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SEC Respects State Jurisdiction

A critical analysis of a recent suggestion that the SEC is seeking to undermine regulatory authority of the states over local utility securities.

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THE SEC was surprised to read a recent article by Asel R. Colbert, of the staff of the Wisconsin Public Service Commission, published in PUBLIC UTILITIES FORTNIGHTLY for August 1, 1940, entitled "SEC Limits State Jurisdiction," in which he asserts that there is "grave danger that by broad administrative interpretation" the jurisdiction of the SEC "may be extended to the securities of subsidiary operating companies even where such utilities come squarely under the exemptions provided" in the Public Utility Holding Company Act, with the result, he says, that state commissions will be "reduced to administrative rubber stamps of such actions as the Federal commission may approve."

Mr. Colbert's comments are completely unjustified and the alleged facts which he uses to support them are glaringly inaccurate. In fairness, the actual facts and the SEC's position should be made known.

MR. Colbert builds his thesis solely upon one instance, the recent case of Wisconsin Electric Power Company, an operating utility organized and doing business in Wisconsin which, however, is a controlled subsidiary of North American Company, the latter being registered as a public utility

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holding company with the SEC.[1] The true facts with respect to this matter are relatively simple.

Early this year, the Wisconsin Electric Power Company filed with the SEC an application for an exemption from the provisions of the Public Utility Holding Company Act of 1935, of a proposed issuance, by it, of preferred stock, which was to be convertible into its new common stock during a specified period of years. At the same time, North American also filed an application for permission to acquire a substantial portion of such convertible preferred stock in exchange for a large block of outstanding Wisconsin Company preferred stock owned by it; that acquisition was an inherent and indispensable part of the proposed program.

In order to understand the purpose of those applications it is necessary briefly to describe certain provisions of the Holding Company Act:

ACCORDING to § 6 (a) of the act, any security issued by a holding company or its utility subsidiaries must conform to the standards of § 7 of the act. However, where the security is issued by a subsidiary and is solely for the purpose of financing the business of such company, and has been authoried by the state commission of the state in which such subsidiary both is "organized" and doing business, the security is entitled, according to § 6 (b), to an exemption from § 6 (a) and therefore from § 7,[2] except that the SEC is authorized by the act to attach such "terms and conditions" to the ex-

[1] Neither the Wisconsin Company nor North American deny that the Wisconsin Company is a subsidiary controlled by North American within the meaning of the Public Utility Holding Company Act of 1935. A subsidiary is defined in the act, generally speaking, as a company, the managerial policies of which are subject to the control of a holding company.

[2]Standards of § 7 of the Holding Company Act

Those standards of § 7, modeled somewhat on § 20(a) of the Transportation Act of 1920 as to the power of the ICC concerning railroads, are by no means vague or boundless. They include subsections 7(d) and (g) which read as follows:

"(d) If the requirements of subsections (c) and (g) are satisfied, the commission shall permit a declaration regarding the issue or sale of a security to become effective unless the commission finds that—

"(1) the security is not reasonably adapted to the security structure of the declarant and other companies in the same holding company system;

"(2) the security is not reasonably adapted to the earning power of the declarant;

"(3) financing by the issue and sale of the particular security is not necessary or appropriate to the economical and efficient operation of a business in which the applicant lawfully is engaged or has an interest;

"(4) the fees, commissions, or other remuneration, to whomsoever paid, directly or indirectly, in connection with the issue, sale, or distribution of the security are not reasonable;

"(5) in the case of a security that is a guaranty of, or assumption of liability on, a security of another company, the circumstances are such as to constitute the making of such guaranty or the assumption of such liability an improper risk for the declarant; or

"(6) the terms and conditions of the issue or sale of the security are detrimental to the public interest or the interest of investors or consumers . . .

"(g) If a state commission or state securities commission, having jurisdiction over any of the acts enumerated in subsection (a) of § 6, shall inform the commission, upon request by the commission for an opinion or otherwise, that state laws applicable to the act in question have not been complied with, the commission shall not permit a declaration regarding the act in question to become effective until and unless the commission is satisfied that such compliance has been effected."

emption as the SEC "deems appropriate in the public interest or for the protection of investors or consumers."

How far these terms and conditions may go has not been the subject of a court decision to date. It is important to note, however, that the security, to be entitled to the exemption pursuant to § 6(b), must be issued *"solely* for the purpose of financing the business" of the subsidiary. It was pursuant to § 6(b) that the Wisconsin Company filed its application, an application for exemption.

IN § 10, Congress explicitly provided, among other things, that *a public utility holding company may not,* in any manner, *acquire* (by purchase, exchange, or otherwise)[3] any securities of a local utility company unless the SEC finds that certain rather strict standards are met. They include the following:

> (b) . . . The commission shall approve the acquisition unless the commission finds that . . .
>
> (3) such acquisition will unduly complicate the capital structure of the holding company system of the applicant or will be detrimental to the public interest or the interest of investors or consumers or the proper functioning of such holding company system.
>
> (c) Notwithstanding the provisions of subsection (b), the commission shall not approve
>
> (1) an acquisition of securities or utility assets, or of any other interest which . . . is *detrimental to the carrying out of the provisions of § 11;*[4] *or*
>
> (2) the acquisition of securities or utility assets of a public utility or holding company unless the commission finds that

[3] See definition in § 2 (a) (22).

[4] Section 11 calls for the geographical "integration" and corporate simplification of registered holding companies.

The Distinction between § 6(b) and § 7

In *Dayton Power & Light Company,* SEC Holding Company Act Release No. 1925 (1940), the commission explained as follows the difference between §§ 6(b) and 7:

"In an order dated January 19, 1940, the public utilities commission of Ohio has, subject to certain conditions, approved the proposed issue and sale. As we have previously noted, the applicant is 'organized in Ohio' and is 'doing business' in Ohio. Thus it is apparent, in view of our previous finding that the proposed issue and sale are solely for the purpose of financing the applicant's business, that the applicant falls within the express statutory exemption of § 6(b). The present case, therefore, differs from the facts and issues recently before the commission in *Consumers Power Company,* Holding Company Act Release No. 1854 (1939). The Consumers Power Company was *organized in Maine but doing business in Michigan;* consequently, although the issue had the approval of the Michigan commission, it was not within § 6(b) exemption and was, therefore, directly subject to the requirements of § 7, including, of course, § 7(d)(3), which provides that '. . . the commission shall permit a declaration regarding the issue or sale of a security to become effective unless the commission finds that . . . financing by the issue and sale of the particular security is not necessary or appropriate to the economical and efficient operation of a business in which the applicant lawfully is engaged or has an interest.' It was under this section that a majority of the commission made its adverse findings in the Consumers Power Company Case as to the issuance and sale of $10,000,000 of bonds which increased the corporate debt in that amount. In that case, the commission permitted the issuance and sale of $18,594,000 of bonds for refunding, at a lower rate of interest, of outstanding debt."

That the word "organized" in the phrase, "the state in which such subsidiary company is organized," in § 6(b), means the state in which such company was originally incorporated, is made clear by the use of similar phraseology in other sections of the act in which no other meaning could be assigned to the word "organized."

It will be noted that, where § 6(b) is applicable, the approval of the state commission is one of the bases of the exemption, whereas, if § 6(b) is not applicable, then, under § 7(g), the absence of state commission approval, if such approval is required by state law, prevents the SEC from giving its permission to the issuance of the securities.

Even under § 7, the SEC gives much weight to the views of an approving state commission.

such acquisition will serve the public interest by tending towards the economical and efficient development of an integrated public utility system.

IT was pursuant to § 10 that North American, the holding company, filed its application with the SEC. As noted above, *that acquisition by North American was an indispensable part of the proposed program. And over that acquisition by the holding company the SEC admittedly had jurisdiction, while the state commission had none. This is an important phase of the matter to which Mr. Colbert in no wise refers.*

Nowhere does he even mention the existence of § 10 or describe the important exclusive jurisdiction of the SEC with respect to a holding company's acquisitions; the reader of his article would erroneously suppose that any consideration given by the SEC to that aspect of the transaction was based not on specific statutory language but on an unwarranted effort of the SEC to extend its powers.

As is not unusual in such matters, officials of the Wisconsin and North American companies, prior to the hearings on their applications, conferred with the SEC staff. In the course of the discussions some doubts were expressed by the staff as to whether the proposed privilege of conversion of the preferred stock of the Wisconsin Company into common stock, over a period of twelve years, met the requirements of §§ 6(b) and 10 of the act. Thereafter, the commission sent one of its representatives to Madison, Wisconsin, to discuss that item with the staff of the Wisconsin commission—which was ready to issue an approval order—and representatives of the utility companies concerned, in the hope that the possible difficulties could be avoided.

Subsequently, at hearings on the applications, evidence was heard by an SEC trial examiner. The staff then reported that the officials of the companies, aware that the SEC commissioners still had doubts as to some aspects of the proposed transaction, desired to learn the tentative informal views of the SEC commissioners prior to a final and considered opinion. Such requests are often made by applicants. The commission, in order to aid companies subject to its jurisdiction, is usually willing to express such informal views, but insists that in a case where there are doubts whether an approval should be given, they must be regarded not as final but as merely tentative and subject to modification after the filing of briefs and an oral argument (if the applicant so desires) and fuller consideration of the problems presented.

CONSEQUENTLY, in the case now being discussed, the SEC authorized its staff to advise the companies, *purely tentatively,* as follows: (1) Assuming that, because of the Wisconsin commission's approval, the issuance of the Wisconsin Company's convertible preferred stock was, under § 6(b), entitled in all respects to an exemption, yet there was doubt as to whether the requirements of § 10 would be satisfied by the *acquisition* by the controlling holding company, North American, of the conversion privilege, such acquisition by the holding company being within the exclusive jurisdiction of the SEC. *In that connection, the effect of such acquisition on the geographical*

integration of North American pursuant to § 11 and the question whether such acquisition would unduly complicate the capital structure of the holding company system were, of course, factors to be considered because of the requirements, in that respect, of § 10. (It should here be noted that geographical integration proceedings, under § 11, relating to North American,[5] were begun by the SEC on March 8, 1940, and were, therefore, pending during a considerable part of the time when the Wisconsin Company matter was being discussed.)

(2) As to the *issuance* of the securities by the Wisconsin Company, this question arose: It was not clear that the new common stock to be issued on the exercise of the conversion privileges was entitled to a *present* exemption, since such common stock was not to be issued at once but from time to time, in the future, as such privileges were exercised over a period of twelve years, and at a fixed price regardless of any changes of corporate circumstances; *as such common stock was not to be issued at once, it might be impossible for the commission now to determine whether or not to attach to an exemption order a condition "in the public interest or for the protection of investors or consumers," since the determination of whether such a condition could be attached and what it should contain would depend on circumstances not now existing but which might arise in the future; this raised a possible question whether, if, for such reasons, such common stock could not now be given an exemption under § 6(b), the SEC, under § 6(b), could and—if it lawfully could—should attach to its exemption order a condition requiring the preferred stock to be issued without the conversion privilege.*

CERTAINLY the acquisition of preferred stock—plus such a conversion privilege—by a holding company, which might or might not be entitled, under § 11, to retain any interest in the issuing company, presented specifically and acutely to the SEC, under § 10, these questions over which the state commission had and claimed no jurisdiction: Would such acquisition by the holding company unduly complicate not the capital structure of the local utility but of the holding company system? Would such acquisition by the holding company tend toward the development of an efficient integrated system? Would such acquisition by the holding company be detrimental to the carrying out of the geographical integration of the holding company under § 11?

The staff was instructed to and did tell the companies that *those tentative views were not final and might all be disregarded by the SEC after an argument at which the companies could in detail endeavor to show the commission that its tentative views were wrong in law or fact.*

The commission thereafter learned from its staff that the companies contemplated amending their applications so as to eliminate the conversion privileges, with the result that there would be no argument on that subject.

Subsequently, however, on April 4, 1940, at the request of the Wisconsin

(Continued on page 266)

[5] In an answer subsequently filed by North American in those proceedings, it stated that it had in mind possibly disposing, voluntarily, of its controlling interest in Wisconsin Electric Power Company.

The SEC Minutes for April 4, 1940

(Italics added)

Commissioners Frank, Healy, and Eicher present.

The commission again discussed with Chairman Peterson and *Mr. Colbert* of the public service commission of the state of Wisconsin, Messrs. Way and Seybold of the Wisconsin Electric Power Company, and Mr. Fogarty of The North American Company, *the problems involved in the application* under the Public Utility Holding Company Act of 1935 *filed by Wisconsin Electric Power Company* (File 70-1) *for exemption from the provisions of § 6(a) of the act of the issuance of new preferred stock* to redeem its outstanding preferred stock, *and the proposal of The North American Company* (File 70-9) *to exchange its present holdings of outstanding preferred stock of Wisconsin Electric Power Company for the new preferred stock to be issued by the latter company.*

After considerable discussion, and *in answer to a specific inquiry from Chairman Peterson of the Wisconsin Public Service Commission* as to the commission's position with respect to the two alternative proposals for the issuance of preferred stock by Wisconsin Electric Power Company (one involving the issuance of 4½ per cent preferred stock *with a conversion privilege* and the offer of one share of such stock, together with ½ share of new common stock, in exchange for each share of 6 per cent preferred stock of such company now outstanding; and the other involving the sale of 4¾ per cent preferred stock *without the conversion privilege* and the offer of one share of such stock, together with one share of new common stock, in exchange for the outstanding 6 per cent preferred stock), the commission took the position indicated below:

(1) That any expression of views at this time must be considered as *purely tentative* in character. It was pointed out that the *commission has not had sufficient time to consider in detail the problem presented—more particularly, whether in a case under § 6(b) it has the power to condition its order of exemption in such manner as to preclude the use of the convertible aspect of the preferred stock approved by the state commission;* that the *usual and more orderly procedure would be to set the matter down for oral argument before the commission, giving all the parties the right to be heard,* following which the commission, after full consideration of the contentions of the parties and a thorough analysis of the facts and of the law, would make a determination through entry of its findings and opinion and order, the publication of which would disclose the reasoning in support of the position taken by the commission; *and that any expression of opinion in advance of such an opportunity for the commission thoroughly to analyze the problem and reach an informed judgment in light thereof must be considered tentative only, lest the commission be unjustly accused of having rendered a decision on such an important question without fully considering the problem.*

(2) That the commission is presently of the *tentative view* that the issuance of convertible preferred stock is not necessary or appropriate in the interest of investors, consumers, and the public; *and that, if it finds* upon analysis that *it is empowered so to do,* it is presently of the *tentative opinion* that it would refuse to permit the issuance by Wisconsin Electric Power Com-

pany of preferred stock with a conversion privilege. However, it was made clear that the *commission could not and would not take a definite position for or against the issuance of convertible preferred stock except after giving to the problem the thorough consideration and analysis referred to in (1) above and in the manner there outlined, and except through issuance of an opinion expressing the reasoning in support of the determination then made.*

(3) That it appears that *the commission's powers as respects the purchase by The North American Company of the new preferred stock of Wisconsin Electric Power Company are greater than those under § 6(b);*[6] *and that the commission can at this time give no assurance that it would permit North American to purchase convertible preferred stock of Wisconsin Electric Power.*

Judge Healy, at the end of the discussion, recorded himself in the following limited manner: "Everything I have said regarding this entire matter should be considered purely tentative. *It is unfortunate that we find ourselves in a position where, by some informal indication or expression of view, we may be left in the public attitude of having turned down something, or discouraged or prevented it, without any opportunity to spell out our reasons. The very tentative notions which I have voiced indicate a preference against the conversion feature. Whether I would want formally to vote against the conversion feature after giving to the problem the thorough analysis and detailed consideration it deserves and which we should have an opportunity to make prior to expressing an opinion, I do not know. Beyond what I have said I am not willing to go except after the matter has been thoroughly explored at a hearing, oral argument heard, the legislative history of § 6(b) studied, briefs considered, and the commission has had a full opportunity to thoroughly consider its powers and duties."*

Mr. Frank and Mr. Eicher concurred in those views.

The commission then stated that it was tentatively of the opinion that the alternative proposal of Wisconsin Electric Power Company, involving the issuance of 4¾ per cent preferred stock without a conversion privilege and the offer of one share of such stock, together with one share of common stock, in exchange for the outstanding shares of 6 per cent preferred stock, and the exchange of North American's present holdings of 6 per cent preferred for the new 4¾ per cent preferred of Wisconsin Electric Power Company to be followed by an immediate conversion into common stock of $2,000,000 of the new 4¾ per cent preferred stock thus received by The North American Company, would be found to meet the requirements of the applicable provisions of the act; and that the commission is tentatively of the view that the accounting procedure followed by the Wisconsin Electric Power Company, if approved by the Wisconsin Public Service Commission, would not meet disapproval by the commission.

[6] The reader will recall the discussion above of the exclusive jurisdiction by the SEC of such an acquisition by North American, the holding company.

commission, *three of the five SEC commissioners, Healy, Eicher, and the writer,*[7] *conferred for several hours with Chairman Peterson of the Wisconsin commission, Mr. Colbert, and officers of the North American and Wisconsin companies.*

Mr. Colbert, accordingly, knows exactly what was said at that conference by the SEC commissioners. Yet he fails to state all the facts and states others incorrectly. For example, in his article he nowhere even intimates that there was such a conference or that he participated, but states, mysteriously, that "information was received" by him "that indicated the probability" that there were certain alleged reasons described by him, which led the SEC to object to the conversion privilege; *and he then goes on to state the circumstances in such a way as to make it appear that the Wisconsin Company was flatly told by the SEC that its application for a 6(b) exemption would be denied (which is not the case) and that the Wisconsin Company would not be given an SEC order permitting it to sell the convertible preferred stock which the Wisconsin commission was ready to approve.*

LET us look at the *official minutes* of the meeting of the SEC for April 4, 1940, *contemporaneously and permanently recorded in the official minute book by its recording secretary.* From a reading of these minutes there can be no question of what actually took place. They are set forth on page 264.

Those contemporaneous minutes, reciting what Mr. Colbert unquestionably heard, do not at all resemble Mr. Colbert's narrative. Those minutes make this unmistakably plain:

(1) The SEC commissioners called attention emphatically to the fact that they were hesitantly expressing their informal views.

(2) *Those views were underscored as being "purely tentative"; they might not have been adhered to after more elaborate consideration.*[8]

Surely the utterances of the SEC as to its statutory powers under § 6(b) —repeatedly worded as "purely tentative," "tentative only," an "informal indication"—were anything but dogmatic, absolute, or final. No doors were slammed. *Every indication was given that the matter was still subject to*

[7] Commissioner Mathews had already resigned and Commissioner Henderson was unable to attend.

[8] The SEC has, not infrequently, after argument in a matter, abandoned doubts it had earlier entertained.

In the matter of the fees of the principal underwriters of an issue of the Dayton Company's bonds, Mr. Brownell, of Davis, Polk, Wardwell, Gardiner and Reed, counsel for Morgan Stanley & Co., was recently, on April 13, 1940, arguing before the SEC that a rule, made by the commission, on the subject of the fees of "affiliated" underwriters was invalid. In his opening remarks he said:

"Mr. Brownell: *I am in the position,* where we often find ourselves in this connection with administrative procedure, *of urging you gentlemen to reverse yourselves* on a rule which you yourselves have adopted and also of asking you to find that a case which was brought as a result of your own order to show cause and was tried by your own staff is not a well-founded case.

"Chairman Frank: That will not have been the first time.

"Mr. Brownell: It will not, as I was going to say, Mr. Chairman, have been the first time and I was going to add that *I know that when this commission sits in its judicial capacity it considers questions that come up from its legislative branch, as it were, and its executive branch, with the same disinterestedness as the Supreme Court would consider a question that came from Congress or that came from the Attorney General's office.* I would also add that although in the last seven years I have appeared before the commission a good many times, and I have worked with the administrative departments a good many times, *I have never appeared before the commission* en banc, *when it was sitting in its judicial capacity, without getting a full, fair, and considerate hearing, and a determination of facts and the law which was unprejudiced and fair."*

further exploration and discussion: "The commission," it said, *"could not and would not take a definite position for or against the issuance of the convertible preferred.... The commission has not had sufficient time to consider* in detail the problem presented, more particularly *whether in a case under § 6(b) it has the power to condition its order so as to preclude the use of the convertible aspect of the preferred stock approved by the state commission...."*

That is not the language of Federal officialdom ruthlessly and inflexibly asserting its jurisdiction so as to reduce state commissions to "administrative rubber stamps." It is, all too obviously, the language of Federal officials with open minds as to their statutory powers and duties, and hesitantly and contingently uttering a revocable informal curb-stone opinion, an opinion which they insisted must not be regarded as their final decision, since a final decision in the particular case would require far more mature deliberation.

(3) Aside from the question of the issuance of the convertible preferred by the Wisconsin Company under § 6(b), there was tentatively considered the question of the validity of *acquisition* of the conversion privilege by the controlling holding company, North American, under § 10—*a matter nowhere even mentioned in Mr. Colbert's article.*

This is significant, since the SEC had exclusive jurisdiction of that acquisition and because Mr. Colbert remarks in his article that the effect of that acquisition on the holding company was not a proper subject for consideration by the SEC in connection with the proposed financing. He could not plausibly have asserted that attitude (a) had he called attention to the fact that that acquisition by the holding company was an inherent part of the program and (b) had he referred to and described the requirements of § 10 with respect to such acquisitions by holding companies.

No further advice was given by the SEC or its staff to the companies on the subject.[9] Two days after the April 4th conference, the companies, without seeking a formal argument before the commission on the questions tentatively raised by their applications, voluntarily withdrew those applications and substituted others, in accordance with the alternative plan (discussed at that conference) involving no conversion privilege. Those applications, after a hearing, were approved by the SEC (SEC Holding Company Act Release No. 2026) and, as to the action of the Wisconsin Company, by the Wisconsin commission.[10] The securities were subsequently issued.

In the circumstances, it is obvious that the informal and tentatively voiced objections by the SEC to the conversion privilege became wholly academic, and that *it is simply contrary to fact that the SEC issued any order which had the effect of overruling or disagreeing with any order or views of the Wisconsin commission.*

As above stated, the SEC, out of a desire to be coöperative, is, at the request of an applicant, usually willing, in advance of an argument, or mature deliberation, to express its tentative views

[9] Mr. Colbert in his article refers several times to the views of the public utilities division of the SEC. He is entirely aware, however, of the fact that whatever views may have been tentatively expressed by that division were superseded by the tentative views expressed by the SEC commissioners at the conference which he attended.

[10] In Mr. Colbert's article he purports to describe the alleged objections advanced by the SEC to the conversion privilege. As its actual but tentative objections were never finally considered and became academic—because of the revision by the companies of their applications—it will serve no useful purpose to discuss in what respects Mr. Colbert misstates those tentatively expressed objections.

in matters of this character. That, at the request of the North American and Wisconsin companies, and the Wisconsin commission, it expressed such tentative views in this case surely did not justify Mr. Colbert in misdescribing the position the SEC took; *i. e.*, did not justify him in asserting that the SEC exceeded its statutory authority, prevented the Wisconsin Company from issuing securities in accordance with the approval order of the Wisconsin commission, and, in doing so, unlawfully assumed jurisdiction of securities of local utilities and exerted, by broad administrative prerogative, an assumption of power which (he says) will "nullify state regulation of securities of local operating utilities" and which, if "not stayed" will have the result that "state commissions will have little real authority over security issues of local utilities."

IT would be unfortunate — and it would surely be regretted by those in the utility industry—if the SEC decided no longer to give expression to such tentative views because in so doing it risked such misrepresentation.[11]

That Mr. Colbert has given a grossly inaccurate account of the *facts* as to the position taken by the SEC is apparent. It follows that his *conclusion*—based solely on that inaccurate account —as to the purposes of the SEC, is equally erroneous.

It may be that Mr. Colbert's reference to and quotation from Commissioner Healy's concurring opinion in the West Penn Power Company Case were for the purpose of indicating that Commissioner Healy disagreed with the majority of the commission in the Wisconsin Company matter. If that was his purpose, then again he was in error. For, having attended the conference, Mr. Colbert was well aware that, as the SEC minutes (see page 264) show, Commissioner Healy was entirely in accord with his colleagues in that matter. There was no inconsistency between the views expressed by Commissioner Healy in the concurring opinion in the West Penn Case and those tentatively expressed five days earlier by the commission at the conference on the Wisconsin matter. That, in referring to the West Penn Case, Mr. Colbert was using a red herring will be clearly apparent to anyone who troubles to read the opinions in the latter case. (SEC Holding Company Release No. 2009.)

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[11] Cf. *Columbia Gas & Electric Corp.* (1939) 4 SEC 406, 422, where the commission said:

"If tentative prehearing discussions (which aid representatives of corporations in determining what action they should take under the act) could operate as estopping us from acting in such manner as we find to be our duty under the statute, after the formal record is made in the case, then we would be compelled to stop such conferences. Otherwise, the statutory provisions with respect to notice and hearing would become a dead letter. This point has been summarized by Commissioner Healy in his opinion in *In the Matter of International Paper & Power Co.* (2 SEC 274 at 290-291), as follows:

"'It is also suggested by applicant's counsel, and others, that before the pending application was filed a conference was held between representatives of the company and representatives for this commission in which commission approval was given to the method of procedure adopted by the company in the pending application. I agree, of course, that, especially since we are dealing with a new statute, it is desirable to confer with those having business before us and to give them all possible aid in getting their problems passed on, but all such discussions must be regarded as purely tentative, as not the equivalent of a decision by the commission after hearing and argument.... It would be unfortunate if a different view were taken which might force the commission into a position where it would not confer with the companies as freely as heretofore.'"

But there are broader and more fundamental matters which the writer cannot allow to remain in doubt. There should be no mystery about the long-range objectives (founded entirely upon the provisions of the act) of the SEC's utility program; the commissioners as well as members of its staff have attempted to acquaint the industry fully in this respect. The commission has definite and specific statutory obligations. It does not, as some would like to make the public believe, undertake policies without statutory sanction, or arbitrarily intrude itself on managerial judgment.

Its limited veto power over the issuance of securities by utility holding companies and their controlled subsidiaries is explicitly set forth in provisions of the Holding Company Act, modeled somewhat upon § 20 of the Transportation Act of 1920, pursuant to which the Interstate Commerce Commission, for two decades, has been exercising a similar power with respect to the issuance of railroad securities.[12]

The Public Utility Holding Company Act, as everyone well knows, arose out of the exhaustive investigation conducted by the Federal Trade Commission and congressional committees; the reports of these investigations do not make pleasant reading.[13] Congress attempted to eliminate specific evils and abuses, and, in great detail, enacted a statute which called for a definite program which the commission was instructed to carry out. This program was explicitly directed to the restoration of reasonably localized utility management and effective local regulation.

It is the express purpose of the integration provisions in particular to restore vitality to "localized manage-

[12] When William Howard Taft became President he sponsored a statute giving the ICC control over the issuance of railroad bonds and stock. He was bitterly assailed on the ground that such a law would mean interference with managerial judgment and with state regulation.

President Taft also urged the enactment of a Federal incorporation law, one of the purposes of which was to abolish holding companies that fell within its scope.

A subcommittee of the Senate Committee on Interstate Commerce, of which Senator Wheeler—one of the two chief sponsors of the Public Utility Holding Company Act of 1935—is chairman, on July 29, 1940, issued a report on its investigation of railroads, concluding that the facts therein contained "indicate the difficulty, if not the impossibility, of state regulation of [railroad] holding companies." See additional report of the Committee on Interstate Commerce pursuant to S. Res. 71 (74th Congress), being Report No. 25, Part 8, 76th Congress, 3rd Session, pp. 19-20.

[13] Congressman Sam Rayburn, one of the two principal sponsors of the Holding Company Act, reviewing a portion of those investigations, said on the floor of Congress on June 27, 1935, of public utility holding companies:

"These creatures of legal ingenuity are operated by a few clever men. They are used as the agencies for disfranchising stockholders of thousands of necessary and prosperous operating companies. They are used to take the control and direction of these local companies away from those who built them and place it in a city oftentimes far removed. Through the simple device of pyramiding, a small investment by those in control of the top holding company enables them to do as they like with hundreds of millions, and in some instances even billions, of other people's property. This pyramiding, supplemented by the use of service contracts and sometimes other practices, makes for a concentration of management that is staggering to the imagination.

"The holding company has developed to where control is exercised through a maze of intercorporate relationships, impossible to be understood by the ordinary man. The holding-company device has been pyramided to give a few small but powerful groups control of the billions of dollars of the public's money invested in the utility industry. This places the great utility properties of the country in the control of men who themselves have only a small stake in their real ownership and who have shown neither prudence nor capacity in the management of these properties. And then the banking houses control the holding com-

ment" and local regulation of the local operating company. Indeed the entire legislative program is so drawn that if the commission carries out the provisions of the act, brings about integrated systems and breaks down many of the present complicated capital structures, local management will reassert itself and the commission's limited review of management, when controlled by holding companies, will disappear or at least approach the vanishing point.[14]

Anyone who follows the work of the commission closely knows that from week to week we are allowing many 6(b) exemptions with few or any important conditions attached.[15] It has seemed best to adopt, in that respect, the traditional case-to-case method, as Congress clearly contemplated, and to examine each security issue in the light of the applicable circumstances.

Plainly there was no "strong-arming" of § 6(b) in the Wisconsin Electric Power Company matter. Furthermore, it will again be recalled that the commission also had before it an application under § 10 which gives the SEC exclusive jurisdiction of the acquisition of the securities of a local utility company by a holding company. Given a situation such as existed in the Wisconsin Company Case, where the commission had at least a limited jurisdiction of the sale of the securities by the local utility company and also an exclusive jurisdiction of the acquisition of a large portion of such securities by one of the principal purchasers, it is clear that the operation of one section of the act could not be examined apart from the other. This is exactly what Congress intended, for it desired that the commission should closely supervise interholding company system financing to make certain that the objectives which it had in mind were carried out.

ONE final word. Our entire utility program is so designed that we may—as we do—work in coöperation with the state commissions. Under the

panies which control the operating companies.

"Whole states are served with power, with gas, by operating companies in the charge of employees who have no authority, no independence of judgment. The people who complain of the high rates charged, or of the quality of service, have to carry their complaints to the men who have no authority to act, who have to get on the telephone or write a letter to New York city, who are subject to removal by those in the top companies without notice. . . .

"What is needed is to take from the backs of the clean, honestly operated operating companies of this country these leeches and bloodsucking holding companies, who perform no service, but who are milking to death the local operating companies under their control and are milking those who have invested their hard-earned money in the securities of these local operating companies. Over *three-fourths* of the investor's money in the utility industry is directly invested in securities of the *operating* companies, not the holding companies. The average investor does not own any stock of a holding company but of an operating company."

[14] See, for instance, the following, written by the writer, which, among other things, explain the integration provisions of the statute and show how their enforcement will, without injury to investors, revitalize localized management: "Corporation Management and the SEC," an address before the American Management Association, January 25, 1940; "SEC Sees Integration Aiding Utility Industry," an article published in the *Electrical World*, April 13, 1940; "Integration and Utility Investors," an article published in *The Annalist*, June 6, 1940.

[15] In a concurring opinion in Southwestern Gas & Electric Co., SEC Holding Company Act Release No. 1931 (February 16, 1940), the writer said: "Many cases of refunding issues have arisen under the express statutory exemption created by § 6(b). Accordingly, the requirements of § 7, including, of course, § 7(d)(3), were inapplicable. See Public Service Co. of Indiana, Holding Company Act Release No. 1826; Central Illinois Electric & Gas Co., Holding Company Act Release No. 1591; Northern Indiana Public Service Co., Holding Company Act Release No. 1836."

express provisions of the Holding Company Act itself, state commissions have an express right to intervene in any SEC proceeding affecting them. The courts are also open to any state commission which believes that the SEC in any case has unlawfully encroached on its jurisdiction, as § 24 provides for judicial review of our orders in an appropriate Federal court.

Far more important, however, is the fact that in the exercise of its statutory duties and powers the SEC has, whenever time permitted, held conferences with the state commission having jurisdiction over an operating utility subsidiary which applies for permission to issue securities.

Several months ago the commissioners conferred at length with the members of the Pennsylvania commission on problems of common interest; and more recently we have been in communication with the New York commission. We recently agreed, at its request, to hold a joint hearing with the District of Columbia commission with respect to the issuance of securities by a local operating subsidiary of North American. Even more recently, we have agreed to make a public investigation of certain utility service charges at the specific request of the public service commission of the state of Vermont which asked our help, stating that it had reasonable grounds to believe that the allocation of charges being made in the particular situation were "unfair and inequitable and that the services are unnecessary."

The SEC has coöperated with state commissions. It will continue to do so. It trusts, therefore, the contrary impression which Mr. Colbert endeavored to create by his inaccurate and misleading article will not be taken seriously.

IN conclusion, it may be added that the foregoing remarks are based on the thought that Mr. Colbert's article reflected solely his own attitudes and not those of the Wisconsin commission of which he happens to be an employee. The relations of the SEC with that commission have always been most cordial. We see no reason why they should not continue so. Indeed, since the Wisconsin Electric Case has been concluded, the SEC has had numerous occasions for exchange of correspondence with the Wisconsin commission relating to matters of mutual interest; the Wisconsin commission has, in particular, expressed its appreciation of our coöperation in supplying it with information on the progress of various pending integration proceedings, under § 11, in which it is interested.

¶ "OUR *entire utility program is so designed that we may—as we do—work in coöperation with the state commissions. Under the express provisions of the Holding Company Act itself, state commissions have an express right to intervene in any SEC proceeding affecting them. The courts are also open to any state commission which believes that the SEC in any case has unlawfully encroached on its jurisdiction, as § 24 provides for judicial review of our orders in an appropriate Federal court.*"