RECENT SECURITIES AND EXCHANGE COMMISSION DEVELOPMENTS OF INTEREST TO PUBLIC UTILITIES

address by

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After having spent a very vigorous and hot week in the Nation's Capital, let me assure you that it is most pleasant to be with you in the cool Poconos. This is also an appropriate occasion to discuss with your Committee and fellow members of the Bar some of the current problems which today's money market presents to the utility industry.

At this point, I would like to turn for a few moments to a brief discussion of some of our work under the Public Utility Holding Company Act of 1935. I will not go into the history of events that led to the enactment of this legislation nor into the extensive reorganization of the entire electric and gas utility industries which has taken place pursuant to the provisions of this Act during the past 20 years. This story has been told many times. Suffice it to say that whereas some 90 per cent of the electric utility industry and natural gas pipeline mileage of the United States was subject to holding company control when the Act became law in 1935, today only about 20 per cent of the aggregate assets of these industries continue under the control of holding companies.

On June 30, 1956, 23 public utility holding company systems were still registered with the Commission and approximately 7 of these are expected to be released from the jurisdiction of the Act by means of exemption or disposal of their domestic utility properties. We anticipate that the remaining 16 systems will continue subject to the Act indefinitely. These systems will comprise more than 160 companies with assets (less valuation or depreciation reserves) of some $8.5 billion.

Contrary to the rather widespread popular misconception, the Congress in drafting the 1935 Act had no intention of abolishing all holding companies. It recognized that a number of groups of electric and gas utility properties could be operated more economically and could provide better service to the consuming public as coordinated systems than as independently operated utility companies.

Therefore, the Congress concluded that those groups of electric and gas utility companies controlled by holding companies, which met certain size standards and constituted physically integrated systems operating in compact geographical areas and which had been boiled down to soundly financed systems with unnecessary corporate complexities removed, could continue in existence as holding company systems subject to permanent regulation by the Commission of their corporate and financial transactions.

Despite the contraction in the area of our interest in the public utility business, one of the Commission's important responsibilities today is the regulation under the 1935 Act of the financing of registered holding company systems. During the 12 months ended June 30, 1956, registered holding companies and their subsidiaries sold to the public and to financial institutions 43 new issues of securities totalling $565 million. This represented 22 per cent of the total volume of $2.5 billion of long-term financing completed in that period by all companies in the electric and gas utility and gas pipeline industries of our country.

Unlike the provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934 under which our principal concern, in addition to enforcement, relates to the adequate disclosure of information by the issuers of securities to investors, under the Holding Company Act the Commission is required to pass upon the terms and provisions of securities issued by registered holding company systems and even upon the methods employed for their sale. Thus, we are concerned with the provisions for protection of investors which are set out in the indentures securing mortgage bonds, debentures and notes of registered holding companies and their subsidiaries, and in the charter provisions defining the rights and privileges of holders of the common and preferred stocks of those companies.

In this connection, I should like to digress for a moment and tell you about a novel approach to regulatory procedure which the Commission worked out in 1956. On February 17 of that year, it adopted Statements of Policy with respect to first mortgage bonds, such as bondability of property, sinking fund, renewal and replacement fund, limitation of dividends, etc; and to preferred stocks of public utility companies such as limitation on unsecured debts, voting rights limitation on common stock dividends, etc. In effect, these Statements of Policy represented a codification of certain principles and policies prescribed for the protective provisions of securities announced on a case-by-case basis over a period of 15 years, as modified in the light of experience, and a reappraisal of those principles and policies in the further light of comments received from the numerous interested persons whose views had been solicited prior to adoption of the Statements. This development has already brought about substantial simplification in our administration of the Act and it has provided the means of achieving a greater degree of uniformity of treatment and interpretation than was possible under the case-by-case method formerly used. The Statements of Policy also provide investors, the issuing

company, and the professional practitioners who specialize in this field with a convenient guide to enable them to determine in advance the basic standards required by the Commission.

The SEC is not the only authority having regulatory responsibility over the financing of those electric and gas utility and natural gas pipeline companies which are associated with registered holding company systems. The State public utility commissions, which regulate the rates charged by the electric and gas utility subsidiaries of registered systems for the service which they provide their customers, also have jurisdiction over the issuances of their securities. The Federal Power Commission has certain jurisdiction over the financing proposals of natural gas pipline companies which are also subject to the Act we administer.

Congress did not intend that our jurisdiction overlap or duplicate the powers of the State commissions or of the Federal Power Commission. Rather, it was designed to supplement and strengthen the jurisdiction of those agencies. A financing proposal by any company in a registered holding company system cannot be considered as just the problem of an individual company. It must be viewed as an important part of the over-all financing program of the entire system. The issuance of securities by one company in a holding company system must be so designed that it will not impair the financial integrity of the holding company system as a whole.

While I could spend hours discussing all the problems which arise in connection with our review of financing proposals under the Holding Company Act, there are two in which it occurs to me you would probably have the greatest interest at this particular time. The first relates to the preservation of sound capital structures and the second pertains to that warmly debated topic of call prices on fixed income-bearing securities.

The interest paid by a public utility company on its bonds and the dividends which it pays on its preferred and common stocks are generally regarded by regulatory authorities as an important element in the rate-making formula. Indirectly, of course, the interest and dividends paid by a registered holding company to its security holders influences the capital costs incurred by its subsidiaries. If a holding company is over-capitalized with debts, its subsidiaries must even stint on maintenance in order to pay up enough dividend income to support the parent's capitalization. In fact, this was one of the abuses which led to passage of the Act.

We do not regulate rates under the Holding Company Act. However, we are concerned with the costs of capital to the public utilities and holding companies under our jurisdiction, not from choice but by mandate of the Congress of the United States.

The policy guide lines laid down by the Congress which we and the courts are required to follow in interpreting the Holding Company Act, are set forth in Section 1(b). This section states in part, "... it is hereby declared that the national public interest, the interests of investors in the securities of holding companies and affiliates and the interest of consumers of electric energy and natural and manufactured gas, are or may be adversely affected ...". "When, ... control of such companies is exerted through disproportionately small investment ..." and "... when in any other respect there is ... lack of economies in the raising of capital." The Act further directs that " ... all the provisions of this title shall be interpreted to meet the problems and eliminate the evils as enumerated in this section." (Section 1)

Ever since the Holding Company Act became law in 1935, the Commission has consistently urged that registered holding company systems maintain strong capital structures. As stated on numerous occasions: "A balanced capital structure provides a considerable measure of insurance against bankruptcy, enables the utility to raise new money economically, and avoids the possibility of deterioration in service to consumers if there is a decline in earnings."

The SEC has not attempted to prescribe optimum or ideal capitalization ratios. In certain cases we have expressed the policy that debt ratios should not exceed 60 per cent and that common stock equity should not be less than 30 per cent. Nevertheless, it is realized that these standards might not be applicable to all holding company systems and under all conditions.

In September 1956, our Division of Corporate Regulation undertook a broad gauge study for the purpose of determining the advisability of recommending that the Commission issue for comment by interested persons a proposed Statement of Policy concerning appropriate capitalization ratios for registered holding company systems. Essentially what the study sought to determine were the maximum debt and minimum common stock equity ratios which the Commission should permit under the standards of the Act; what the optimum or ideal capitalization ratios, if there be such things,

should be; and whether or not the Commission should promulgate such a Statement of Policy. It is still too early to say what will come out of this study. However, I might say that many of the interesting comments received indicate that the setting up of specific capitalization ratio standards can lead to harmful inflexibility and that we should continue our present practice of judging the appropriateness of ratios on a case-by-case basis, which takes account of the many variations existing among utility companies as well as the economic climate at any given time when securities are issued.

That the achievement and preservation of sound capitalization ratios are essential to the financial health of the public utility industry has been recognized not only by the Commission, but by other regulatory bodies and also by informed writers on the subject. Most of these authorities are generally agreed on the necessity for an adequate "cushion" of common stock equity to take up the shock of a severe decline in earnings. Debt securities should not be issued in excessive amounts notwithstanding the attractive tax advantages presently accruing from this type of financing. A strong capital structure assures maintenance of a company's high credit rating in periods of falling security prices and thus enables a company to keep its capital costs at the lowest levels obtainable in the market place at all times. In this connection, I am also talking about excessive preferred stock capitalization. If dividends are passed on these issues, it might well reflect on the over-all credit of the system even though its debt obligations have not been defaulted.

A number of authorities urge that a utility company should not use up all of its property bonding credit in periods of low-interest rates, but rather that it should reserve a substantial portion of that credit for the inevitable time when it may become difficult, if not impossible to sell common stock. Furthermore, it is a matter of record that in a period of severe declining bond prices, such as we are witnessing today, the interest costs on issues of lower investment quality have increased to a greater degree than the interest costs of top quality offerings.

Let me illustrate. Boston Edison Company, whose bonds are rated "Aaa", sold an issue on June 4 of this year at an interest cost of 4.58 per cent. The Company's previous bond issue on July 27, 1954 brought an interest cost of 2.96 per cent. Thus, the Company sustained an increase of interest cost resulting from the tightening trend of the money market in the interim of 162 basis point. This represented a 55 per cent advance in cost. Community Public Service

Company, whose bonds are rated "A", sold bonds on May 28 of this year at an interest cost of 5.49 per cent, compared with an interest cost of 3.19 per cent obtained on its previous bond sale on April 7, 1954. The rise in interest rates during the interim cost this company an additional 230 basis points, or an increase of 72 per cent.

The present state of our bond market with interest rates at the highest levels in 25 years is giving the public utility industry some painful headaches. Because of the continuation of serious inflationary pressures and increasing outlays for construction of plant and equipment by all industries, no immediate relief seems to be in sight. The latest estimates of plant and equipment expenditures by the electric gas and water utility industries , as compiled by our Division of Trading and Exchanges, indicates that expenditures planned for the first 9 months of 1957 will reach a level of $4.63 billion, or 34 per cent above the total of $3.44 billion recorded in the corresponding period of 1956. While increasing prices for capital goods accounts for a substantial portion of this dollar increase, the public utility industry will have to raise the money to pay for this increased investment and the major portion of it will have to come from our public securities market. No one knows how long this pace will continue, but the utility industry had to expend money for plant additions even in the depths of the great depression of the early 30's.

It is not generally realized that public utility companies cannot turn their plant expansion programs on and off like the spigot at the kitchen sink. This is because of the long lead time required for construction of major plant items, such as the electric generating stations which take up to two and one-half years to build. Consequently, whether we like it or not, public utility companies will have to resort to public financing at regular intervals of from one to three years, regardless of the levels of security prices.

This brings me to one final thought that I would like to leave with you as I close my remarks on capital structures. It is a point that I want to emphasize very strongly; and that is the important matter of timing in your long-range financial planning. Because you have to go to the capital markets at such frequent intervals, it is of the utmost importance that plans be kept as flexible as possible. In our experience over the years, we have seen a number of companies borrow so heavily on short-term notes from commercial banks and extend their notes so many times, that they get backed into a corner and are forced to take whatever the market will pay for their securities at a particular moment and frequently this is a time when security prices are low.

By this I mean that a public utility company or a holding company should always try to keep as much leeway as possible so that it can switch its financing plans on short notice if it appears to find itself in a falling securities market. In a market like the present one, where quality bonds have to be sold at the highest interest costs in 25 years but when new common stock offerings can be sold at the most attractive rates in many years, it seems to be a good calculated risk to sell as much common stock now as can possibly be sold in anticipation of funding requirements for as much as two or more years ahead. Similarly, try to stretch out bond financing until some later date when we all hope that interest rates will have receded to a more attractive level.

By way of illustration, let me illustrate with two security offerings which took place on Tuesday of this week. Southern Bell Telephone & Telegraph Company, a subsidiary of A.T.&T., sold $70 million of Moody's "Aaa" rated debentures due 1986, at competitive bidding, and received an interest cost of 4.9136 per cent on a 5 per cent coupon. The bonds were reoffered on a 4.85 per cent basis and are non-callable for any purpose for 5 years. At the same time, Gulf States Utilities Company, whose bonds are rated "Aa" by Moody's, sold 200,000 shares of common stock at competitive bidding and received a price of $37.88 per share with a dividend cost of 4.22 per cent. The shares were priced for public offering at 39-1/4 to yield 4.08 per cent. The stock earned $2.28 per share in the 12 months ended April 30, 1957, with the result that the stock cost the company an earnings-yield basis of about 6.02 per cent.

Now, I would like to say a few words to you about call prices and so-called "freezes" on refundability. This subject has been widely discussed in the industry and in the financial community during the past six months. Let me say that the Commission is fully aware of the terrific pressures which are being brought to bear on the financial officers of public utility companies and holding companies when they start getting a new bond offering ready for market.

As I indicated earlier, we are not free agents in this debate. Because of the strong mandate contained in Section 1(b) of the Act against " ... lack of economies in the raising of capital", the Commission has always felt compelled to concern itself with the prices at which bonds, debentures, or preferred stocks may be redeemed for refunding purposes. In a number of cases the Commission has set forth its long established policy that senior securities should be fully redeemable at the option of the issuing company upon the payment of a reasonable redemption premium.

It has strongly opposed the use of non-callability provisions or redemption premiums which are so high as to preclude any foreseeable possibility of refunding at lower interest or dividend rates. In the Arkansas-Louisiana Gas case (35 S.E.C. 317, 1953), the Commission stated: "Without attempting to predict the future state of the money market, we feel strongly that the proposed provision for non-callability of the bonds over the next ten years introduces a potential 'lack of economies in the raising of capital'." In the Indiana & Michigan Electric Company case (35 S.E.C. 326, 1953), which followed a few days later, the Commission stated further: "It is our opinion, however, that non-redeemable features in senior securities, even though the period of non-redeemability is as short as three years, should not be resorted to as a means of reducing the cost of money, and we shall in the future insist that all reasonable efforts be made to keep this undesirable feature out of financing programs."

In the Statements of Policy, to which I alluded earlier, the Commission prescribed that the first mortgage bonds and preferred stocks of public utility companies subject to the Act be redeemable " ... at any time upon reasonable notice and with reasonable redemption premiums, if any." This has been our policy for a number of years. The problem is one of determining what is a "reasonable premium" under varying market and other conditions. In recent years we have employed a rule of thumb formula for this purpose, one which until recently had been used widely throughout the utility industry. This formula provides that the initial call price for refunding and general purposes should be the initial public offering price plus the interest coupon or dividend rate.

Certainly no one would contend that this formula produces the best measure of reasonableness in all situations, and the Commission carefully considers all of the circumstances in each case coming before it stictly upon a case-by-case basis. However, I would like to point out that the formula approach does contain a considerable degree of built-in flexibility. In periods of low-interest rates, when investors are not particularly concerned with the risk of loss from refunding, the formula produces comparatively low redemption prices which give the investor reasonable protection and also give the issuer some leeway in the event of a further substantial decline in interest rates.

At times like the present, when interest rates are very high interest or preferred dividend rates operate to produce higher call prices and greater margins of compensation against any sub-

sequent losses from refundings. Thus, we have seen call prices in excess of 10 per cent on the two recent issues of 6-1/4 per cent bond offerings by Michigan-Wisconsin Pipe Line Company and Michigan Consolidated Gas Company, where the purchases were provided by the formula with a protection of 6-1/4 points, which is the coupon rate, over the initial public offering price.

On August 25, 1954, Arkansas Power & Light Company sold 3-1/4 per cent bonds at a public offering price of $101.93 which, if we had applied the formula, would have given the purchasers a net call premium over the initial public offering price of only 3.25 per cent. Actually, in this case the company used a slightly lower initial call price than the formula.

At the present time, I know you are being subjected to a great deal of pressure to put a "freeze" on refundability for 5 years or more in the indentures securing your new bond and debenture issues. There has been much discussion of the amount of any savings which may accrue to the issuer from using such a non-callable provision. While, as I mentioned earlier, the Commission regularly follows its long established policy of opposing non-redeemable features or call prices which are so high as practically to preclude refunding, our staff has done considerable research on this question.

However, one pair of new electric utility offerings came out recently which sheds some light on the subject. On May 15, 1957, New York State Electric and Gas Corporation sold $25 million of 30-year 4-5/8 per cent bonds. They were rated "A" by Moody's and "A1" by Standard-Poors. They brought an interest cost of 4.575 per cent and were reoffered to yield 4.53 per cent. This issue carried a 5-year freeze on refunding.

On the following day, May 16, Florida Power & Light Company sold $15 million of 30-year 4-5/8 per cent bonds at an interest cost of 4.5524 per cent and the bonds were reoffered to yield 4.50 per cent. This issue was rated "Aa" by Moody's and "A1" by Standard and carried an initial call price for refunding and general purposes of 107.046 - equivalent to the initial public offering price plus 5, which is only nominally different from the formula.

The Florida bonds enjoyed an immediate sell-out at the syndicate price. The New York bonds, with the 5-year freeze, moved slowly on the first day of the offering. The issue picked up speed the next day when the Florida issue started to move out and ultimately

was entirely sold at the syndicate price.

A comparison was made of the market quotations for seasoned bonds of the two companies carrying comparable maturity and other security provisions. The market for seasoned corporate bonds of investment grade is extremely thin because such bonds are invariably purchased by institutional investors who hold the bond permanently or for long periods of time. Nevertheless, the market quotations for several pairs of comparable seasoned bonds of Florida and New York indicate that when the two companies sold their new bonds in the middle of May, their outstanding seasoned bonds were valued at virtually the same figures in the market place. Since the Florida and New York bonds were offered at about the same time, and carried closely comparable terms and security provisions, it would seem that the 5-year non-callable feature of the new New York State Electric bonds did not give them any significant price advantage. At the time of the offering, the Wall Street Journal reported that the New York company had received approximately 7 basis points lower interest cost as a result of putting in the freeze.

In this connection, I would like to refer again to the recent Southern Bell Telephone bond offering with the 5-year freeze. The company received an interest cost of 4.91 per cent and the bonds were publicly offered on a 4.85 per cent basis. The bonds were rated "Aaa" by Moody's. At the time of this offering, the previously offered New York Telephone bonds, which carry a 5-year longer maturity, an initial call price of $106.755 for refunding purposes and also a Moody's rating of "Aaa", were trading in the over-the counter market at around a 4.63 per cent yield basis. These bonds were offered at $101.755 as recently as May 22, and the offering syndicate was terminated with a substantial amount of the issue still unsold. The higher interest cost received by the Southern Bell Company, as compared with the 4.63 per cent yield on the New York bonds, indicates that the value placed by the market on the 5-year freeze was not great. In the June 19th issue of the Wall Street Journal, the comment was made in the "Financing Business" column: "Yesterday's Lofty rate came about notwithstanding the fact that Southern Bell agreed to make the 29- year securities non-callable for the first 5 years."

This question is not one of mere academic importance. No one knows what the future trend of interest rates will be. But history could repeat itself in the next one to five years and we all remember the big wave of refundings which occurred late in 1953

and early in 1954 following the period of sharply rising interest rates which ended in the summer of 1953. One company refunded an issue of bonds which had been outstanding less than 6 months. In the first three years following the close of World War II, there was a much larger volume of refundings of both bonds and preferred stocks.

Up to this point we have not had presented to us any real concrete evidence as to just what saving can be obtained by increasing the call prices for refunding purposes. However, as I indicated earlier, the Commission has a long established policy against non-callability. Against any saving which might be demonstrated as flowing from an increased call price or a freeze on refundability, you must weigh the added cost to you, as the issuer, resulting from surrendering a possible opportunity to refund the bonds at a substantial interest saving in from one to five years following the initial offering.

In closing our discussion of call prices, I would like to tell you briefly of the results of an informal survey our staff has made of the market responses to six new offerings of utility bonds. The first four of these carried conventional call provisions without freezes on refundability. They were the Florida Power & Light 4-5/8s, El Paso Electric 4-3/4s, National Fuel Gas 5-1/2s, and Columbia Gas System 5-1/2s. The two remaining issues, New York State Electric and Gas 4-5/8s and Public Service Company of Colorado 4-3/8s carried 5-year freezes on refundability.

The information obtained was not complete. Nevertheless, it indicated that the patterns of distribution of the bonds of each issue among institutional investors were generally similar. The "Big Five" insurance companies in the New York metropolitan area did not buy any of the issues and the interest shown by the large New York commercial banks administering personal and pension trust funds was not great. With one minor exception the large insurance companies in the Hartford, Connecticut area did not buy any of the issues.

In the June 6, 1957 issue of the Public Utilities Fortnightly, the Honorable Eugene S. Loughlin, Chairman, Connecticut Public Utilities Commission, has taken an opportunity to comment on the Holding Company Act administered by the SEC. The tenor of his comments is that "when business-managed companies seek to join forces for purposes of joint financing, and other cooperative efforts, they find themselves blocked by provisions still left on the statute book by the old Holding Company Act."

I think that the learned gentleman has raised a very interesting question. In this connection, you may find some interest in reading page 161 of our 22nd Annual Report. Without the benefit of new legislation, and wholly within the concept of the statutory standard, several large generating companies sponsored by registered holding company systems as well as several non-affiliated utility companies were organized to furnish power to installations of the Atomic Energy Commission. These financing applications were authorized by the Commission.

In the past fiscal year, Yankee Atomic Electric Company, sponsored by 12 utility systems operating throughout New England, presented the first formal proposal under the Act relating to the construction of an electric generating plant powered by atomic energy. I cannot see how the conclusion can be drawn that the Act is inflexible or is administered without flexibility. The Commission, in the Yankee Atomic case, authorized all of the proposed transactions and granted the requested exemptions to the sponsoring companies, two of which operate principally in Connecticut.

We found that the proposed acquisition of Yankee Atomic's securities by the sponsoring companies would not be detrimental to the carrying out of the integration and corporate simplification provisions of Section 11 of the Holding Company Act and that the joint project tended towards the economical and efficient development of the integrated utility system in the New England area.

Personally, I do not believe that S. 2643, known as the Pastore Bill, would accomplish more than what is provided for by the Act. In fact, I am not aware of any specific example of a utility financing recently submitted to the Commission which was blocked "by provisions still left on the statute book".

In a more recent case, Power Reactor Development Corporation, located outside of Detroit, was organized by utility and non-utility business interests for the purpose of research and development in the field of atomic power. This Commission, under the Holding Company Act, found that Power Reactor Development Corporation was not an electric utility company within the meaning of Section 2(a)(3) and was therefore exempt from the Holding Company Act. Thus the sponsoring companies, a number of whom were industrial corporations, did not by virtue of their relationship to Power Reactor Development Corporation become holding companies subject to regulation under the Holding Company Act. We have made it quite clear that the Holding Company Act was maturing and growing with the state of the

art and that undue fears as to the reach of the Act were unwarranted. I might also point out that the Commission had previously promulgated Rule U-7 under the Act to make our position quite clear, that companies such as PRDC which produce heat or steam and are primarily engaged in research and development in the power reactor field and organized not for profit, are not subject to the Act. I again offer this as an illustration to you that the Holding Company Act and the standards that must be met thereunder need not, and have not, been so interpreted so as to preclude the development of the art of power generation and distribution.

In Holding Company Act Release No. 13292, we refused to investigate the American Gas and Electric Systems construction of a proposed 450,000 kilowatt generating station in western Indiana, over 130 miles from AG&E's nearest generating plant and distribution area. It was alleged that the mere location of the plant would put the company in a position to render service in the territory serviced by another utility company and that as a result such action would violate the integration standards of the Act.

Our refusal to investigate was the clearest expression that the Act can mature concomitantly with the state of the art. We found that there is no statutory requirement that all generation and transmission facilities of an integrated electric utility system must necessarily be entirely within its service area. This would answer the sometimes expressed industry fear that larger and more economic generating facilities cannot be constructed because the Act would preclude it. The fear may possibly be that the administration of the Act, and not the provisions themselves, constitutes the threat. I think that the record shows that this fear has no basis in fact.

S. 1168, better known as the Fulbright bill, is current legislation with which we are vitally concerned. This bill was introduced by Senator J. W. Fulbright, of Arkansas, Chairman of the Committee on Banking and Currency, on February 11, 1957, and is identical, with one exception, to S. 2054, introduced on August 5, 1955 at the previous session of the Congress following Senator Fulbright's stock market study. That exception is that the exemption for insurance corporations in S. 2054 does not appear in the present S. 1168.

On May 25, 1956, following intensive study of the financial reporting and proxy practices of a great many companies, this Commission presented its report on the Fulbright bill which would

make companies having 750 or more stockholders, or $1 million of debt securities outstanding in the hands of the public and $2 million of assets subject to the financial reporting, insider trading and proxy provisions of the 1934 Act, Sections 13, 14 and 16. Approximately 1200 corporations with total assets of $35 billion would come within the scope of this legislation. Thus we are not here talking of small business but rather of big business.

As a result of our study, the Commission unanimously took the position that the principles and objectives of the bill are sound and supported its enactment subject to certain changes. One of these changes, following another detailed study of financial reporting and proxy practices of insurance companies, was the recommendation that the exemption for insurance companies be deleted from the bill, which was adopted by the Senate Committee. There would be 169 insurance companies having total assets of about $24 billion which would meet the size provisions of the bill. Of these 169 companies, 44, having total assets of $5 billion, are presently required to file financial reports with the SEC pursuant to Sec. 15(d) of the 1934 Act. The other 125 companies with total assets of $19 billion would for the first time be obligated to make such filing.

We also found that most of the companies, not presently subject to our proxy rules, issued proxy material that was inadequate to furnish investors with sufficient information to enable stockholders to cast informed votes in corporate elections. The typical proxy was accompanied by a notice of meeting with no proxy statement. In 75 per cent of the cases we reviewed, the identity of the management slate of directors was not disclosed. In many cases where proposals were submitted for stockholder action, no ballot was provided on the proxy form by which the shareholder could vote for or against the proposal. Many of the proxies provided only for a "yes" vote, making no provision for the stockholder desiring to vote in the negative.

It has been almost 23 years since the Securities and Exchange Act was enacted. Our report indicates that absent the jurisdiction of this Act, self-regulation has not succeeded to any great degree. Our recommendation is based on our study and the obvious fact that after almost a quarter of a century of SEC jurisdiction, many large corporations who have not been required by law to give information to their stockholders have not done so because they have not felt morally impelled to do so.

I would like to discuss some recent developments in our

rules and regulations. On June 6, 1957, the former Chairman of this Commission, J. Sinclair Armstrong, in a speech given at the Annual Meeting of the Illinois Society of Certified Public Accountants, concluded that Rule 133, the "no-sale" theory, was an unsound interpretation of the Securities Act of 1933. Rule 133, in effect, provides that no sale is involved in the submission to the stockholders, of a corporation, of a plan or agreement for a statutory merger, consolidation, or reclassification of securities which vote will authorize the plan and bind all but the dissenting shareholders. Mr. Armstrong's reasoning is most persuasive. Our proposal to amend the Rule so as to require registration has been withdrawn recently, but the problems presented by this Rule are of great concern to industry, to the bar and to me. Those who opposed our amendment or recision of the Rule seem to overlook the abuses that have occurred by individuals using the guide-points of Rule 133 to free-up stock and facilitate a distribution. I would like to call your attention to the difficulties I have with the Rule as an interpretation by pointing out that the end result of a vote of the shareholders constitutes an "attempt ... to dispose of ... a security ... for value," as those words are used in the Securities Act.

It has been argued that an administrative interpretation of such long standing cannot be altered without consultation with the Congress, especially where the Congress had amended the very section to which this problem applied and did nothing about the Rule. But this is no argument supporting the correctness of the Rule. Suffice it to say that the Second Circuit in F. W. Woolworth v. U. S. 91 F2d 973, 976, stated: "To suppose that Congress must particularly correct each mistaken construction under penalty of incorporating it into the fabric of the statute appears to us unwarranted." The issue is now whether or not the Rule is valid. If invalid, this would not of necessity mean a plethora of reports as some people seem to imagine. On the contrary, if these corporate acts require filing with this Commission, these can be facilitated by incorporating by reference other reports required to be filed with this agency. Companies subject to the proxy rules would not have the slightest difficulty if the Commission saw fit to adopt a form which would incorporate by reference the proxy soliciting material which is otherwise filed with this agency.

The Commission has recently adopted its note to Rule 460 which explains its policy in accelerating the effective date of a registration statement. The note to Rule 460 recites a number of situations in which acceleration may not be granted. These situations include cases where the registrant will indemnify its directors for liabilities arising under the Securities Act of 1933; where the registrant

likewise indemnifies its underwriter; where an investigation is currently being made of the registrants, its controlling person or underwriter; where one of the underwriters violates the net capital rule, and where persons connected with an offering may have conducted activities which indicate a cause of artificial market action. This has been the Commission's policy for many years and the note for the first time clearly sets forth these cases. We have had much discussion about provisions which provide for indemnification of directors.

It is the Commission's view that a provision which specifically indemnifies a director narrows down the class of persons Congress sought to make liable for violations of the Act. In effect, these indemnification provisions, even though valid in the state of incorporation, limit the effect of Section 11 of the Securities Act of 1933.

If acceleration of the registration statement is desired, the Commission requires that the registrant insert a statement that the issue of indemnification will be submitted to a court of competent jurisdiction if the problem is ever raised. As a practical matter, the issue has never been raised.

On November 23, 1956, Rule 434A was adopted which permitted certain issuers to use a summary prospectus. The Rule is limited to registrants filing on Form S-1 or S-9, where at the time of filing such registrants are required to file reports under Section 15(d) of the Securities Exchange Act of 1934, or if such issuers are listed companies on a national securities exchange.

Rule 434A is on trial for it can easily be abused. Brief solicitation materials can be false and misleading as was evident in the 1920's when one-page brochures were utilized in the distribution of securities. However, I have high hope that this new summary prospectus, urged by industry, will be used to secure broad dissemination of information about new issues consistent with the spirit of disclosure under the Federal securities acts. We have every indication that issuers are using these summary prospectuses and that the Rule is being utilized more often.

It has been a pleasure to address this Committee of the Edison Electric Institute and I hope that these few words will assure you that our objective is a common one -- a sound capital formation process and public service.

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