During the '20s the tempo of property acquisitions reached such a pace that prices on utility properties reached fantastic levels. Though he underestimated the detrimental effect of this activity, Professor Arthur Dewing, writing in the New York Times Annalist in January 1928 put his finger on the problem when he commented:

"... a menace to the stability and permanent welfare of the industry has recently arisen from within the industry itself. It is the excessive prices which public utility operators have been paying for the control of water, gas and electric properties. Owing to the ease with which money may be made by selling junior securities of holding companies to the public, bankers and promoters have bid against each other for the acquisition of the underlying operating companies. The prices they have been willing to pay have borne little resemblance to the actual invested capital, because the public, in its turn, has bought securities on apparent earning power without thought of the permanecy of this earning power - or thought of the morrow."

As a result of the original cost studies of the S.E.C. and of the Federal Power Commission, about $1.5 billion has been eliminated from property accounts. Removal of this excess in carrying values has freed the consumers from a heavy charge. Depreciation reserves have doubled, service rates have been made lower, and, of equal importance, investors know today they can trust the figures appearing in the balance sheet.

Furthermore, investors in operating company securities and consumers of their product are now assured that service, construction, and management contracts are free of overreaching and that the subsidiary relationship, where it continues, is not being abused.

In the electric utility industry, for instance, energy production has surpassed all expectations. Both KWH and dollar sales per customer have increased in every one of the past 12 years. Average rates paid for residential electric service, however, have declined each year from 4.14 cents per KWH in 1938 to 2.88 cents in 1950. Here in Michigan the record has been equally impressive with electric rates declining from 3.40 cents to 2.85 cents during the same period.

This decline in rates against a trend of rising costs of operation and construction is without parallel in American industry. It is due in large measure to increased managerial efficiency and to technological advances in the design, manufacture and operation of plant and equipment. Not to be overlooked, however, are the benefits conferred upon the industry by the Holding Company Act. Of course the S.E.C has no jurisdiction over rates, and we have nothing to say about how management shall render service. But I do not think it mere coincidence that such significant progress in rates and service was made during the period of the Holding Company Act. As a direct consequence of the Act, excessive service charges have been scaled down, and large amounts of intangibles have been removed from plant accounts. The costs of raising capital have been substantially reduced through competitive bidding and improvement in financial structure, enabling the industry to take full advantage of the low money rates prevailing in the past 15 years. The act has created a favorable climate in which the industry could develop and expand; the consumer has reaped the benefits.

Securities Issuance

Congress also gave the Commission extensive jurisdiction over new security issues. As our work under Section 11 nears completion, this aspect of our duties, always a major activity, has assumed increasing emphasis, timed, as it is, with the greatest expansion program in the history of the industry.

In fulfilling its responsibilities under the Act to pass upon price and spread of new security issues and to "assure the maintenance of competitive conditions," the Commission in 1941 adopted its competitive bidding rule. Although this rule has excited a good deal of controversy -- to put it mildly -- I think it has proven itself. Sensible administration, with sensible recognition of the need for exemption in the proper case, has eliminated a large part of the criticism.

The rule has assured true and free competition among underwriters for the securities of registered companies. The free market price thus established has been of considerable benefit to companies not subject to our jurisdiction, for it establishes a going rate for measuring their own costs.

The volume of securities approved under the Holding Company Act has, of course, been declining with the removal of many companies from its jurisdiction. However, "still subject" companies sold over nine hundred million dollars of securities to the public in the fiscal year 1950. A major portion of the industry's financing is also reviewed by the Commission in connection with registration requirements of the Securities Act of 1933. It is a surprising fact that registrations by electric, water and gas companies during the fiscal year 1950, totaling just over two billion dollars, accounted for almost half of all corporate security registrations during the period.

In recent years we have come to regard as normal the situation in which utility management undertakes a program of balanced security financing, matching its offerings of debt securities with regular issuance of equity securities. Yet this discretion in fund raising, aside from limitations imposed by market conditions, is a recent achievement. When the Commission first entered actively into the utility picture in the late thirties, financing was severely hampered by the top heavy capital structures of most utility systems, by the uncertainty of managements faced with serious problems of compliance with Section 11 and, to some extent, by the general fear of utility security "dumping" which never occurred. As a result security issuance was centered chiefly in the effort of managements to refund high cost debt obligations and where possible high dividend preferreds with new issues of a low rate. The volume of new money offerings was extremely limited and companies were forced to rely most upon retained earnings for their limited construction requirements.

This trend of the utility industry toward the refunding of higher coupon senior securities gave the Commission its first extensive experience in applying the statutory standards of Sections 6 and 7. Initially, the Commission was inclined to make some distinction between the refunding issues and the infrequent new money offerings in determining the maximum limits of debt to property and to overall capitalization. However, as more issues were processed and Commission experience was broadened the soundness of this distinction came into question. Finally, in 1941 companies were warned that refunding programs for high debt ratio companies would have to include definite provisions for improvement. In some instances, this resulted in the application of heavier sinking fund requirements. In extreme situations contributions of equity capital or the forgiveness of outstanding senior obligations by the parent holding company were found to be necessary.

During these years the Commission also undertook the development of protective provisions for mortgage indentures and corporate charters. Many of these provisions have been improved and standardized and are recognized today by institutional security purchasers as important components of overall investment quality.

With the advent of World War II the volume of security issuance dropped sharply but the rehabilitation of holding company systems was going forward and investors were beginning to recognize the beneficial effect of the effort. Frequently, the progress of a Section 11 plan from the time of filing to the time of ultimate enforcement was matched by the upward trend in the prices of the securities affected thereby.

Though a few utility operating company stocks were sold or distributed during the war years, the major test of common stock receptivity occurred in the spring of 1946. Then, in a favorable climate of rising stock prices, a series of successful portfolio offerings of large size were made including shares of Central Maine Power, Cincinnati Gas & Electric, Columbus & Southern Ohio Electric, Dayton Power & Light, and Public Service Co. of New Hampshire. Ohio Edison made a public offering of common for new money at this time. Shares of Consumers Power common were sold for new money two months after the September decline and, though receptivity diminished, other new offerings were also made in the following year.

While the success of these portfolio sales offered proof that holdings of utility equities could be marketed without the need for sacrificial bargain basement pricing, it also gave promise that new money stock financing could become an important factor in the fund raising of individual utility managements. The combination of improved capital structures, sound property values and liberal dividend yield had contributed a new investment quality and encouraged the resurgence of investor interest. The capacity to finance was no longer solely the capacity to sell debt securities. Corporate capitalization could now be expanded on a more balanced basis.

For many utilities this new capability came at a critical point of time. The tremendous upsurge in post-war demand for electric power and natural gas had already brought capacity reserves down to the danger line. New construction and new financing were urgently needed. Response of the industry to this challenge has been no less than magnificent. The dollar volume of construction expenditures tells the story -- $2\frac{1}{2}$ billion dollars for electric and gas utilities in 1948, 3 billion in 1949 and again in 1950, with estimates for the present year running to over $3\frac{1}{2}$ billion.

The effect of this continuing growth upon financing programs of the industry has been well told in your annual reports and is reflected in the large number of applications and registrations presented to the Commission for processing. New money financing by electric and gas utilities during the past three years has shown awareness of the need for adequate common stock sales. An increasing percentage of the new money raised has been through common stock.

The market for new common stock has continued to show great strength in the early months of this year. This showing has been made in the face of an uncertain bond market upset by shifting interest rates and against the background of a noticeable decline in the demand for new preferred issues. More than thirty common stock issues aggregating over 200 million dollars were undertaken successfully in the first four months alone. The group includes several successful offerings made by managements in the North Central areas including American Gas & Electric Company, Detroit Edison Company, Wisconsin Power & Light Company, Lake Superior District Power Company, Ohio Edison Company and three utilities serving areas in the State of Illinois. Most of these common offerings have been accomplished by means of the rights offering procedure and have been successfully undertaken both with and without underwriting assistance. The repeated use of the rights method is but another indication of the extent of investor confidence now enjoyed by the utility industry.

Continuing Systems

Among the many utility stock offerings made in recent months are a number of important issues marketed by registered holding companies which can be expected to remain as continuing systems under the jurisdiction of the Holding Company Act. Naturally we, at the Commission, have a direct and important interest in the successful financing of these systems and their success tells much about the changed financial status and integrated operations which have resulted from the streamlining process of Section 11.

In the Spring of 1935, when the President of the United States transmitted to Congress a report of the National Power Policy Committee recommending the adoption of legislation affecting utility holding companies, he took occasion to make the point that "For practical reasons we should offer a chance of survival to those holding companies which can prove to the S.E.C. that their existence is necessary for the achievement of the public ends which

private utility companies are supposed to serve." The Congress recognized the appropriateness of the recommendation and wrote into the act the standards which have determined the pattern of the continuing systems. Those that have emerged may be segregated into three major groups.

The first type is the electric holding company system illustrated by such companies as Middle South Utilities Co., The Southern Co. and Central and South West Corp. In these instances the holding company stands above a group of integrated interconnected electric operating companies, coordinating and directing their operations to obtain maximum system efficiency and minimum overall construction and operating costs. Largest among these electric systems is American Gas and Electric Company serving a seven state area from Virginia to southern Michigan. Its management has set a very high standard of operating achievement and its common stock is valued by investors on a quality basis comparable to that of high grade operating utilities.

The second type of holding company system, found exclusively in the electric power field, is the operating-holding company type. Here the parent company is the major operating unit of the system and its subsidiaries are smaller satellites operating in adjacent states. Delaware Power & Light Co., Utah Power & Light Co. and the Ohio Edison system are examples of this type.

The third holding company group is comprised of the natural gas transmission and distribution systems, which have participated so importantly in striving to meet the tremendous post-war demands for the "wonder fuel". Among the gas systems registered with us are American Natural Gas Company, Consolidated Natural Gas Company and the Columbia Gas System, Inc. I would like to make further mention of American Natural Gas because the company is well known to many of you and because the formulation and development of its system represents the answer of a progressive management to the challenge of Section 11.

As early as 1944, when American Light & Traction Company, predecessor of American Natural, filed an 11(e) plan proposing its ultimate dissolution, it contemplated the organization of a new pipe line company to be owned by its three gas utility subsidiaries and financed from the sale of its holdings in Detroit Edison Company. The Commission did not interfere with the decision of management to organize this enterprise.

When the new Michigan -Wisconsin Pipe Line Company was granted a Certificate of Convenience and Necessity by the Federal Power Commission in 1946, the parent system undertook to file a new plan under Section 11(e) which, among other things, proposed continuance of Light & Traction as a registered holding company and construction of the pipe line as a means of integrating the operations of its utility subsidiaries. Hearings on the plan were extensive and the opposition vigorous. Participants pointed to the unknown total cost of the project, the pending litigation affecting gas purchase contracts and the appeal taken by another pipe line company from the order

granting the Michigan-Wisconsin certificate as demonstrating its lack of soundness. The Commission was well aware, however, that the Detroit area suffered from an acute shortage of natural gas and that a new source of supply was also urgently needed in the State of Wisconsin. The proposed system offered the combined advantages of a high pressure transmission line and utilization of underground storage fields close to the points of distribution. These circumstances, among others, formed the basis of the F.P.C. certificate.

Our Commission concluded that the new system of American Natural could meet the standards of Section 11 and that there existed no basis for overruling the decision of management to undertake construction and operation of the pipe line enterprise. Thus through the planning, resources and credit of American Natural the pipe line company has been successfully organized, developed and brought into operation with a present capacity of over 110 billion cubic feet annually. It is now a vital component in the integrated gas operations of the American Natural system.

A major test of a successful and responsible holding company management is the ability to plan and secure adequate system financing on a sound and economical basis. In programming construction and fuel requirements, the continuing systems must be ready to match additions to subsidiary debt with additional parent common stock investment. In seeking this equity capital holding company managements must compete successfully with independent operating utilities. The long range program should assure maintenance of a sound capital structure with a proper proportion of common equity.

A few systems have shown a reluctance to recognize this responsibility. In these instances, the Commission has had to urge repeatedly that common stock financing be undertaken to provide a foundation for necessary expansion. Others have met the challenge promptly and well. Since July 1, 1948, 25 successful holding company common stock offerings have been made. The proceeds of some 230 million dollars have been devoted primarily to reinvestment in the stock of operating subsidiaries.

Outlook For the Future

The accomplishments of the Commission and the industry in effecting extensive integration and simplification over the past 15 years have been in large measure responsible for the present high investment status of utility securities. It is true, of course, that utility stocks have not shared in the upswing of market prices characteristic of many industrial and rail issues since the start of the Korean conflict. They do not possess the speculative appeal of the so-called war stocks. Yet the reception accorded to new offerings indicates the presence of substantial investment demand and a recognition of underlying corporate stability.

One investment service recently offered this comment, "Electric power stocks have every reason to look forward to a sound investment future. They do not promise to increase dividends fast enough to make them best suited as a medium for long term inflation protection. But their position is remarkably well protected as investments providing steady income."

This confidence in the stability of utility securities places upon management a heavy responsibility in the present critical period when every problem it must face is in some way linked to the Nation's increasing defense effort. There is no question of its ability to meet present urgent needs for power and fuel except in a few isolated instances. The problems I speak of are those which affect future construction, future financial programming and future dividend policy.

The construction situation is illustrated by a recent report of electric power industry which shows that despite the heavy expansion program which has now been under way more than four years, electric power in the winter of this year will be tighter than in any year since 1948. Total generating capacity at the close of 1951 is expected to reach 74,700,000 kilowatts compared with 67,650,000 at the end of 1950. But the margin of reserve generating capacity is expected to be slightly less than nine percent at the December peak. Demand for power is increasing faster than had been anticipated and installations are not going in fast enough with some delays caused by metal shortages including tubing for steam generators. While individual managements will spare no effort to meet the needs of their communities, the imposition of this new demand coming as it does on top of a tremendous post-war, peace-time growth may raise some question as to the ultimate dependability of the present high level of consumption. Prudence requires that we take this into account in planning our financing.

In the natural gas industry fuel requirements continue to run ahead of available supply while the prospect of obtaining adequate amounts of large diameter pipe grows dimmer. Columbia Gas System has already announced that its construction program will be cut back this year because of this factor. Other sources have indicated that pipe supplies may equal only half of the industry's total needs for 1951.

Aside from these problems of production, the utility industry is also faced with an increased tax burden, again related directly to the Nation's defense effort. With logic, the Congress has provided concessions which remove most of the burden of excess profit taxes from the industry. But higher normal and surtax rates will take an increasing proportion of earnings. For some companies higher tax rates may constitute a threat to their present level of dividend payments but even where this point is not reached the greater percentage of dividend payout will leave a smaller amount of retained earnings available for construction. Absence of these funds will of course, mean heavier reliance upon outside financing.

This additional drain on net earnings should not become a deterrent to further equity financing nor should the disparity in capital costs as between debt and equity financing control the choice of issue. The continuance of regular equity financing is the best guarantee of sound operations not only for the investor but the consumer as well. In a sense it is the common equity that will provide the measure of resiliency which management will need in future crises.

Since adequate equity, predicated upon adequate income return, is closely related to the factor of public interest it must remain the common concern of both management and the various regulating agencies. Over-reliance on debt, because it is cheap and has certain tax advantages, is, in our opinion, a short-sighted policy. High debt ratios in time bring lower credit rating and in

turn this means higher debt cost and higher equity cost. On the other hand, it can easily be demonstrated that a properly balanced capital structure with an adequate equity base means better credit, lower debt cost, better price-earnings ratios. There comes a point when the market grows wary of leverage.

The strength of America is essentially its high productivity and the tremendous capacity of its machine power. The present scale of industrial activity in this Michigan area demonstrates that fact. As the recent news letter of a leading bank pointed out, the United States with six percent of the world's population now produces 42 percent of the world's electricity and accounts for 42 percent of total world income. The Marshall Plan countries with 11 percent of the population produce 24 percent of the world's electric output and account for 23 percent of total income. By comparison, Russia and her satellites have 34 percent of the world's population but only 15 percent of total electric power and about 20 percent of total income. Our Nation may never be able to match the Communist masses of manpower, but with our expansion of power facilities and sources of fuel, we can attain a level of productivity which may well be decisive. We at the Commission are confident of the success of your important contribution to this effort.