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of

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Chairman, Securities and Exchange Commission

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As most of you know, I am here today as a result of a generous acceptance by your officials of my own invitation to appear. My purpose in seeking a place on your program was to make a statement of policy in behalf of the Commission on a subject as to which we find there has been much loose thinking and much loose and dangerous talk in holding company circles. I refer to the effects on holding company investors of our enforcement of Section 11 (b) (1) and Section 11 (b) (2) of the Holding Company Act.

The executives of some of your larger holding company systems have recently been before us in Washington with a plea which, in homely language, runs something like this: "Our stockholders are scared to death! They believe that the enforcement of Section 11 will wipe out their values! The prices of our securities are sinking out of sight! Please do something to help us!" It is true that the stockholders in many holding companies have been badly frightened. But that fear has been nurtured by a systematic campaign of fear conducted by some of the very executives who are now pleading for help. It is not necessary to name names. It is only necessary to refer to the periodic official announcements of several holding company managements to their security holders - the statements in the annual reports and at the annual stockholders' meetings. Those statements speak for themselves. They have been calculated to generate the fear that the enforcement of Section 11 would result in the distress sale of assets within a brief and completely unelastic period of time. And if we read the signs properly, those who created this monster of fear are now themselves frightened by the results that they have produced.

There is the clear duty, coupled with the very strong desire, to protect the security holders of those holding companies from the effects of the dissemination to them of such propaganda. The purpose of my appearance here is,

then, to set forth the truth as to the policy of the Commission with respect to Section 11 of the Holding Company Act.

The first and most important truth about our policy with respect to Section 11 is that we intend to enforce it. Let there be no question about that.

The second truth is that there is nothing in the law which requires the sale of any holding company assets at unfair or inequitable prices. In fact, it is clearly the statutory duty of this Commission to protect holding company security holders against sales on such terms. It is our duty to see to it that assets and securities are disposed of (to quote the law) on a "fair and equitable" basis. Our show cause order directed against the North American Company in connection with its proposed dissolution of the North American Light and Power Company in the past week indicates that we will not permit a proposed method of compliance with Section 11 where we are not satisfied that the interests of security holders or consumers would be adequately protected. I can state unequivocally for the entire Commission that we shall perform that duty, even though at times it may appear to slow up the effectuation of our orders under Section 11 (b) (1).

The third very important truth is that there is no frozen period of time in which orders under Sections 11 (b) (1) and 11 (b) (2) must be carried out. Orders under Section 11 are not self-enforcing. Failure to comply with such orders is expressly exempted from the criminal sanctions of the statute.

Subsection (c) of Section 11 specifies the time within which compliance shall be effected. As a matter of right, one year is given for compliance in all cases. In addition, however, upon a showing that the company has been, or will be unable in the exercise of due diligence, to comply within that time, the Commission must grant an additional year if it finds such extension necessary or appropriate in the public interest or for the protection of investors or consumers.

Congress indicated by this provision that ample opportunity would be given for compliance before any sanction could be employed other than the directory provisions of the order itself. The Commission, for its part, can scarcely be accused of having been unduly hasty when it is remembered that Section 11 came into full force on January 1, 1938. In the event the order is not complied with within one year, or even within the additional year if that time is granted, the procedure then applicable is found in Section 11 (d). That subsection provides that the Commission may apply to a court to enforce compliance with any order issued under subsection (b).

It is to be noted that the Commission is not required to apply to the court at any particular time. In this respect it is like many other provisions of the Act, where in each case we must exercise our discretion in the manner most appropriate, in our judgment, to the proper enforcement of the statute.

Under these circumstances, it is obvious that at the appropriate time in each case we will consider what procedure will most equitably bring about the results required by the statute. If, for example, a particular company is making reasonable progress under its particular circumstances to carry out the Section 11 (b) order, whether by submission of a plan or otherwise, and that company and its security holders could receive no substantial assistance from the entry of a court order, it is obvious that no purpose would be served by going to court. In that event we would have no reason to make application for a court order under Section 11 (d). On the other hand, if the public interest and the interest of investors or consumers required the commencement of legal proceedings, we would, of course, exercise our discretion in favor of instituting such action. In most instances, we anticipate that the one or two year statutory period of compliance will be sufficient to enable the holding company to comply with Section 11 (b) in an orderly way

without prejudice to its security holders. In some instances, there may be factors which will make it in the interests of investors and consumers to delay the sale of particular securities. In such cases, the Commission will obviously use its discretion not to employ court proceedings under Section 11 (d). Court proceedings will be used only where the facts indicate that the holding company is not doing a reasonable job of compliance under the then existing circumstances -- where it is pretty obviously "dragging its feet".

The fourth truth is that the sale by a holding company of its holdings in operating companies is by no means a losing proposition for the holding company and its security holders. In fact, studies of independent statistical agencies indicate that the "break up" value of many holding companies is substantially greater than their "present going" value. In other words, the market appears to consider holding companies (with their heavy expenses and taxes) and holding company management to be liabilities rather than assets. It is true that holding company investors, because of malpractices of holding company management and financiers in the 1920's, have suffered heavy losses. But those losses all occurred long before there was any Federal regulation of holding companies. A tragic number of them, as a matter of fact, occurred at the very minute the securities were first offered, although because of manipulation of the books and records of the companies, they did not show up until some years later when the water began to be squeezed out by more conscientious management. Other concealed losses occurred as a result of the market manipulations of the original promoters which induced investors to buy at prices not even justified by the inflated values placed on underlying securities. Any effort of management to lay the blame for these losses on the doorstep of the Federal Government must be

regarded as an untruth. In short, those investors in holding companies who held securities representing any underlying value when the Holding Company Act was passed, will have that same underlying value (and in many instances, because of the benefits from the operation of the Act, substantially more) when Section 11 is enforced.

Much progress has already been made toward a working solution of the integration program. Many holding company systems, including some of the very largest, have agreed to comply with the integration provisions of the Act. Some holding company officials, such as Leo Crowley, head of the Standard Gas and Electric System, believe that the integration program is "... a necessary and practical treatment of obvious corporate needs." The head of The United Light and Power System, William G. Woolfolk, recently told his stockholders that:

> "In the rearrangement of properties by way of compliance with the Act, we have noted no indication that the regulatory authorities will be other than helpful in protecting the investor, and out of what must now seem to you a complex and nebulous situation, your management foresees in the reasonably near future the emergence of a company which, though smaller perhaps, will be in every way creditable. To this end we are bearing our every effort."

The fifth truth is that, in many instances, there will be no necessity for the sale of underlying securities in the general market. The fact is that there are quite a few situations in which such public sales would seem to be wholly inappropriate and could probably not be approved by the Commission as the proper method for complying with Section 11 orders. For example, there are holding companies in which the obvious way to meet the requirements of the statute would be to distribute the underlying securities directly to the security holders of the holding company on a pro rata basis. Those security holders would then become the direct owners of the operating property.

Of course, many investors might choose to sell their newly acquired shares and a market for them would develop if one did not already exist, but there would be no need for a general public offering. This method is already being employed as a means of meeting the requirements of the Act. There is little question that it will be much more widely employed in the future. It is, in many instances, an appealing solution of the problem because it leaves with the holding company security holder the decision as to whether he wants to retain the operating company stock and if not, at what price or time he wishes to sell.

With these five truths in mind, investors in public utility holding companies and their subsidiaries can rest assured that many of the fears which have been conjured up for them are wholly unjustified. Holding companies are not going to be smashed by sudden explosions of dynamite. The process of accomplishing the objectives of Section 11 is to be carried forth carefully and thoughtfully, with the best interests of the investors and consumers always uppermost in our minds.

There has been some discussion in holding company circles during recent weeks suggesting that because of the national defense program, the Securities and Exchange Commission should suspend its enforcement of Section 11. The suggestion appears to be based on the claim that enforcement interferes with the efforts of the public utility industry to meet the urgent requirements of defense. Nothing could be further from the truth. If there was ever a time when it is of the utmost importance to clear away the debris of holding company disintegration, holding company extravagances, holding company siphoning-off of assets and earnings, now is that time. Operating companies must be freed from these encumbrances so that they can go full speed ahead in serving the nation's needs.

The power demands of our unprecedented production program can be met only by far-sighted, concerted, and ceaseless efforts on the part of both industry and government to increase our present facilities. Total, all-out production is imperative to meet the total, all-out-war-making of the totalitarian states. A recent report of your own Institute shows that the production of electric energy by the electric light and power industry in this country for the week ending May 10, 1941, was approximately 17% greater than in the corresponding period in 1940; in some sections of the country, particularly in the heavily industrialized areas, power production increased 25 per cent and more over last year, and in the case of some systems production increased approximately 30 per cent. Power experts estimate that additional electric power requirements for 1942 will be at least 15 to 20 per cent greater than in 1941. In the industrial areas, the percentages may rise even more sharply.

Competent authorities — as you know — are predicting that serious generating deficiencies will be encountered shortly in many areas. For example, Chairman Olds of the Federal Power Commission, stated only this week that the end of 1941 may be the most critical period in the history of the electric utility industry in this country. Furthermore, it is uncertain to say the least, whether the power equipment industry is in a position to supply the additional steam turbines, generators, transformers and other equipment that will be required. The naval and maritime requisitions for national defense are competing with public utility companies for the available productive capacity of the power equipment manufacturers. Expansion of that industry, therefore, will have to keep corresponding pace with mounting

calls for more and more power. The Securities and Exchange Commission must, therefore, review each application for the issuance of securities for capital expansion by public utility companies from the standpoint of the availability of materials, equipment and labor under national defense priorities.

It might be fatal to our national existence if we should experience the power shortages of the last World War. In some respects, the task today of providing adequate power for industry is even more difficult than during the last World War. Prior to 1914, few holding company systems had been created and fewer still had developed the practices which led to the passage of the Holding Company Act. Not many of the holding companies in existence then either had acquired widely scaterred properties or had fully developed the technique of rearing the top heavy financial structures built up of layer upon layer of holding companies -- all resting heavily upon the operating subsidiaries which sustained them. The industry was not yet exposed to the intricate mass financial manipulations later revealed. The policies of the industry were still, to a large extent, dictated by the engineering and operating personnel responsible for its previous growth. Independent local or regional operating companies still supplied the power needs of most communities.

A glance through the index to Moody's, 1919, is of interest in this respect. Missing are such names as Commonwealth & Southern, Utilities Power & Light, Electric Power & Light, National Power & Light, United Corporation, United Gas, Niagara-Hudson - and particularly you will not find the names of numerous other holding companies that blossomed into existence during the late '20's only to be blown away in the path of the financial hurricane of 1929.

To be sure, you will find Associated Gas & Electric Co., but with combined gross earnings of less than $1,000,000 and total consolidated assets of less $6,500,000 and with operations still at that time largely centered in New York State; Columbia Gas & Electric Co., with a consolidated gross of $11,500,000 and assets of $73,000,000, but with all its subsidiaries serving areas all within a radius of 200 miles of Charleston, West Virginia; Middle West Utilities properties, having but $41,200,000 of assets and $14,600,000 of combined gross, still largely centered in the Middle West States, although already reaching out into New England, Texas, and the Mid Continent areas; and North American with its operations not yet extending beyond the Milwaukee and St. Louis areas although owning them, as it does now, a minority interest in Detroit Edison Co. Comparison of these magnitudes with those of the holding companies of today indicates the relatively small influence which this type of company exerted in the industry in 1914-1918 as compared with what it now exerts. Not until after the World War did large parts of the policies come under the domination of financial interests or financially minded operating men. In the last World War, the problems of the increased needs of power were solved primarily by true operating men whose interest was in production for service. Today, the problem is complicated by the fact that the front line operating men - those who really know the down-to-the-earth defense power needs of their own communities - are powerless to make decisions. The decisions must come from distant holding company executives who at best are only remotely familiar with particular power problems and who at worst are selfishly refusing to do anything which they fear might weaken their own stranglehold on a scattered system.

All of these facts point to a joint obligation resting on the public utility industry and the Government, including the Securities and Exchange Commission. The public utility industry must plan, more carefully than it ever has done before, to create additional capacity for the critical years ahead of us, and it must plan now. It must plan comprehensively in terms of projected production -- liberally estimated -- and in terms of financing conservatively the facilities that are necessary for such stepped-up production. It must plan to build and locate additional utility facilities so that they will be coordinated and integrated with existing utility facilities as far as possible in a manner that will afford maximum use of all our generating capacity and will produce the maximum of energy therefrom. It must plan to coordinate and integrate to the fullest extent possible all existing utility facilities so that munitions of all kinds can flow uninterruptedly from our factories. It must plan to produce and distribute power at the lowest possible cost without unnecessary overhead and service charges so that our national defense bill will not be unduly increased. To facilitate its financing and to encourage public acceptance of its securities, the industry must simplify its corporate structure. It must relieve operating companies of the burden of excessive debt and preferred stock capitalization, and of over-capitalized holding company system structures. It must act now to eliminate practices which are objectionable even in peace-time and which in this emergency tend to imperil our entire defense effort. I refer to such practices as inadequate depreciation, excessive dividends, unwarranted service charges to operating companies, impairment by holding company officials of the advantages of localized management, attempted frustration of State and Federal regulatory authority, and certain other practices.

The electric industry has a much greater responsibility today than in the period of the first World War, 1914-1918. At the beginning of that period, American industry was only about 40 percent electrified and less than half of that was supplied by electric utility companies. Today American industry is 90% electrified and nearly 65% of the horse power in electric motors is served by the utility companies. Our dependency upon electric power and the utility industry is, obviously, very great. Our country cannot permit them to fail us.

Upon the Securities and Exchange Commission -- within the bounds of its authority -- rest concurrent responsibilities. We are presently studying the financial position of public utility companies -- particularly those that are in present and prospective defense material areas -- in the light of the probable impact of the defense program on their dollar needs. Necessary additional facilities must be correlated with the future financing plans of the operating company in order that money be raised most advantageously and in the light of the company's continuing ability to meet defense needs and the requirements of future peace-time rehabilitation.

There appears to be a disposition on the part of some holding company managements to underestimate the effects of the national defense program on their projected system loads. In fact, we have some reason to believe that a few holding company managements may be curtailing or postponing the installation of additional facilities that are known to be needed for defense production, either because of apprehension as to the holding company's ability to finance them, or because of fears that their control might be endangered. Such avoidable circumstances cannot be permitted to jeopardize power expansion.

New funds for capital expansion in the public utility industry have come largely from three sources -- new capital issues, depreciation accruals, and reinvestment of earnings. Because of holding company control, a public utility operating subsidiary, unlike most other industries, is not always permitted to provide production capacity on the basis of its own ability to finance, its own depreciation accrual requirements, or its own decisions as to dividend policy. Too frequently, all of these are determined for it by the holding company managers in New York, who take into account, first, the effect of such decisions upon the scattered, complicated, entire holding company system security structure, and, second, the possibility that their control of the system with all its attendant emoluments, may be diluted. Even in this emergency period, the interests of the operating company in obtaining peak production are being sacrificed in favor of the manifold holding company interests, which may run contrariwise. Thus, the decision whether a utility in a defense production area will increase its generating capacity may depend upon completely extraneous factors that are only of the remotest concern to the operating company. It is at this point that the Securities and Exchange Commission is obliged to exercise its statutory powers to prevent such holding company abuses.

Students of utility problems have pointed out that one of the most serious consequences of ownership of our power resources by the scattered holding company has been the "misintegration of our utility assets" resulting in the building of generating and transmission facilities in accordance with holding company interests, and without real regard for the power needs of the area served. It is urgently necessary now - not only for National Defense, but to protect consumers against execessive rates for the next few decades - that new utility facilities be planned and operated as coordinated parts of integrated public utility systems.

We can remove major impediments to this desirable objective if we free some operating companies from holding company control and if we permit the others to be controlled by holding companies only where their assets form a part of an integrated, coordinated system. The present scattered holding company systems, consisting of utility properties that were gobbled up in the mad scrambles of a few years ago, have prevented groupings of utility properties along sound engineering lines. Holding company promoters have too often forgotten that electric power can only be transmitted through physical interconnections, not through paper lines of control manipulated by remote holding company officials. The present scattered systems have Balkanized the utility assets of this country without regard to economical or efficient operation or coordination of utility assets. For example, the power supply of vital industrial areas is split up into islands of separate utility properties, owned by many rival holding company systems. In many cases, properties of one system in a single state are separated from each other by intervening properties of other companies. The resultant hodge-podge utility operations require the surgery of Section 11 in order that integrated utility properties may be developed in accordance with the power needs of the area served. In this connection it must be remembered that the operations of Section 11 do not change the location of a single nut or bolt on a utility operating property.

In short, National Defense is an all-important reason for speeding up the operations of Section 11 rather than for slowing down. As I have indicated in the earlier part of this talk, there is no disposition on the part of the Commission to urge unreasonable haste in the enforcement of Section 11 in those special circumstances where such haste might seriously injure the security holders. But there are very many points at which the program can and must be

speeded up. In those situations, especially where they relate to areas in which power needs for defense are great, delay cannot be countenanced. I do not believe that those who disingenuously express the view that suspension of the operations of Section 11 is necessary for National Defense represent the majority in the industry. And I know that those who, at a time like this, would deliberately delay the program are a very small minority. It seems clear beyond a shadow of doubt that, where a subsidiary operating in a defense area can be in a better position to meet the needs of increased production if it is freed from holding company control, there can be no choice but to bring about that freedom in the very shortest period of time possible with the full cooperation of the government and the holding company management.

The President's Proclamation of "an unlimited national emergency" confronting our country and his call to all of us to place the nation's needs first in mind have unified Americans as never before. There is complete agreement that every factor in our nation - employers and employees, business and government - must, in the words of the President, "merge their lesser differences" and contribute to the national security to the fullest measure of their abilities and powers. The times call for patriotism, service, and a willingness to devote one's energies and life to the interests of the nation not only from our young men in the services but from all of us.