PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

STATEMENTS OF POLICY OF BOND INDENTURE AND PREFERRED STOCK CHARTER PROVISIONS AND ATOMIC POWER PROJECTS

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at the

BRIEFING CONFERENCE
ON
SECURITIES LAWS AND REGULATION

Sponsored by

THE FEDERAL BAR ASSOCIATION
in cooperation with
THE BUREAU OF NATIONAL AFFAIRS, INC.

Chicago, Illinois

The Sheraton Hotel

February 19 and 20, 1959

My topic is the Holding Company Act - or rather two aspects thereof - and I find this to be a difficult subject to discuss before a sophisticated audience of practicing attorneys such as this. Not all lawyers are fortunate enough to have a Holding Company as a client. The Holding Company Act is a very specialized statute, applicable to only a limited number of corporations. Persons subject to its jurisdiction are very familiar with its provisions - and historical background - and all too aware of the ramifications of regulation by the Commission. The "have-nots" are usually not only uninformed as to the law but also unconcerned. To accommodate such divergent attitudes presents something of a problem, but at the risk of boring the experts, rather than confuse the novices, let me give a brief description of the background of the Holding Company Act.

The Holding Company Act was passed by the 74th Congress in 1935 following a nine-year study by the Federal Trade Commission which disclosed a variety of abuses in public utility holding company system financing. Among the more significant of these abuses which Congress sought to eliminate through passage of the law were:

(1) inadequate disclosure to investors of the information necessary to appraise the financial position and earning power of the companies whose securities they purchase;

(2) issuance of securities against fictitious and unsound values;

(3) overloading of the operating companies with debt and fixed charges, thus tending to prevent voluntary rate reductions.

Contrary to a widely-prevalent misconception, the Act is not self-liquidating and does not provide for the elimination of all holding company systems. While it is true that perhaps the most important provision of the Act is Section 11 which provides for the physical integration and corporate simplification of holding company systems and also that pursuant to this section many holding companies have been eliminated, there are today 22 registered holding companies of which some 18 are expected to continue as active registered systems. This figure represents the residue from a total of 216 holding companies which have been registered between June 15, 1938, and today. The 18 remaining systems have assets of some $8.5 billion, and account for approximately 20% of the aggregate assets of the privately-owned electric and gas utility and gas pipeline industries of the nation.

The remaining registered holding company systems are subject to regulation by the Commission and this regulation includes approval of the issue and sale of securities under prescribed standards of the law. Under the Holding Company Act, the Commission can require certain substantive protective provisions in a security being issued by a company subject to its jurisdiction. This is to be contrasted with the more restricted power of the Commission under the Securities Act of 1933 to require merely full disclosure, without any power to impose specific provisions designed to affect the quality of the security.

STATEMENTS OF POLICY

In passing upon issuance of first mortgage bonds and preferred stocks, the Commission examines the mortgage indenture and charter provisions to determine whether or not they contain the various protective provisions which it has required issuers to include in first mortgage bond indentures and charter provisions as set forth in the applicable Statements of Policy which were adopted in 1956. The first part of my speech will be devoted to a discussion of these Statements of Policy, which are to be found in Holding Company Act Release No. 13105 (Bond) and Holding Company Act Release No. 13106 (Preferred Stock).

As many of you are undoubtedly aware, in May 1954, after a very thorough analysis by its professional staff, aided by an outside attorney who was a true expert in such matters, the Commission circulated for comment throughout the country a draft of proposed Statements of Policy with respect to indenture and preferred stock protective provisions. Former Director McDowell discussed the provisions of the proposed Statements of Policy at a previous FBA-BNA Briefing Conference in Washington, D. C., in June 1954. My talk today is in the nature of a progress report and appraisal of the efficacy of this means of achieving the desired result.

The Commission's authority to promulgate Statements of Policy regarding mortgage bond and preferred stock issues rests specifically upon Sections 6(b) and 7 of the Holding Company Act. The third sentence of Section 6(b), while exempting from Section 7 the issue and sale of a security by a public utility company which is a subsidiary of a registered holding company where the issue and sale are for the purpose of financing the business of such subsidiary company and have been expressly authorized by the State commission of the State in which the subsidiary company is organized and doing business, nevertheless provides that the Commission may impose such terms and conditions as it deems appropriate in the public interest or for the protection of investors or consumers. Section 7(d), which applies to declarations regarding the issue and sale of a security filed by holding companies and to public utility companies which cannot meet the exemptive requirements of Section 6(b), provides that a declaration shall be permitted to become effective unless the Commission finds that 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. Section 7(d) contains additional bases for negative findings which the Commission may make in denying effectiveness to a declaration.

The purpose was to codify, to the fullest extent practicable, those salutary protective provisions which had developed over the years at the Commission under the Holding Company Act, but which had been applied with all too little uniformity and consistency by this agency and its staff to first mortgage bonds and preferred stock issues sold under the Act. As so very often was the case, the tightness or looseness of indenture or charter provisions, between one company and another, varied in accordance with the different notions and abilities of the staff members of the different operating sections in the Division.

The Commission considered that it was being responsive to the justifiable complaints and criticisms voiced by the issuers, their counsel, and their financial advisers, that, since the Commission had not set forth in any complete or definitive form its views as to appropriate protective

provisions, and since the indenture and preferred stock charter provisions differed, sometimes quite widely, as between one company and another and even as between one supplemental indenture or charter and another within the same company, they could not know what to expect of the Commission and its staff whenever it became necessary to issue additional bonds or preferred stock. Actually, however, in its Thirteenth Annual Report to Congress for the fiscal year ended June 30, 1947, the Commission had undertaken to state in some detail the principal protective provisions which it deemed to be required in indentures and preferred stock charters. But it is true that the Commission had not, prior to 1954, issued to the public a detailed set of standard protective provisions to be followed.

After a substantial number of public comments to the proposed Statements of Policy were received, the staff had the task of analyzing each comment to see whether the views of the particular commentator could be incorporated into the proposed Statements of Policy. A very substantial number of valuable comments were received and included in the definitive Statements of Policy which were adopted by the Commission on February 16, 1956.

I think it would be helpful if I were to point out first that the Statements of Policy have application only to first mortgage bond issues and preferred stocks issued by public utility companies. By a first mortgage bond issue, I do not mean a collateral trust bond issued by a holding company or a debenture issued by a holding company or an operating public utility company. By public utility company I mean an operating electric utility company or an operating gas utility company. On the other hand, I should point out that, since the provisions of the Statements of Policy contain useful criteria and standards governing security issuances, they can be, and are, taken into consideration in varying degrees when we are passing upon security issuances to which the Statements of Policy do not strictly apply.

The principal provisions in the bond Statement of Policy relate to the redeemability of the bonds, the circumstances under which additional bonds may be issued, the sinking and improvement fund, the renewal and replacement fund, limitation on dividends, and the acquisition of property additions subject to prior lien obligations. Other provisions of the bond Statement of Policy relate, generally, to definitions and certain miscellaneous matters.

In connection with these various provisions, it is important to bear in mind that we at the Commission approach every proposed supplemental indenture with a full awareness that flexibility is particularly required where a supplemental rather than an original indenture is being executed. It is our position that, generally speaking, where the Commission has previously permitted the issuer to sell bonds pursuant to an indenture which the Commission and the staff have examined, the issuer should not be required, in the absence of a significant change of circumstances, to incorporate additional protective provisions into a supplemental indenture in order to conform fully to the Statement of Policy.

There are two specific exceptions to this. They involve the restriction of additional earned surplus otherwise available for dividends on the common stock, and the provision relating to the adequacy of the renewal and replacement fund requirement. I shall refer to these two provisions in some detail shortly.

In determining to allow considerable flexibility with respect to strict conformity with the Statement of Policy, subject to the two exceptions noted, where a supplemental rather than an original indenture is being executed, the Commission was quite mindful of the fact that substantial amounts of these public utility bonds were purchased by and are held by experienced investors and that such securities have received favorable ratings in the public markets.

In this connection, I should like to call your attention to the fact that at present there are outstanding some 48 first mortgage bond indentures of public utility companies subject to the Holding Company Act. In all but four cases the bonds outstanding under these indentures are rated A or better by Moody's; in these remaining four cases the rating is Baa.

The first important provision which I referred to a moment ago deals with the redeemability of bonds. Because this provision has, in the last two years, taken on a transcendent importance, I should like to reserve my discussion of this matter until I have concluded with the other important provisions in both the bond and the preferred stock Statements of Policy.

The bond Statement of Policy provides that after the original issue of bonds under the original indenture, additional bonds may be issued under the indenture or under a supplemental indenture in an amount not exceeding 60% of the bondable value of net property additions, and then only if earnings available for interest during any 12 consecutive months has been equal to at least two times the annual interest requirements on all bonds to be outstanding after the proposed issuance. No earnings test, however, is required if the additional bonds are being issued solely to refund an outstanding series of bonds issued under the indenture or prior lien obligations, bearing a higher interest rate than such additional bonds, or to refund an outstanding issue of bonds issued under the indenture or prior lien obligations within two years of their maturity. In other words, if the refunding takes place within two years of maturity, no earnings test is required even though the bonds to be refunded carry a lower interest rate than the new bonds.

The Statement of Policy also provides for a 1% sinking fund which, however, can be satisfied with either cash or by the deposit of bonds or by certification of property additions taken at 60% of the bondable value thereof. Of course, property additions used for this purpose cannot be used as the basis for issuing additional bonds. Neither can such property additions be used to satisfy the renewal and replacement fund requirements which I shall now discuss.

The renewal and replacement fund requirement, which is frequently called the R & R requirement, provides that the issuer must expend annually for property additions an amount which it has demonstrated to the Commission

is a reasonable annual requirement for the replacement of the book cost of depreciable mortgaged property of the issuer, which amount shall be expressed as a percentage of book cost. It is actually a cumulative requirement in that the annual expenditure requirement may be satisfied by expenditures for property additions made in a previous period. If the issuer fails to satisfy the R & R expenditure requirement, it must deposit either cash or retire bonds with the indenture trustee to the extent of any deficiency. Where the issuer can demonstrate to the Commission, as several issuers have been able to do, that a different R & R formula prescribed by its indentures, as, for example, a percentage of gross operating revenues less maintenance, can produce substantially the same result as an R & R requirement stated in terms of a percentage of book cost of depreciable property, the Commission will not require any change in the indenture provision. But it is the burden of the issuer to present such proof.

From April 1, 1956, the date when the bond Statement of Policy became effective, until January 31, 1959, applications or declarations were filed by public utility companies under the Holding Company Act with respect to 50 first mortgage bond issues aggregating $847,200,000 principal amount. Of these 50 issues, the indentures or supplemental indentures of 39, having an aggregate principal amount of $672,700,000, expressed the R & R requirement as a percent of depreciable property; those of nine issues, having an aggregate principal amount of $114,500,000, expressed the requirement as a percent of revenues; that of one issue, having a principal amount of $40,000,000, and filed prior to July 1, 1956, was not required to conform to the R & R provision in the Statement of Policy since that particular requirement did not become effective under the Statement of Policy until July 1, 1956. The R & R requirement in the nine issues which were not required to be restated in terms of a percent of depreciable property were deemed by the Commission to afford no less protection to the bondholders than would be available from a requirement based on an appropriate percent of property. Where the issuer has changed over to a percent of property, the Commission, in the interest of flexibility, has permitted the issuer to insert a provision in the supplemental indenture under which the issuer, upon application to, and approval by, the Commission may modify the specific percent of depreciable property requirement.

Turning to the matter of limitation on dividends, generally speaking, the Statement of Policy requires that a company may not pay out as dividends upon its common stock any earnings out of its earned surplus accumulated prior to the effective date of the new indenture in excess of the amount of one year of normal dividends on the company's preferred and common stock -- plus any additional amounts allowed by the Commission as not adversely affecting the existing capitalization ratio. This restriction on dividend payments prohibits the unfreezing of frozen earned surplus in the event of the subsequent sale of equity securities. The purpose behind this is that the bondholders are entitled to maintenance of their relative ratio position in the company, as distinguished from a fixed dollar cushion of equity under the bonds irrespective of growth. We feel that if a surplus restriction is to be required at all it should have some meaning, and that to permit the unfreezing of frozen earned surplus upon a subsequent sale of common stock -- which takes place almost annually in a period of expansion -- is to have no surplus restriction at all.

Here too, as in the case of the R & R requirement, the Commission, in the interest of flexibility, has permitted the issuer to insert a provision in the supplemental indenture to the effect that additional amounts of earned surplus, which would otherwise be frozen, may be distributed uppn application of the issuer to, and approval by, the Commission.

Of the 50 first mortgage bond issues to which I have previously referred, 29 issues,having an aggregate principal amount of $497,000,000, included provisions, as set forth in the Statement of Policy, imposing additional restrictions on the distribution of earned surplus to the common stockholders. In respect of the other 21 issues, having a total principal amount of $350,200,000, no additional restrictions were required since the indentures already conformed in this regard to the Statement of Policy.

With respect to prior lien obligations, the Statement of Policy does not prohibit the acquisition of property subject to a prior lien. It simply provides that where property additions are acquired which are subject to prior lien obligations, the issuer may not use such property additions for any purpose under the indenture unless there is deducted from the amount of such property additions an amount at least equal to 166-2/3% of the principal amount of outstanding prior lien obligations. No earnings test is required to acquire such property. If such property is used as a basis for issuing additional bonds under the principal mortgage, there must be deposited with the trustee under the principal mortgage a principal amount of prior lien bonds not theretofore issued under the prior lien indenture at least equal to the principal amount of the additional bonds then being issued to the public under the principal indenture. The Statement of Policy prohibits the issuance of additional prior lien bonds directly to the public in order not to aggravate the divisional lien situation which the Commission has historically opposed.

Turning now to the preferred stock Statement of Policy, I think you will find that this is a much simpler document to comprehend than the bond Statement of Policy. Preferred stock must be cumulative, and, as in the case of the first mortgage bonds, it must be redeemable at any time upon reasonable notice upon the payment of a reasonable redemption premium, if any. The holders of the preferred stock are given the right to elect a majority of the directors upon default in the payment of four full quarter-yearly dividends. Once the right accrues, it continues in effect until all dividend arrears have been eliminated. The issuance of secured debt is not restricted, but unsecured debt may not be issued in an amount exceeding 20% of existing secured debt plus capital stock and surplus, and then only if the portion of the unsecured debt maturing within 10 years does not exceed 10% of such aggregate base figure.

Dividends on the common stock are limited by the so-called ABC test. This provides, in substance, that if common stock equity, which includes the par or stated value of the common stock plus earned surplus and capital surplus, exceeds 25% of total capitalization and surplus, there is no limitation; if it drops below 25% but not below 20%, only 75% of any income available

for dividends on the common stock can be declared out of dividends; if it drops below 20%, only 50% of such income can be paid out as dividends. The company receives credit for dividends which it could have paid, but did not pay, in a prior year.

A two-thirds vote of the preferred stock outstanding is required to change adversely any of the preferred stock protective provisions, except that if such change adversely affects only one or more but not all series of preferred stock outstanding, then only the consent of the holders of at least two-thirds of the total number of outstanding shares of the affected series is required. A two-thirds vote of the outstanding preferred stock is also required to authorize any prior ranking stock or to issue any shares of any such prior ranking stock more than 12 months after the date as of which the corporation was empowered to create or authorize such prior ranking stock.

A majority vote of the outstanding preferred stock is necessary to effect a merger or consolidation or sale of assets. A majority vote is also required to issue additional shares of preferred stock or any other stock ranking on a parity with the preferred stock unless a specified earnings test is met (gross income after deducting all taxes, including income taxes, must equal at least one and one-half times interest charges and preferred dividend requirements on debt and preferred stock to be outstanding), and unless the common stock equity is at least equal in amount to the preferred stock equity. The charter must prohibit the issuer from buying in its preferred stock whenever any preferred dividends are in arrears, unless approval is first obtained under the Holding Company Act or unless all the outstanding preferred stock is redeemed. Upon voluntary liquidation, the holders of preferred stock must have the right to receive the then current redemption price as distinguished from par value or some other figure.

Between April 11, 1956, the date when the preferred stock Statement of Policy became effective, and January 31, 1959, applications or declarations were filed by public utility companies under the Act with respect to five preferred stock issues having an aggregate par value of $28,000,000.

I should now like to return to the subject of redeemability of bonds or preferred stock. Both the bond and the preferred stock Statements of Policy provide that the bonds or the preferred stock can be called by the issuer for redemption at any time upon reasonable notice and upon the payment of a reasonable redemption premium, if any. Let me preface a discussion of this provision by pointing out that Section 1(b) of the Holding Company Act declares that the national public interest and the interest of consumers of electricity or gas are or may be adversely affected by lack of economies in the raising of capital. Other provisions of the Act provide the Commission with the necessary means of implementing this Congressional policy. Thus, while the Act itself does not give the Commission jurisdiction over utility rates charged to consumers, the Act does direct the Commission to protect the consuming public against being required to support unreasonable interest costs.

The Commission has taken the position that free callability upon the payment of reasonable redemption premiums is necessary to secure this result. In two cases which arose in 1953, the Commission explicitly set forth its position on redemption restrictions. In one of them, Indiana & Mchigan Electric Company (35 S.E.C. 321, 326), the Commission stated:

> "It is our opinion, however, that non-redeemable features in senior securities, even though the period of non-redeemability is as short as three years, should not be resorted to as a means of reducing the cost of money, and we shall in the future insist that all reasonable efforts be made to keep this undesirable feature out of financing programs."

The other case was Arkansas Louisiana Gas Company (35 S.E.C. 313).

Following those two cases, as I have already indicated, the Commission issued its proposed Statements of Policy in May 1954, and in February 1956 it adopted the definitive Statements of Policy. Although neither the bond nor the preferred stock Statement of Policy contains any formula as to what constitutes a reasonable redemption premium, the Commission's working policy has been that the initial redemption price should not exceed the sum of the initial public offering price plus the interest rate in the case of bonds or the dividend rate in the case of preferred stock. For example, if the bonds are offered to the public at 102 and bear a 5% coupon, the initial redemption price may not exceed 107, and the 7-point premium must thereafter be reduced pro rata to maturity. It may reasonably be assumed that the Commission will continue to adhere to this policy unless it is presented with a special or unusual situation which makes its application in the particular circumstances an unreasonable hardship.

At the direction of the Commission, the staff is engaged in a continuous study of the problem of redeemability. Our principal points of interest are threefold:

(1) Does free callability for purposes of refunding result in higher interest costs to the issuer than, say, a five- or ten-year freeze on refundability?

(2) Does free callability chill or limit the number of bonds which an issuer receives from prospective underwriters in a competitive bidding?

(3) Does the winning bidder experience greater difficulty in marketing a freely callable issue than an issue which is restricted against refunding for, say, five years?

Our studies indicate that there is very little, if any, difference between interest costs to the issuer where the bonds are freely refundable as against issues which are nonrefundable for five years. A member of our staff is presently serving as a member of a committee established at the Wharton School of Finance and Commerce of the University of Pennsylvania under a grant from the Life Insurance Association of America. This committee is studying the entire question of the redemption characteristics of senior securities. While the results of the Wharton School study have not been formally published as yet, the persons directly in charge of it have indicated publicly that data accumulated on corporate bond issues offered between 1945 and 1958 indicate that there is very little evidence that the value of the call privilege is reflected to any significant extent in the yields on the bonds; i.e., the presence or absence of the call privilege appears to have no significant effect on the interest rate. This bears out what we at the Commission have found to be the case.

In studies which our staff has made of the second and third questions which I have posed to you, we have found that during a period of 18-1/2 months extending from May 14, 1957, to November 30, 1958, there was a total of 137 electric and gas utility bond issues (including debentures) offered at competitive bidding, aggregating $2,956,000,000. These included companies subject to the Holding Company Act as well as those not subject to the Act. The refundable issues numbered 109 and accounted for a total of $2,005,000,000, while the nonrefundable issues -- each one nonrefundable for a period of five years -- numbered 28 and totaled $951,000,000 principal amount. The refundable issues thus represented approximately 80% of the total number of issues and 68% of the aggregate principal amount.

It is noteworthy that when we list the number of bids received at competitive bidding, ranging from 1 to 8 bids in the case of the refundables, and from 2 to 8 bids in the case of the nonrefundables, we find that the weighted average number of bids received on the refundables was 4.46 while on the nonrefundables it was 4.11. The median number of bids on both groups was the same, i.e., 4.

In terms of the relative marketing success which the underwriting syndicates have had in selling the bonds to the ultimate purchasers, we have assumed, for purposes of comparison, that a successful marketing is one in which, at the termination of the syndicate, at least 95% of the bond issue has been sold at the syndicate price, or, conversely, not more than 5% of the issue remains unsold. Of the 109 refundable issues, 75.2% were successful according to this definition. Of the 28 nonrefundable issues, 75.0% were successful. In terms of principal amount, 72.3% of the refundable issues were successful, while 73.9% of the nonrefundable issues were successful. Extending the comparison to the aggregate principal amounts which were sold at the applicable syndicate prices up to the termination of the respective syndicate, we find that 90.9% of all the refundables and 89.5% of all the nonrefundables were so sold.

In view of the virtually equal results of number of bids and of marketing success which the two groups showed, it is our position that the presence or absence of a frèeze on refundability has no especial significance, let alone a controlling influence, on the ability of a public utility company to raise bond money.

In retrospect, let us consider how successful we at the Commission have been in our administration of these policy statements. Some issues have questioned the constitutionality of some of the requirements of the Statements of Policy, such as the surplus freeze, but to date we have not had occasion to defend our position in any court. I am very happy to say that the length of time required to process a security issuance filing has been measurably shortened as a result of the adoption of these two statements. Issuers have been enabled to arrange their time schedules with little apprehension that wrangles over the terms of the indenture or the charter will produce interminable delays with the possible risk of missing a good market. The disputes which frequently arose between the issuer and its representatives on the one hand, and the staff of the Commission on the other hand, have been very greatly reduced. Uniformity and consistency have become the norm rather than the exception.

ATOMIC POWER PROJECTS

We come now to the second phase of my discussion, and that has to do with the impact of the Holding Company Act on the development of atomic power projects. The advent of the atomic age has presented problems to the electric utility industry which are of concern to the Commission under the Holding Company Act. In order to make possible the construction of giant generating plants -- plants too big for a single system to install economically -- as well as to share the expenses of research and development in the atomic energy field, many utility companies have realized the advantage of consolidating their assets and undertaking joint ventures. This raises the question of whether by reason of creating a subsidiary company to carry out such joint ventures the sponsoring companies themselves become holding companies within the definition of the Act.

Mr. Arthur Dean, at the luncheon address yesterday, indicated that in the light of the national emergency in connection with the development of atomic energy perhaps the 1935 Act has served its purpose and has outlived its usefulness. The basis of this statement is undoubtedly that the threat of subjection to regulation under the Holding Company Act would deter the managements of utility companies from entering into these projects designed to further the development of nuclear energy, and that any such deterrent should be eliminated in the national interest.

This very question has been thoroughly considered by the Commission and by several committees of Congress in connection with an attempt to amend the Holding Company Act by the introduction of Senate Bill 2643 in 1956.

On this point former Chairman J. Sinclair Armstrong expressed his opinion as follows:

> "The Securities and Exchange Commission is fully aware of the national and world-wide importance of the development of nuclear power for peaceful purposes in accordance with the policies expressed by the Congress in the Atomic Energy Act of 1954. These include the promotion of world peace, improvement of the general welfare, increase in the standard of living, and strengthening of free competition in private enterprise.
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> "We do not believe that the Public Utility Holding Company Act, as administered by the Securities and Exchange Commission, should deter private enterprise from going forward with nuclear power projects. We believe that nuclear reactors for the generation of electricity can be developed and ultimately incorporated into the electric utility industry in a manner consistent with the principles and standards of the Holding Company Act." (Holding Company Act Release No. 13221)

S. 2643 contained two major provisions embodied in Section 4 and Section 5. Section 4 of the bill would have amended the Holding Company Act so as to exclude from the definition of "electric utility company" in Section 2(a)(3) a nuclear reactor company, even though the heat produced by the reactor is used for the generation of electricity. Section 5 of the bill would have amended Section 2(a)(7) of the Act so as to exclude from the definition of "holding company" a company whose subsidiary is a generating company which meets certain requirements, including a requirement that all of its stock be owned by electric utility or holding companies which either directly or through operating subsidiaries purchase all of its output.

Section 5 was sponsored by a group of four electric utility companies, the parents of Pacific Northwest Power Company, which was created to construct two hydro-electric projects on the Snake River. The Commission opposed the enactment of Section 5 in written comments on the bill and in oral testimony of the Chairman and Director of the Division of Corporate Regulation. The Commission reviewed the adverse effects upon the capital structures of the four sponsors which would result from the announced plans for financing the hydro-electric projects. The exemptions available under Section 3(a) of the Act were pointed out to the subcommittee, and the Commission took the position that even if an exemption were not available, the regulation imposed by the Act would be beneficial to the national interest. Subsequently, the sponsors of the bill agreed to delete this Section 5 from their bill.

Section 4 was designed to satisfy the sponsors of Power Reactor Development Company, sometimes referred to as the "Detroit Edison Company project". In August 1955 a group of public utility and industrial companies had participated in the formation of this company as a non-profit membership corporation organized for the purpose of financing the art and technology of producing electric power by the use of fissionable materials. The Commission

opposed Section 4 of the bill granting an automatic and permanent exemption for nuclear reactor companies and their sponsors, taking the position that the objectives of the bill could be met by appropriate Commission action under the present Act. The Commission referred to the case of Yankee Atomic Electric Company (Holding Company Act Release No. 13048, November 28, 1955) as an example of joint participation by a large group of utility companies in atomic nuclear development on a regional basis.

The revised bill, as ultimately approved by the Senate Committee on Interstate and Foreign Commerce and the Joint Committee on Atomic Energy did limit the exemption to a non-profit corporation and provided for termination of the exemption upon a finding by the Atomic Energy Commission that the project was no longer devoted primarily to research and development. However, this bill failed of passage by the Congress.

In the meantime the Commission determined that it had authority to exempt certain non-profit reactor companies by rule and accordingly published for comment and ultimately adopted an amendment to Rule U-7 for the benefit of nuclear power projects (Holding Company Act Release No. 13221). This rule provides that a nuclear reactor company is not an electric utility company if it is non-profit and engaged primarily in research and development activities, and if its "only connection with the generation, transmission and distribution of electric energy is the ownership or operation of the facilities used for the production of heat or steam from special nuclear material which heat or steam is used for the generation of electric energy".

Notwithstanding the availability of the exemption under this rule to Power Reactor Development Company, it filed an application pursuant to Section 2(a)(3) of the Holding Company Act requesting that it be declared not to be an electric utility company. After a hearing the Commission found that since PRDC would be engaged primarily in the business of research and development, a business other than that of an electric utility company, it was entitled to the exemption (Holding Company Act Release No. 13364).

The Yankee Atomic Electric Company case, referred to above, involved a company formed in 1956 by 12 sponsoring utility and holding companies in the New England region. The company was organized to construct and operate a nuclear power plant of an estimated capacity of 134,000 Kw. The original cost was estimated at $33,400,000, which figure has recently been revised to $57,000,000. The Commission approved the initial issuance of the securities by Yankee and the acquisition of these securities by six of the sponsoring companies (Holding Company Act Release No. 13048). The Commission took into account the novel, unusual circumstances present in the case, including unusual risks not merely in higher capital costs but also with respect to the dependability of its operations and the possibility of its early obsolescence as new developments in the atomic power field were made. However, it added that a group approach would not merely minimize these risks to each of the sponsoring utilities but would provide them with a full opportunity to gain experience in the new field of atomic power.

The Yankee case demonstrates the adaptability of the Holding Company Act, as administered by the Commission, to meet the needs of the atomic age. Yankee's sponsors have been able to combine their forces to develop atomic power in full compliance with the Act without seeking or receiving any exemption based on the research and development aspects of the project. It appears that the effect of the Act is not to impede this important development but rather to channel it along sound corporate and financial lines and to prevent the advent of atomic power from causing the reappearance of abuses which the Act was so successfully designed to remove.

Accordingly, in answer to the inquiry as to whether the Holding Company Act has "outlived its usefulness", the Branch of Public Utility Regulation of the Division of Corporate Regulation submits an emphatic negative answer and would be inclined to oppose strenuously any attempts to curtail its jurisdiction.