STATEMENT

OF

GANSON PURCELL

CHAIRMAN OF THE SECURITIES AND EXCHANGE COMMISSION

BEFORE

THE

SUBCOMMITTEE OF THE HOUSE COMMITTEE

ON INTERSTATE AND FOREIGN COMMERCE

Monday, March 25, 1946.

We are here today to continue our statement in behalf of the Securities and Exchange Commission in response to the Committee's invitation to submit comments on possible amendments to the Holding Company Act.

Our presentation will consist of the following parts: First, I shall outline certain general considerations forming the background against which any specific amendments must be viewed. This background material is brief, almost to the point of presenting you with an inadequate picture of the data and information which will be helpful to you in considering these amendments, but, because of the expressed desire of the Committee for brevity, we have not attempted to give you more adequate background materials. Second, we shall comment on the various amendments which have been proposed by industry witnesses in the past few months. Mr. Milton H. Cohen, Director of our Public Utilities Division who appeared previously on November 12, 1945, will present these comments, which will constitute the greater part of what we have to say. Third, after Mr. Cohen has given you our comments on these various proposals to amend the Act, I will give you our recommendations on the question of whether the Act is in need of amendment. Finally, I will have some brief comments concerning the public power question which has been brought into the proceedings from time to time by the various witnesses. Both Mr. Cohen and I, of course, will be available to answer questions on any aspects of our presentation to the best of our ability.

Our testimony will cover only the major points raised by the industry witnesses. The testimony of the industry witnesses, as well as the testimony of the non-industry witnesses who appeared to propose changes in the Act, contain, we believe, many factual misstatements which should not be allowed to stand uncorrected in the record of these proceedings. We will not, however, take the time to point these out to the Committee in our oral

testimony, but we beg leave within a few weeks after the termination of our oral presentation to submit to you a written memorandum for insertion in the record correcting such erroneous statements.

Chairman Boren has stated on the record of these proceedings on numerous occasions that the design and purpose of the Subcommittee is not to cover any fundamental change in the conception of the Holding Company Act, but merely to consider administrative problems arising in ten years' experience under the Act which might necessitate minor changes to plug up loopholes and the like. If the industry witnesses had adhered to this clear limitation of the scope of this inquiry, the material to be presented by Mr. Cohen commenting on the specific amendments would have undoubtedly been far briefer and more promptly presented. But instead, as we will later demonstrate, the industry witnesses have proposed fundamental and far-reaching amendments -- no less so because they may have been presented under the guise of minor verbal changes or with disclaimers of drastic intent -- and we have no other course but to take the time necessary to demonstrate exactly how fundamental and far-reaching the amendments would be and why the public interest and the interest of investors and consumers requires that they be rejected.

I do not know to what extent the presentation of the various industry witnesses has resulted from concerted planning through industry-wide organizations, such as the National Association of Electric Companies. But I think it is interesting to note the following phenomenon which may be a mere coincidence: Practically every industry witness stated that he was not proposing fundamental or numerous changes in the law. Yet, when we fit together, like pieces in a jig-saw puzzle, the two or three suggestions coming from each of the numerous witnesses, under the guise of "clarifying amendments", we find that altogether they reach substantially every provision in the statute and that their combined effect would be to remove or restrict

every important regulatory provision of the statute and substantially to destroy its effectiveness as a regulatory measure.

Thus, one witness proposes a so-called called clarifying amendment in Section 2 or Section 11, another in Section 3 or Section 13, another in the text of Section 5 or 21 but relating to Sections 6, 7, 9, 10, 12 and 15. One witness suggests broadening the exemptions while another would cut down the regulation of non-exempt companies. One amendment would remove restrictions against retaining non-utility subsidiaries, another would remove the power to regulate those which are retained. One amendment would modify the size standard of Section 11 (b) (1), another deals only with the geographic standard, and a third would change the burden of proof of that Section. One witness touches only on Section 11 (b) (1), another only on 11 (b) (2), and so on. Add them all together, the two or three changes here and there suggested by each of the industry witnesses, and the Holding Company Act is gone. Hence, we feel that it is of highest importance to demonstrate how far the witnesses have gone beyond the Subcommittee's original purpose, and how fundamental and far-reaching and drastic the proposed amendments really are. Since these amendments relate to every important provision in the statute and potentially raise anew every fundamental question of policy entering into its legislative history, and since the proponents have, all told, covered some 700 pages of the transcript in stating their views, our statements on such amendments must necessarily be somewhat extensive even though we confine them to the barest essentials.

Before we turn to the amendments themselves, we think it necessary to recall very briefly the situation which led to passage of the Act, the purposes which it was intended to accomplish, and what has in fact been accomplished since its enactment.

We deem it unnecessary to take the Committee's time to recall to it in any detail the evils and abuses which moved Congress to enact the Holding Company Act. As the Committee is aware, the Holding Company Act was passed with express reference both to the comprehensive study of the industry contained in the 90 odd volumes of Reports of the Federal Trade Commission (70th Congress, 1st Session, Document 92), which has been characterized as "the most thoroughgoing investigation of an American industry that has ever appeared" [Barnes, The Economics of Public Utility Regulation], and to the 6-volume Splawn Report of the House Committee on Interestate and Foreign Commerce (73rd Congress, 2nd Session, House Report No. 827). I respectfully refer the Committee to Volume 72-A of the Federal Trade Reports which contains a well documented summary of the findings of the previous volumes, and to Volume 73-A which marshalls the numerous evil conditions and practices then prevalent, some of which may be quoted as follows:

> "1. Pyramiding companies owning or controlling the operating companies for the purpose of enabling a minimum of investment to control a maximum of operating facilities, involving a greedy and highly speculative type of organization detrimental to the financial and economic welfare of the Nation.
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> "2. Loading the fixed capital account of public utilities with arbitrary or imaginary amounts in order to establish a base for excessive rates.
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> . . . . .
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> "5. Exaction of payments from affiliated or controlled companies for services in excess of cost or value of such services.
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> "6. Gross disregard of prudent financing in excessive issues of obligations, imperiling the solvency of the company and involving excessive charges for interest, discount, commissions, redemption, etc.
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> . . . . .

"13. Deceptive or unsound methods of accounting for assets and liabilities, costs, operating results and earnings, including write-ups unrealized or fictitious profits, stock dividends, etc.

"14. Corporate organization which gives powers inconsistent with a just division of responsibilities and emoluments as between various groups or parties furnishing capital by loan or by contribution, either directly or indirectly by purchase, succession, or otherwise:

. . . . .

"17: Intercompany financing on a basis disadvantageous to operating company borrowers or lenders.

"18. Evasion of State laws in effecting sales of security issues.

In characterizing these practices and conditions the Federal Trade Commission stated:

"In the last analysis the foregoing practices and the conditions which they have created must be judged not only by economic results but by ethical standards. It is not easy to choose words which will adequately characterize various ethical aspects of the situation without an appearance of undue severity. Nevertheless the use of words such as fraud, deceit, misrepresentation, dishonesty, breach of trust, and oppression are the only suitable terms to apply if one seeks to form an ethical judgment on many practices which have taken sums beyond calculation from the rate paying and investing public."

In Section 1 of the Act Congress expressly referred to the evil practices and conditions which were prevalent and declared, in Section 1 (c), that the policy of the Act, "in accordance with which policy all the provisions of this title shall be interpreted, /is/ to meet the problem and eliminate the evils as enumerated in this Section, . . ." It is important to note that it was not the Federal Trade Commission or the S.E.C. but the Congress itself which made and declared this policy which underlies the Act and furnishes the fundamental basis for interpreting its provisions. Moreover, the adoption of such policy by Congress was preceded

by a legislative history which, in addition to the comprehensive investigations by the Federal Trade Commission and the Splawn Committee to which I have referred, included extensive hearings before the House and Senate Committees and debate on the floors of Congress. The hearings before the House Committee consumed 33 days and the record of the hearings, which exceeds 2300 printed pages, includes the testimony of about 50 witnesses, representing the industry and the Government, and communications from some 30 other persons, including public utility and holding companies. The hearings before the Senate Committee took 11 days and cover in excess of 1100 printed pages containing the testimony of 21 witnesses, memoranda submitted by representatives of the Government, and briefs submitted by holding companies and other representatives of the industry. The debates in Congress covered a period of some 7 months and are contained in some 730 pages of the Congressional Record.

The disastrous effect upon the investing public of the conditions and practices to which I have referred is graphically illustrated in statistics which indicate that from September 1, 1929 to April 15, 1936, fifty-three (53) holding companies went into receivership or made applications for relief under Section 77B of the Bankruptcy Act. The aggregate capitalizations of these holding companies represented by their outstanding securities in the hands of the public totaled in excess of $1,600,000,000. Twenty-three (23) additional holding companies with publicly-held securities exceeding $530,000,000 offered readjustment or extension plans after

defaulting on interest payments. As to the preferred stocks of holding companies, while we do not have available the statistics as of 1935 we do have them as of December 31, 1938, the year in which most of the holding companies registered following the decision of the United States Supreme Court upholding the constitutionality of the registration provisions of the Act. They indicate that, as of December 31, 1938, registered holding companies had outstanding in the hands of the public $2,083,000,000 of preferred stock (on an involuntary liquidating basis), of which more than half, or $1,169,000,000 were in arrears, the total arrearages as of that date aggregating approximately $282,000,000.

Serious injury also resulted to investors in many of the public utility operating subsidiaries of the holding companies. From September 1, 1929 to April 15, 1936, thirty-six (36) public-utility operating companies with outstanding securities in the hands of the public of $345,000,000 went into bankruptcy or receivership. Sixteen (16) additional companies, with $154,000,000 of securities outstanding in the hands of the public offered readjustment or extension plans after defaulting on interest payments. Public investors in the preferred stocks of operating companies, totalling $1,508,000,000 at December 31, 1938, also suffered seriously. Mismanagement and exploitation by holding companies through excessive service charges, excessive common stock dividends, upstream loans, and an excessive proportion of senior securities, were among the factors which led to an accumulation of arrears at December 31, 1938, of $90,000,000 on preferred stocks of the face amount of $412,000,000.

The Federal Trade Commission Reports demonstrate that, in the organization and growth of public-utility holding company systems, the leading roles were not played by engineers and other experts in the operations of public utility companies, but by investment bankers who created some of the largest of such systems for the purpose of obtaining new clients or protecting existing banking relationships. Thus, J. P. Morgan & Co. and others organized the super-holding company, The United Corporation, and as a result found themselves, as the Federal Trade Commission reported, "in practical control of a network of utilities that extended, with only one important break, from the Great Lakes and the St. Lawrence River to the Gulf of Mexico". (Federal Trade Reports, Volume 72-A, p. 111.)

Similarly, H. M. Byllesby & Co., investment bankers, controlled the vast Standard Gas and Electric Company system. This system, comprising over $820,000,000 of assets, was subjected to intense andbitter competition between various investment banking groups for control. Standard Gas was among those holding companies which later was forced to file a voluntary petition under Section 77B of the Bankruptcy Act.

The evil practices and conditions to which I have referred flourished in spite of such regulation as then existed. Then, as now, some members of the industry urged that State laws and administrative measures so protected the public interest that not even Federal investigation of holding company systems, apart from Federal regulation of such systems, was called for. But the Federal Trade Commission, and subsequently the Congress, found State regulation inadequate, largely because such regulatory

efforts were circumvented and frustrated through the holding company device: While the State commissions dealt with local officials, they in turn were subject to the authority of the absentee managers in the holding company who were located in remote financial centers without concern or responsibility toward local development, but interested primarily in the financial emoluments attendant upon control. They deliberately created corporate complexities to baffle State commissions or to circumvent State inquiry. A State utility commission might have complete jurisdiction over the accounts, records and practices of the local operating company, but it still could not ascertain the most elementary facts pertinent to effective regulation without examining the holding company's books which were usually inaccessible.

In this connection, I should like to take a moment or two to read a few passages from a document in the public records of the Commission which furnishes a concrete example, and to distribute copies to the Committee. This document, dated in 1927, is from the files of Electric Bond and Share Company, a holding company controlling 14% of the electric energy in the United States. It seems that the operating properties of the Electric Bond and Share system in the State of Pennsylvania were being reorganized into a larger operating company, and that one of the company's financial experts had drawn up a reorganization program. This program was reviewed by one of the Electric Bond and Share lawyers - a lawyer who later became president of the system - and he made the following comments, among others:

"As a general comment I suggest that as far as possible both reorganizations be run at the same time and in connection with each other; that is all agreements and all plans of reorganization should be laid so that no one will be able to separate one part of the reorganization from the other part. My reason for this is that while in the Pennsylvania Power & Light reorganization the increase in the Plant Account is apparently not so large, the increase of the Plant Account in the so-called Susquehanna Power & Light reorganization is tremendous, and we must not forget that in Pennsylvania the Commission has the right to approve or disapprove the acquisition of utility properties by a public utility.

"I suggest, therefore, so that the Commission will find it much more difficult to unravel the cost of the various properties, that we go before them with a plan that contemplates both the transfer of certain properties to Pennsylvania Power & Light Company as well as the formation of a new utility company and also the transfer to the Lehigh Valley Transit Company of the railway properties, so that it will be practically impossible for anyone to find out what the cost of any individual property was or the cost of any particular group of property. I believe that while you could get the Commission to approve your Pennsylvania Power & Light reorganization they would not approve the Susquehanna Power & Light reorganization, but they might be willing to approve the reorganization of all your properties in Pennsylvania if it would be impossible for anyone to determine at what figure the various properties were going into the whole reorganization."

Now skip two pages:

"I again desire to impress upon you the importance, in my opinion, of scrambling all these reorganizations together so that about the only thing the Pennsylvania Commission will be able to understand will be the result and not how the result was reached. Root's reorganization, in my opinion, is too simple and too easy to follow, particularly the Plant Account of the Susquehanna reorganization from $25,000,000 to $61,000,000 through a merger. I also desire to call your attention to the fact that Mr. Sawyer desires to talk over this whole matter with Governor Fisher of Pennsylvania, and I believe that we do not want to put Mr. Sawyer in the embarrassing position of giving him a plan to submit to the Governor, which the Governor would approve if no figures were presented to him, and then have the Commission refuse to approve the transfer of the utility properties because of the tremendous increase in Plant Accounts. The net result of Root's plan as I see it is to have the whole Susquehanna situation cost Lehigh [—that is, the holding company] nothing, and while I believe that is a very salutary result in the ordinary case,

> I do not believe that we ought to risk obtaining this result by damaging our reputation before the Pennsylvania Commission. Such a result, in my opinion, might start an investigation into our whole rate and financial structure in Pennsylvania and lead to all sorts and kinds of consequences."

While this memorandum itself is an interesting document, to say the least, in some respects its most striking feature consists of certain comments written in the margin by the author of the plan which was under criticism. For example, where the memorandum emphasized the importance of "scrambling" for purposes of obscurity, the marginal comment reads:

> "This plan at its present stage is for home consumption only, and I tried to make it simple for that reason. Is not scrambling just a matter of presentation?"

And where the memorandum pointed out that there might be an investigation into the whole rate and financial structure in Pennsylvania if it were known that the holding company's cost was zero, the marginal comment reads "Don't see how Commission" - that is the Pennsylvania Commission - "will see original costs, as they are all on Lehigh books". Lehigh was a Delaware corporation whose books were kept in New York.

It will be noted that the importance of accomplishing a writeup in the accounts of the operating company was taken for granted, so that the discussion was confined to the methods of concealment. The objectives also included realizing the maximum capital gain possible for the holding companies involved, together with the achievement of a maximum leverage position for Electric Bond and Share - that is, absolute control with a minimum or no investment.

The consequences to the public involved in the transactions become apparent when they are followed through in the form they finally took. The Pennsylvania company emerged with its Plant Account (and no doubt it was hoped, its rate base) expanded by some $85,000,000, which the operating company paid for by the issuance to the public of bonds, debentures and preferred stock. Of this amount $13,000,000 constituted immediately realized profit to the holding companies involved, of which $4,300,000 was derived by Electric Bond and Share itself. Studies recently concluded by the Federal Power Commission reveal that only $37,000,000 of the $85,000,000 represented the original cost of the utility assets. The excess of $48,000,000 consisted of approximately $18,000,000 of writeups and the system profits to which I have referred, some $17,500,000 of acquisition costs incurred by the Bond and Share system, and approximately $12,700,000 of capitalized debt discount and expense. These facts indicate that all of the objectives were accomplished, -- the rate base was grossly inflated, a substantial profit was realized by the holding companies; and Bond and Share attained a maximum leverage position on the residual earnings of the properties, having recaptured its entire investment through sales to the public of senior securities.

However, in 1939 the Pennsylvania company, prior to requesting approval of the Commission of a refunding of its debt securities, removed from its Plant Account the financing costs of $12,700,000 to which I have referred. Further, pursuant to an order of the Federal Power Commission under the Federal Power Act, on December 31, 1945, the Pennsylvania company removed from its Plant Account approximately $26,200,000 of inflationary items and provided for the amortization of some $25,900,000 of additional intangibles. In addition, in a plan of recapitalization recently consummated in compliance

with the standards of Section 11 of the Holding Company Act, approximately $18,000,000 in cash was invested in the common stock of the Pennsylvania company, giving it its first real equity, and, further, provision was made for building up this equity to reasonably conservative proportions in the next few years. Of the $18,000,000 of such cash investment, $9,500,000 was invested by the public, and $8,500,000 by Bond and Share. This investment by Bond and Share represents its first real cash investment in the equity of the Pennsylvania company since 1920, when the company was organized under Bond and Share's auspices. Since that time, Bond and Share's subsidiary holding companies received in cash dividends from the Pennsylvania company in excess of $61,000,000, a substantial portion of which was in turn disbursed to Bond and Share. In addition, from the Pennsylvania company's inception to 1939, the Pennsylvania company paid to Bond and Share and its subsidiary service companies approximately $11,000,000 in servicing fees, on which, Bond and Share estimates, its profits aggregated $4,300,000.

I should like to supplement our relatively brief reference to the situation obtaining prior to the passage of the Act by furnishing to the Committee copies of a document entitled "Summary of Economic Data" which the Commission has filed in the Courts in two or three litigated cases as a supplement to its brief. The facts and financial data therein summarized furnish indication of the extent to which the Nation's vital interest in its electric and gas public-utility companies had been seriously jeopardized by financial practices conducted in the interest of a small group of promoters and bankers; that public investors and consumers of such companies suffered heavily as a result of the practices which I have briefly described; and that a constructive program of rehabilitating and simplifying the corporate structures of holding company systems was highly desirable in the national interest. Such a program was provided by Congress in the Holding

Company Act; and I should like now to tell you briefly about the actual administration of the Act and what some of the accomplishments have been.

Under the Act there are registered 54 public utility holding company systems, the aggregate consolidated assets of which amounted to more than $16,000,000,000. These systems include 118 registered holding companies and 943 electric, gas and nonutility subsidiaries as set forth in a document published by the Commission entitled - Registered Public Utility Holding Company Systems, June 30, 1945; and I should like to furnish copies to the Committee. A major part of the Commission's work under this statute since 1938 has been the task of passing upon the reorganization of the complex financial and corporate structures of these systems as required by Section 11 of the Act. The provisions of Section 11 are designed to strengthen the capital structures of utility systems, to free the nation's utilities from absentee holding company domination and to return them to local management and State and local regulation. Section 11 (b) (1) of the Act requires the limitation of each holding company system to a single integrated public utility system with provisions for the retention of additional utility systems and related incidental businesses under certain designated circumstances. It is, in effect, a specialized antitrust act designed to meet the problem of the serious and uneconomic concentration of control of public utility companies. At the same time it affords holding companies the opportunity to build up and retain integrated public

utility systems. Section 11 (b) (2) provides for the simplification of the structures of holding company systems, including the elimination of unnecessary and "great-grandfather" holding companies and the reorganization of holding companies which are unduly complicated and overcapitalized, and the redistribution of voting power among security holders of holding and operating companies.

The basic provisions for carrying out Section 11 (b) are to be found in Section 11 (d), which permits recourse to the courts by the Commission, if necessary, to enforce the Commission's orders, and in Section 11 (e), which permits the filing of voluntary plans for compliance with the standards of Section 11 (b). To a very large extent, Section 11 results in the Holding Company Act being self-liquidating, for, as utility companies are freed from holding company control, the Commission generally loses jurisdiction over them under this Act.

Because there has been considerable misunderstanding on the point, I wish to make it clear that the Act does not require that an integrated utility system be broken up, whether or not it crosses State lines, or that a holding company necessary to integrate the properties of several operating companies be abolished. Furthermore, the Commission has not imposed any narrow limit on the concept of what is an integrated utility system. Recently, for example, we issued our Findings and Opinion in the American Gas and Electric case, in which we found that its $450,000,000 central system serving 1700 communities in seven states, was an integrated electric utility system and could be retained as such under Section 11.

The problem of conforming the electric and gas utility holding companies to the requirements of Section 11 (b) is a task of great magnitude. Progress under Section 11 was slow in getting under way. Although the statute was enacted by Congress in August 1935, the Commission was directed to enforce the integration and simplification provisions only "* * * as soon as practicable after January 1, 1938." In the intervening period holding companies were given an opportunity to take voluntary steps to comply with Section 11. However, the companies did not avail themselves of that opportunity but chose instead to contest the constitutionality of the Act. After the decision of the Supreme Court in March 1938 upholding the constitutionality of the registration provisions, the Commission gave all holding companies a further opportunity to submit to the Commission their plans for voluntary compliance. They responded to the Commission's invitation by submitting tentative plans which, in general, amounted to little more than attempts to justify the retention of existing scattered holdings.

It thus became clear to the Commission that compliance with the Act could be achieved only by the institution of affirmative proceedings pursuant to the statutory direction in Section 11 (b). Accordingly in the spring of 1940, the Commission instituted integration proceedings with respect to nine major utility holding company systems and corporate simplification proceedings with respect to three major systems. The two classes of proceedings are interrelated, since action taken to comply with the geographical standards may also facilitate corporate simplification, and steps taken in the direction of corporate simplification may serve to eliminate substantial problems which would otherwise require determination in proceedings under Section 11 (b) (1).

Once proceedings under Section 11 are instituted by the Commission (or are initiated by the filing of a voluntary plan), full hearings are held in which all interested parties are given the opportunity to present evidence and voice their views before the Commission. On the basis of the record before it and the contentions made as to the applicability of the law to the facts, the Commission issues its findings and opinion and order. All such orders are subject to full judicial review in the Federal courts.

In the enforcement of Section 11 (b) (2), the Commission's orders have required numerous holding companies to dissolve, many others to recapitalize so as to achieve a simple structure, and certain operating companies, where control was exercised by a class of stock which had an insufficient investment in the company in relation to the investment of all the security holders, to change their capital structures so as to achieve an equitable distribution of voting rights.

The orders issued by the Commission under Section 11 have carefully guarded against any forced liquidations or dumping of securities on the market. Although it is the Commission's view that it has the power to specify methods of compliance, its practice in most cases is to issue a general order specifying the objective to be achieved, but without detailing the manner in which the company should comply. This is intended to encourage voluntary compliance, assist the company by indicating the goal to be reached, and give the company a reasonable opportunity to work out the specific methods of compliance.

A classification of the proceedings instituted by the Commission under Section 11 (b) (1) and Section 11 (b) (2) which were pending at

the close of the past fiscal year is set forth in a tabulation which we have had prepared for the Committee's information. This tabulation shows that there were pending a total of 63 Section 11 proceedings affecting 36 separate holding company systems, including 113 holding companies and 711 subsidiary companies having aggregate assets of $14,862,000,000. This total included 16 Section 11 (b) (1) proceedings, 34 Section 11 (b) (2) proceedings and 13 proceedings involving both Section 11 (b) (1) and 11 (b) (2) issues.

These figures evidence the fact that the Commission has instituted integration or corporate simplification proceedings, or both, in regard to practically all of the holding company systems. In these proceedings integration orders outstanding on June 30, 1945 require the divestment of holding companies' nonretainable interests in 147 subsidiary companies having aggregate assets of $4,352,000,000 as detailed in an additional tabulation, which I should like to furnish to the Committee. This figure is exclusive of divestments already effected to which I shall refer in a moment.

In a number of holding company systems, as previously stated, there are holding companies which are merely pyramiding or leverage devices and perform no useful function. Many of these have already been ordered dissolved after appropriate Section 11 (b) (2) proceedings. We have prepared an additional tabulation listing the holding companies which have been ordered to dissolve or liquidate under Section 11 (b) (2) orders outstanding as of June 30, 1945. These orders are only about one-third of the 46 orders issued by the Commission prior to last June involving corporate simplification and equitable redistribution of voting power.

The figures I have given you tell only part of the story of the steps taken to enforce Section 11 of the Act. To round them out it is necessary to refer to the large number of applications filed by the

companies under Section 11 (e) and other applicable sections of the Act to comply wholly or partially with Section 11. Now, under Section 11 (e), the Commission is authorized to approve voluntary plans of reorganization submitted by registered holding companies and their subsidiaries, and to seek court enforcement of such plans if they are necessary or appropriate to effectuate the geographic and corporate simplification requirements and are fair and equitable to the persons affected. Up to June 30, 1945, a total of 146 plans had been filed with the Commission under Section 11 (e). The Commission approved 56 of these plans, frequently after securing necessary modifications; 23 were withdrawn or dismissed; 3 were denied; and 64 were pending in various stages of completion. In addition, a great many steps to comply with Section 11 have been taken under other applicable sections of the Act without the filing of Section 11 (e) plans. As we have stated in our annual reports to Congress, the filing, approval and consummation of these plans represent major achievements in the financial and operating reorganization of the utility industry.

Now, what are some of the effects of the over-all program that I have been describing? The first effect will be to convert most of the subsidiaries of holding companies into independent operating companies. It will release these companies from remote holding company control and permit the local management to be more responsive to the needs of the communities served. Moreover, by increasing the responsibility and autonomy of local management officials it will promote their self-reliance and sense of responsibility. They will have better and more attractive jobs because they won't have to take orders from a high-salaried supermanagement.

Let me say a few words about the financial effects of the Section 11 program. When we began administering the Holding Company Act the common stocks of utility operating companies comprising about 75 percent of the electric utility industry were in the portfolios of the holding companies. In turn, the holding companies, as mentioned earlier, had issued their debentures, preferred, and common stock, sometimes in a bewildering variety. Very few of the holding companies were in good financial condition and the securities of most of them were severely depressed and yielded no income to the investors who owned them. Under the Holding Company Act these situations are being cleaned up. Complex capital structures are being replaced by simple capital structures. Holding company debts are being paid off, risky holding company preferred stocks, with their huge accumulation of dividend arrearages, are being converted to common stock so as to permit once again a flow of income to the security holders. In addition, the holding companies are being reduced in size because they must slough off their scattered holdings and their security holders are receiving, either in exchange or as liquidating dividends, the common stocks of sound operating companies. This is a factor of great significance both to the operating companies themselves and to the investors who thought they had an equity interest in the utility industry but found that all they had was a speculative interest in a holding company. Under these conditions in the years to come, the operating utility industry will have a greater ability to raise equity capital on a sound basis to finance its ever-growing needs; and the investors who furnish that capital will receive their dividends directly, without being subjected to the expense and the risk of supporting an outmoded holding company organization.

In my view these developments in the public utility field will have important effects on the maintenance, expansion, commercial policies, and the public position of the companies. There is ample evidence that routine financial decisions such as the adoption of construction and maintenance budgets are more soundly and intelligently arrived at when an overburdened capital structure with its attendant pressures does not force a cramped judgment upon the managers. The ability of any business unit to adjust itself to the ever-changing circumstances of our economy rests in substantial degree upon a conservative financial and corporate structure which will permit a free choice of action based upon considerations of the well-being of the enterprise rather than one of expediency which is compelled by financial stringency.

So far I have outlined our Section 11 work in somewhat general terms. Now I wish to refer more specifically to some of the divestments of non-retainable properties already effected by the various holding companies. We have prepared a document which lists in detail all the divestments of electric, gas and nonutility properties up to June 30, 1945. We also have a table which gives an over-all summary of these divestments. You will note, by referring to the summary table, that 342 electric, gas and non-utility subsidiary companies with total assets of $4,347,000,000 were divested up to June 30, 1945. The table also shows that 292 of these companies with total assets of $3,145,000,000 or 72 percent of the properties divested are no longer subject to the Holding Company Act.

I wish to call your attention to a few of the more important cases which illustrate the practical operation of the statute as it relates to the divestment of properties by registered holding companies. First, I shall refer to some of the larger properties the common stocks of which have been sold to the general investing public through the medium of investment bankers.

In April 1940, Ogden Corporation, the successor company to the bankrupt Utilities Power & Light Corporation, sold its entire common stock interest in Indianapolis Power & Light Company to an underwriting syndicate for distribution to the public. At the time the total assets of Indianapolis Power & Light Company amounted to more than $85,000,000. In November 1943 Cities Service Power & Light Company sold all the stock of Public Service Company of Colorado to an underwriting syndicate for distribution to the public. Public Service of Colorado had consolidated assets of more than $105,000,000. Similarly, parent holding companies have marketed their common stock interests in Idaho Power Company (Electric Power & Light Corporation) which has assets of $50,000,000; Connecticut Light & Power Company (U.G.I.) with assets of more than $122,000,000; Central Illinois Electric & Gas Company (Consolidated Electric and Gas Company) with assets of more than $30,000,000; Laclede Gas Light Company (Ogden Corporation) with assets of $66,000,000; Empire District Electric Company (Cities Service Power & Light Company) with assets of $30,000,000; Lake Superior District Power Company (Middle West Corporation) with assets of $16,000,000; San Diego Gas & Electric Company (Standard Gas and Electric Company) with assets of $49,000,000; and Houston Lighting & Power Company (National Power & Light Company) with assets of $67,000,000. Part of the stock of the last two companies was exchanged for senior securities of the parent and the remainder was sold to the public through underwriters. This list is not complete but it will serve to illustrate the fact that many substantial utility companies have been divested by means of common stock sales to the public through underwriters. All the companies I have named are now independent operating units and are no longer subject to the Holding Company Act.

Another method of divestment is illustrated by The North American Company's distribution of its common stock interest in Detroit Edison Company as dividends to its own common stock holders in the years 1941-1943. The same holding company also distributed a substantial amount of its common stock holdings in Pacific Gas and Electric Company and, in addition, has sold 700,000 shares of Pacific common stock in a public offering at competitive bidding. I may add that, following North American Company's sale of Pacific common stock, Pacific was declared to be not a statutory subsidiary in the North American system. The United Gas Improvement Company has also used the distribution method of divestment. For example, it distributed its common stock interest in Delaware Power & Light Company to its common stock holders in August 1943 and previously, in March 1943, UGI distributed most of its common stock holdings in Philadelphia Electric Company and Public Service Corporation of New Jersey to its stockholders as a partial liquidating dividend.

The divestment program is being accomplished by other methods of compliance in addition to sales and distributions. Voluntary exchange plans have been used successfully by several holding company systems which offered their preferred stock holders or their bond holders underlying portfolio securities in discharge of their claims. In some cases divestment is effected in the process of reorganizing a holding company or an operating company. For example, last year a plan for the reorganization of the bankrupt Midland United Company and its subsidiary Midland Utilities Company was consummated after it was approved by the SEC and the Circuit Court of Appeals for the Third Circuit. In the reorganization, common stock of Public Service Company of Indiana, with assets of $140,000,000, was distributed to the preferred stock holders of Midland United. I may add that the consummation of this plan, involving companies

in the former Insull system, concluded one of the most difficult and complicated proceedings that the Commission has ever had to pass upon. Among other issues it included the disposition of complex claims and counterclaims which had been the subject of extended litigation and negotiation among the claimants. Divestment resulting from the recapitalization of an operating company is illustrated by Puget Sound Power & Light Company. In this case, the Commission approved a voluntary plan of recapitalization which became effective by court decree in September 1943. Under the plan the preferred stock holders received nearly 97 percent of the new common stock for their claims which included large accumulated dividend arrearages, and the parent, Engineers Public Service Company, received, and later sold, the remainder or 3 percent of the new common stock. As a result, Puget has not been a subsidiary of Engineers and has not been subject to the Holding Company Act since September 1943.

I think it is not generally recognized that the divestment of utility properties by the various holding companies has resulted in a substantial amount of integration. In order that you may observe the large number of instances of integration affecting privately owned utilities resulting from the divestment program, I have had a check mark placed alongside each case involving such integration in the list of divestments set forth in Exhibit 5. You will note that 40 electric utility companies and 26 gas utility companies have been integrated with other private electric and gas utility systems, in addition to many sales of parts of properties which also resulted in integration. I shall comment briefly on a few of the more outstanding cases. Among them was the exchange in August 1943

between The United Gas Improvement Company and the Associated Gas and Electric Company system involving Eastern Shore Public Service Company and Erie County Electric Company. In this instance the Eastern Shore property in the Associated system was acquired by The United Gas Improvement Company for integration with its subsidiary Delaware Power & Light Company, and the Erie County of The United Gas Improvement Company was acquired by Pennsylvania Electric Company, a subsidiary in the Associated system, for purposes of integration. There was a similar exchange of properties between Southwestern Public Service Company and Continental Gas and Electric Corporation involving properties in the Panhandle of Texas and in Kansas. The sale by Illinois-Iowa Power Company of its interest in Des Moines Electric Light Company and Iowa Power and Light Company to Continental Gas & Electric Corporation is another example. There was an important instance of integration in Virginia in June 1944 when Virginia Public Service Company, a subsidiary in the Associated Gas and Electric Company system, was merged with Virginia Electric and Power Company, a subsidiary of Engineers Public Service Company. Still another instance was the acquisition by The Kansas Power and Light Company, a subsidiary of North American Light & Power Company, of all the common stock of Kansas Electric Power Company from The Middle West Corporation in August 1943. The last case I shall mention was the acquisition by Union Electric Company of Missouri, in March 1945, of all the electric utility properties of its competitor, Laclede Power & Light Company, a subsidiary of Ogden Corporation.

In addition to the program of reorganizing the holding companies, the Commission, acting under the Holding Company Act, has passed upon

the issuance of more than $7,300,000,000 of securities of registered holding companies and their subsidiaries. Under the applicable standards of the Act and as a result of cooperation by the companies and action taken by other regulatory authorities, this phase of our regulatory duties has afforded the opportunity to improve the financial structures and policies of the operating utility companies. Inflation is being taken out of their balance sheets. The utility subsidiaries of registered holding companies eliminated more than $1,082,000,000 of write-ups from their property accounts in the years 1935-1945 and nearly $500,000,000 of that amount was eliminated in the past three years. A breakdown of these figures by systems is shown in a table, copies of which have been given to the Committee. Operating utility company debt is being reduced by every legitimate means to establish conservative debt ratios. Depreciation accruals have been increased and their depreciation reserves are being built up to more adequate levels. Among the more important benefits have been the steps taken by the Commission to eliminate banker domination of utility companies. One important measure to accomplish that result was the adoption by the Commission in April 1941 of Rule U-50 requiring competitive bidding in the sale of securities by registered holding companies and their subsidiaries. These benefits are helping to build a better future for the operating utility companies, their investors and their consumers.

I have outlined these developments in general terms; Mr. Cohen, in his testimony, will give you more details of the practical operation of this phase of our work under the Act, including the steps taken by the Commission to improve the protective provisions of mortgage indentures and preferred stock contracts and some facts concerning the successful operation of our competitive bidding rule. He will also show you the

extent to which the statute requires that the Commission's work should be coordinated with the work of the State commissions. He will make clear to you that it is the established policy of the S.E.C. to foster effective cooperation with the State commissions.

I shall take the opportunity to illustrate the effects of this regulatory program by reference to some comparative financial statistics of the electric utility industry as compiled by the Federal Power Commission for the years 1937-1944.

(1) There were gross property additions during the period of approximately $2,800,000,000 and an increase of $900,000,000 in net property after retirements and after elimination of some $800,000,000 of inflation.

(2) Despite this large increase in plant investment during the period there was an actual decrease of $453,000,000 in the amount of debt securities outstanding on the books of the utilities.

(3) As regards depreciation, the annual accrual charged to operating expense increased from 1.7 percent of utility plant in 1937 to 2.4 percent in 1944; and the depreciation reserve increased from $1,495,000,000 to $2,822,000,000 or an increase of approximately 90 percent.

(4) Annual interest charges which were covered 2.97 times in 1937 were covered 3.64 times in 1944.

(5) Many billions of dollars of outstanding bond issues and preferred stock issues have been refunded at substantially lower interest and dividend rates; this has materially reduced the cost of money to the utilities.

(6) Finally, it may be noted that, notwithstanding a downward trend in rates and a material increase in taxes, depreciation and other expenses during the period, the rate of return on total capitalization and surplus increased from 5.8 percent in 1937 to 6.1 percent in 1944.

I shall close these introductory remarks of mine by referring to some of the published comments which informed observers have made with respect to the benefits to investors which have accompanied our administration of the Holding Company Act. My first reference is to a public address by Harold H. Young, Public Utility Specialist of Eastman, Dillon & Co., before the Rocky Mountain Group of the I.B.A. and the Bond Club of Denver, on December 4, 1945. Mr. Young said:

> "I should mention the very strong financial position in which the utility companies are today. There has been a marked reduction in the ratio of their debt to operating revenues; in other words, they have increased their business substantially without a corresponding increase in bonds. The companies are now charging much more depreciation than formerly and this helps finance construction requirements.
>
> "The SEC have done a great deal to promote the strengthening of financial structures. In many respects, the utility financial structure of today is, generally speaking, very much stronger than the typical one of a few years ago. Furthermore, many questionable practices of the past are now entirely impossible under present day regulations."

In addition, we are furnishing the Committee with copies of a two-page statement covering some remarks that Mr. Young made about the Holding Company Act before the Security Traders Association of New York on May 25, 1944.

I next turn to some observations that we found in an 82-page publication of the investment banking firm of Shields & Company, entitled "The Investment Survey--Winter 1945". At page 13 there appeared a general comment with respect to Section 11 of the Holding Company Act as follows:

> "There was undoubtedly good reason for industry executives, and the public as well for that matter, to challenge vigorously the whole theory of disintegration when it was first advanced. The extremists on both sides were checked by the voice of public opinion and a much less drastic statute was finally written. The feeling has persisted, however, and it dies hard, that the control exercised by the SEC is heavily punitive and investors' rights are being ignored. However, a careful reading of the official opinions and court decisions issued in the past few years shows that such an interpretation flies in the face of facts."

I should also like to read two sentences from the "Summary" section of the Survey dealing with utilities, page 18:

> "To summarize, the record of the past few years has clearly proved unfounded the apprehension felt that the passage of the Holding Company Act would cripple the market for utility securities.
>
> . . . . .
>
> "And if to all of that there is added the further belief that a company emerging from an SEC going-over has something of a hallmark attached to it, the continued firm tone in the utility market would seem to be well founded."

The benfits resulting from Section 11 procedures may be illustrated by reference to a statement made by Wm. W. Bodine, President of The United Gas Improvement Company, at a stockholders' special meeting on April 19, 1943 for consideration of the company's Section 11 (e) plan for divestment of certain securities and other assets. He said:

> "U.G.I. Common on April 17, 1943, was selling at 191% of its market price on December 1, 1942 [the plan was filed on December 2, 1942], North American Common at 154% of its December 1 price, and American Gas and Electric Common 129%. The greater improvement in the price of U.G.I. Common undoubtedly results from the Plan."

A similar view was expressed by Mr. Edward Hopkinson, Jr., partner of the banking firm of Drexel & Co., in his testimony at the hearing on the plan. He said:

"In my opinion, there is no doubt whatever that it is enormously to the advantage of the U.G.I. common stockholder to accept the direct ownership of the principal assets /of U.G.I./. . ."

I should also like to hand to the Committes copies of statements made by Mr. A. D. McNab, Vice President and Director of International Utilities Corporation, at a hearing before the Securities and Exchange Commission on July 26, 1945, regarding the experience of his company under the Public Utility Holding Company Act. You will note that, after commenting on the complex capital structure of his company at the time it registered under the Act in 1939 and the steps that were taken to simplify the structure through Section 11 (b) proceedings, Mr. McNab said:

"I just don't think there is any comparison between the financial condition of the company today and the financial condition of the company at the beginning of 1939 when it registered. It has improved immeasurably. Its capital structure is now so simplified that the stockholder almost at a glance can tell what his equity is. ... So I would say that the company has immeasurably advanced its position since coming under this act and very largely I think the improvement comes as a result of the proceedings under the 11 (b) hearings."

I should also like to present a three-page statement covering testimony, in 1942, of Mr. D. A. Hulcy, President of Lone Star Gas Company, in regard to his company's experience under Section 11 of the Act. In the course of his testimony, Mr. Hulcy said:

"... I am well pleased with the picture that Lone Star Gas presents today, and I think that its stockholders certainly have every right to feel a little better about the securities they hold today than they did, say, in 1935, at the time Lone Star Gas Corporation registered under the Holding Company Act."

He was asked if the simplified corporate structure had resulted in actual economies and in fewer headaches to the management. His repy was:

"There isn't any question about that. Of course, I realize—at least I think I relaize that the position Lone Star Gas Company is in today is quite similar, perhaps, to what the Securities and Exchange Commission has had in mind as the goal they were working to for most all utility systems, and if that is true, I can understand the interest that the Commission might have in any holding company system getting themselves finally in that position. But I can only say that if the Commission does have any pride in it, that the directors and executive officers of Lone Star Gas Company are much happier about it than the Commission will be. We are well pleased with what has been accomplished."

I may add that each of these holding companies, International Utilities Corporation and Lone Star Gas Company, is no longer subject to the Holding Company Act.

I also should like to give the Committee copies of a report that was prepared and distributed by Electric Power & Light Corporation, a subholding company in the Electric Bond and Share system, to advertise the improvement in the structure of its system resulting from the application of the Holding Company Act. It consists of a series of graphic charts designed to illustrate, in the words of the booklet, "Simplification and Integration in the Making". If you will examine these charts with me, I should like to comment on them briefly.

The first two charts show the corporate structure of the Electric Power & Light Corporation system as of December 31, 1935 contrasted with its corporate structure as of today. Turning over the page, another chart shows graphically that 15 subsidiary companies have been eliminated since December 31, 1935. The next two pages have further reference to the control of subsidiary companies, showing that in the period since December 31, 1935, instead of five tiers of companies, the system now has three tiers. In other words, the great-grandchildren and the great-great-grandchildren have disappeared, either by sale or by consolidation.

The remaining pages relate to the simplification of security structures in the system. It is shown, for example, that 39 publicly-held bond issues have been reduced to 10 issues. Total bonded debt was reduced and the average rate of interest declined from 5.34 percent to 3.24 percent, involving a total reduction of 42 percent in the annual interest cost. Similarly, 9 publicly-held preferred stock issues were

retired, the total amount of such stock being cut from $117,515,000 to $60,520,000, involving a reduction in dividend requirements of 52 percent. They show that the combined reduction in senior capital amounted to 38 issues or a total of $70,000,000, and the annual cost for senior capital was cut by 46 percent.

I next turn to a page which states that the Southern companies have eliminated all preferred dividend arrearages. The chart shows that preferred dividend arrearages for the Southern companies reached a peak of $15.7 million in 1937 and by 1944 they had been entirely eliminated. I may add, however, that the parent company, Electric Power & Light Corporation, still has arrearages of over $70,000,000 on its outstanding preferred stock, although it recently has resumed the payment of current dividends on its first preferred stock. Last November the company filed a Section 11 (e) plan proposing action designed to afford to the holders of the $7 and $6 preferred stock an opportunity to exchange their holdings for common stock of United Gas Corporation, a subsidiary of Electric Power & Light.

I thought you would be interested in this graphic illustration of the simplification program. It is by no means a hand-picked case, but is typical of the progress that is being made in the public utility industry under this Act in simplifying the capital and corporate structures and in sloughing off scattered and unrelated holdings.

This concludes my introductory statement. Mr. Cohen will now give you our detailed comments on the various amendments that have been proposed to you.