REMARKS OF HUGH F. OWENS, COMMISSIONER,
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ANNUAL CONVENTION OF THE NATIONAL ASSOCIATION OF
REGULATORY UTILITY COMMISSIONERS

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Our topic this morning -- "The Role of Utilities in Meeting the Nation's Housing Needs" -- is a rather ironic one for me to be discussing. I am a member of an agency which has recently had a good deal to do with restricting that role. I refer, of course, to the Securities and Exchange Commission's recent decision in the Michigan Consolidated case. I would like to begin with a short history of the Commission's involvement in the public utility area and then discuss the Michigan Consolidated matter.

The Public Utility Holding Company Act of 1935 was passed to correct the many abuses which Congressional inquiries had disclosed in the financing and operation of electric and gas utility holding company systems. When the Act became law in 1935, some 15 holding company systems controlled 80% of all electric energy generation, 98.5% of all transmission of electric energy across state lines, and 80% of all natural gas pipeline mileage in the United States. 1/

In the process of seeking to dominate the nation's gas and electric utility business, vast and complicated public utility holding companies were created, especially during the decade of the 1920's. These corporate empires were put together with little regard for the efficient service of electricity or gas to customers and equally little regard for the investors whose funds were utilized to concentrate a maximum of control and profit in the hands of a few empire builders. Rather, their function was to circumvent the authority of the state regulatory bodies which were effectively supervising the activities of operating utility companies and, once free of such authority, to create corporate entities which could attract large amounts of investment capital and yet be controlled by holders of junior securities with little or no equity. This was accomplished by pyramiding the holding companies, inflating values of their properties and issuing tier after tier of bonds, debentures, preferred stock, and other debt securities.

This pyramiding process worked in reverse in times of depression. By and large, the electric and gas operating companies, as such, were hit by the great depression more lightly than many other segments of our economy. Yet, the relatively small drop in their revenues that did occur was enough

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1/ The Work of the Securities and Exchange Commission, October 1969, p. 12.

to bring down in ruins many of the elaborate corporate super-structures that had been imposed on top of the operating companies. Several of the largest holding companies were forced into bankruptcy, and all down the line investors who had been enticed into buying supposedly conservative securities found they had lost much or all of their investment.

In enacting the Holding Company Act, Congress delegated to the Securities and Exchange Commission the job of distributing whatever was left of the public utility holding companies among the persons entitled thereto and of regulating and reorganizing the corporate structures of holding company systems to prevent a similar debacle in the future.

From the standpoint of its impact on the electric and gas utility industries, the most important provisions of the Holding Company Act are found in Section 11, which the Supreme Court has characterized as the "very heart" of the Act. 2/ Section 11 is a specialized antitrust law setting up standards for eliminating useless holding companies, reorganizing their capital structures, and bringing about the disposition of unrelated and unretainable properties. Section 11 restricts operations of a holding company to a single integrated public utility system -- that is, one which is capable of economic operation on a single, coordinated system basis and confined to an area or region not so large as to impair the advantages of localized management, efficient operation, and the effectiveness of local regulation.

The overall effect of the Commission's administration of Section 11 has been far-reaching indeed. During the 30-year period from 1938 to 1968, more than 2,400 registered holding companies or their subsidiaries have been subject to the Act. Included in this total were more than 220 holding companies, 1,000 electric or gas utility companies, and 1,200 other nonutility, subsidiary companies engaged in a wide variety of businesses, among which were brick works, laundries, experimental orchards, motion picture theaters, and even a baseball club and a college. Today the picture is strikingly different. Only 17 active holding company systems are now registered, encompassing approximately 170 parent and subsidiary companies with aggregate assets of approximately 19 billion dollars. 3/ Most electric and gas utility companies which formerly were associated with registered holding companies now operate as independent concerns.

In the National Power Policy Committee Report on the holding company industry, prepared in 1934 at the request of President Roosevelt, it was specifically recommended that "holding companies should be restricted as soon as possible to the business of operating and owning securities of

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2/ North American Co. v. SEC, 327 U.S. 686, 704 n. 14 (1946).

3/ The Work of the Securities and Exchange Commission, October 1969, pp. 13-14.

public utility properties; they should not be permitted to engage in nonutility speculative ventures." 4/ Congress had concluded that only by confining the scope of the operations of a holding company system to that of integrated systems and functionally related and necessary nonutility operations could investors be protected from possible misconceptions as to the nature of their investment.

From the investment standpoint, the most important idea associated with a public utility is that of stability, based on the facts that the utilities render an indispensable and generally exclusive service to a large number of customers and that they have a legal right to charge a rate of compensation sufficient to yield a fair rate on invested capital. In order to insure that reality conformed to investor expectations in this regard, Congress carefully designed the Holding Company Act so as to restrict the nonutility interests of holding companies and their subsidiary companies to activities having functional relationship with utility operations.

It is in this context that we must view the Commission's recent decisions in the Michigan Consolidated case and in subsequent related cases. Participation by holding companies or their subsidiaries in the creation of low income housing does not appear to be one of the specific "evils" to which Congress was directing its attention when it drew up the Holding Company Act. But the provisions of that Act having to do with acquisitions certainly must apply to such participation where it takes the form of purchasing an interest in a housing project. Section 9(a) of the Holding Company Act provides, insofar as is pertinent here, that no registered holding company or holding company subsidiary shall acquire any securities or any other interest in any business unless such acquisition meets the standards of Section 10 of the Act.

Section 10 itself contains both positive and negative instructions as to what kinds of acquisitions the Commission may approve under that section. It further complicates matters by raising two additional sections of the Act for consideration; among the numerous criteria for a Section 10 approval are requirements that the acquisition may not be one which is unlawful under Section 8 of the Act or which is detrimental to the carrying out of the provisions of Section 11.

An exception to Section 9(a) is found in Section 9(c)(3), which, on its face, is much simpler than Section 10. It provides that commercial paper and other securities may be purchased as is permitted by rules and regulations or orders where the Commission prescribes the investment as appropriate in the ordinary course of business of the holding company or its subsidiary and not detrimental to the public interest or the interest of consumers.

4/ Report of National Power Policy Committee, printed in S. Rpt. 621, p. 59, 74th Cong., 1st Sess.

The original Michigan Consolidated case was decided March 31, 1969. 5/ The company had made an application to the Commission for approval of its purchase of up to $500,000 in common stock and $3,000,000 in short term promissory notes from Michigan Consolidated Homes Corporation. Homes Corporation is a subsidiary of Michigan Consolidated, in turn a subsidiary of American Natural Gas Company, a registered holding company. Homes Corporation was organized by Michigan Consolidated to construct low and moderate income housing in Detroit, Michigan.

In deciding whether to grant this application, there were three possibilities open to the Commission: They could grant the application under Section 10, they could grant it under Section 9(c)(3), or they could turn it down. In an extreme example of independent thinking, the Commission, at that time composed of only four members, split all three ways. Commissioners Smith and Wheat voted to grant the application pursuant to Section 10. Concurring in the result but arriving there from a different direction, I found that Section 10 approval by the Commission was not merited but that an exemption pursuant to Section 9(c)(3) was justified. Chairman Budge dissented, finding that the facts of the application met neither the test of Section 9(c)(3) nor that of Section 10.

A little more than a year after this decision, on June 22, 1970, the Commission voted on another, similar application made by Michigan Consolidated. 6/ The original housing project for which approval had been granted by the Commission was nearly complete, and the company sought approval for two new ventures similar to the first. In the intervening period, Commissioner Wheat had left the Commission, and Commissioners Needham and Herlong had arrived. The vote was again a three-way split, but this time the theory advanced by Chairman Budge in the earlier case carried the day as both new Commissioners joined the Chairman to form a majority opposed to granting the application. I reiterated my own earlier opinion by concurring with the majority that a Section 10 approval of the application was not appropriate but dissenting in favoring the grant of a Section 9(c)(3) exemption to the company. Commissioner Smith dissented to even a greater degree than I and, laying great stress on the social purpose underlying the application, concluded that he would have granted the application under either Section 10 or Section 9(c)(3). Subsequent to the opinion itself, Michigan Consolidated has made motions for some relief from the Commission's decision that the company must divest itself of the Homes Corporation securities, and other applicants have asked for approval of investments similar to that originally made by Michigan Consolidated. These

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5/ Holding Company Act Release No. 16331.

6/ Holding Company Act Release No. 16763.

have been denied for reasons consistent with the Michigan Consolidated decision of June 22. 7/ (Michigan Consolidated has also filed a petition for review of that opinion in the Court of Appeals for the District of Columbia Circuit. That petition is still pending.)

While I feel it inappropriate for me to explain in any detail the rationale for the opinion of the majority in the decision of June 22 or the dissent of Commissioner Smith in that case, I think I can discuss my own opinion and tell you why I felt the Commission should have granted Michigan Consolidated's application pursuant to Section 9(c)(3). The key language in that section is "as is appropriate in the ordinary course of business of a registered holding company." It is in the interpretation of these words that the majority and I appear to be farthest apart. Michigan Consolidated argued in its application, and I agreed in my opinion, that the company's participation in the proposed housing projects and other future projects of a similar type would help to preserve and rehabilitate the Detroit area as a major service area of the company. In my mind, it certainly was in the ordinary course of business for Michigan Consolidated to protect its present market for gas in Detroit and, hopefully, to expand that market. A very direct way of accomplishing that end was to assist in the creation of new housing which could utilize gas power.

Certain other determinations were necessary, of course, before I could conclude that a Section 9(c)(3) exemption was warranted in this case. As mentioned earlier, that section requires not only that the investment of the holding company or its subsidiary be one which the Commission prescribes "as appropriate in the ordinary course of business" but also that it be "not detrimental to the public interest or the interest of investors or consumers." I believe that the latter was true in this case because of the facts that this housing program was to provide shelter for some of the poorer people of Detroit and that it was in response to the National Housing Act and subject to regulation by the Federal Housing Administration.

When the Commission's majority rejected the applications of Michigan Consolidated and other companies proposing sponsorship of like housing projects, I do not believe that they were rejecting the idea that such projects were desirable and publicly beneficial activities. Rather, I believe they were following what they believed to be the Congressional mandate expressed in the Holding Company Act.

Probably the best hope for Michigan Consolidated and others to engage in future projects of this type now lies with the Congress. Senator Magnuson recently proposed amending the Holding Company Act by adding a new subsection 9(c)(4). 8/ The amendment would exempt from the 1935 Act's

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7/ Holding Company Act Release Nos. 16814, 16819, 16825 and 16842.

8/ S. 4272.

prohibitions "securities of a subsidiary company engaged in the business of providing housing for persons of low and moderate income within the service area of the holding company system" where the venture was sanctioned in a manner specified by the bill by either the National Housing Act or Title IX of the Housing and Urban Development Act of 1968. The Commission would retain authority to apply such terms and conditions to the exemption as it felt necessary in the public interest or in the interest of investors or consumers. The Commission has determined, and has so informed the Congress, that it has no objection to the proposed amendment, and a bill containing the amendment has been passed by the Senate.

One element of the proposed amendment that I would particularly like to stress is that it restricts the exemption to participation in housing projects within the service area of the holding company system. A holding company in Maryland, for example, wishing to participate in a housing venture in Florida would not come within the terms of the exemption. That particular provision is most consistent with the emphasis I placed in the Michigan Consolidated case on the fact that a motive of the utility in investing in housing was to bolster the market for its own services.

I should also mention, in conclusion, that there is another proposed amendment to the Holding Company Act now pending which is of far greater significance to the Commission but which does not directly relate to the issue we are discussing today. The Commission has proposed to the Congress that the administration of the Holding Company Act be transferred from the S.E.C. to the Federal Power Commission. This proposal has been introduced in the House of Representatives by Congressman Staggers 9/ and has been referred to the House Interstate and Foreign Commerce Committee where no further action has yet been taken. No comparable bill has, as yet, been introduced in the Senate. If any of you have any questions as to the rationale for this proposed legislative enactment, I shall be pleased to address myself to them during the discussion period.

9/ H.R. 15516.