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PUBLIC BENEFITS OF THE
INTEGRATION PROGRAM UNDER THE HOLDING COMPANY ACT

ADDRESS

of

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before the

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As you are all aware the Securities and Exchange Commission is charged with the duty under the Public Utility Holding Company Act of 1935 of "integrating" gas and electric holding company systems, bringing about a simplification of their structures and effecting an equitable distribution of voting power with them. You will recollect that when the bill was first introduced into Congress it provided in effect, for the ultimate complete elimination of holding companies. Subsequently there developed from the hearings and the debates the idea that the public interest could be served by the continued existence of holding companies, provided they were reasonably confined in their operations, and provided further that the then existing intricacies and complexities of corporate structure and the maldistribution of voting power were reasonably modified. From this concept Section 11(b) was evolved.

As was pointed out by Chairman Douglas of the Commission in his talk before the American Bar Association this summer, there has been substantially no articulate objection to the provisions of Section 11(b)(2), calling for the simplification of complex corporate structure and the equitable distribution of voting power. Whether serious opposition to that section will yet develop remains to be seen as we begin its enforcement. The attack first centered on the proposed requirement for complete elimination of holding companies and then — after the passage of the Act — upon Section 11(b)(1), providing for integration.

It might be well, in orienting ourselves, to consider first in whose interest the Holding Company Act was drawn. Since the passage of the Act much of the discussion of its provisions has centered around the matter of protection for the investor. Without question, the Act sets up innumerable safeguards for the protection of investors in utility and utility holding company securities and, in my opinion, the administration of the Act has already resulted in great benefits to utility investors. In particular, accomplishment of the objectives of Section 11 will result in greatly improving the position of the utility investor, whether his money is in operating or holding company securities. The advantages from the investors' point of view of integration over "scatteration" of utility properties were carefully and clearly pointed out in Chairman Douglas' speech before the ABA this summer — a speech which I earnestly recommend to those of you who have not already read it. I do not propose today to stress this aspect of my subject.

There is still another very important class of persons for whose benefit the Holding Company Act, as a whole, as well as Section 11 as an important part of that whole, was passed. And it is perhaps peculiarly fitting that it is before a meeting of the National Lawyer's Guild that their interest in the Act is highlighted. I refer to the consumers of electricity and gas. Almost 11 years ago to the day — on February 13, 1928, — Senator Thomas Walsh opened the debate in the Senate on a resolution calling for an investigation of holding company practices. Such an investigation was subsequently authorized to be carried on under the aegis of the Federal Trade Commission. Counsel to this monumental undertaking was Robert E. Healy of Vermont, now a member of the Securities and Exchange Commission. The facts and practices which were disclosed in this investigation were very important factors in bringing about the passage of the Holding Company Act; and their accuracy and completeness were such that the Trade Commission records are still an indispensable source of information in the administration of the Act. In opening the debate on that resolution Senator Walsh said: "The purpose of the proposed investigation, Mr. President, is

to protect two classes of our citizens; first the 17,000,000 of householders who pay for electric lighting; and second, the great body of our people who are now putting their savings into the securities of these corporations

The 17,000,000 householders of whom Senator Walsh spoke have now grown to about twenty-two and three-quarter millions, who include today approximately a million and a quarter farm customers. Alongside of these "householders" are approximately 4,000,000 small commercial consumers, not to mention a quarter of a million large power users, and about 35,000 municipalities which are customers of private electric companies. These are the people who (with the gas consumers) support the utility industry of the country and to whom the industry owes a duty to supply service at reasonable rates, coextensive with the duty of the consumers to pay such rates as will yield a fair return to investors.

By the express terms of the Act and of Section 11, the Commission is charged with the duty of administering them with a thoroughgoing regard for consumers' rights and with a careful weighing of the effect of each step taken upon consumer interests.

Section 1(b) of the Act sets out that, on the basis of facts disclosed by the reports of the Federal Trade Commission and the reports of the House Committee on Interstate and Foreign Commerce, the national public interest and the interest of investors and consumers are or may be adversely affected under certain general types of circumstances which the Section then proceeds to set out in detail. The first subdivision of Section (1)(b) deals principally with the baneful results to investors of certain unregulated holding company practices. The next four sections deal primarily with harmful results to consumers of unregulated holding company practices. This of course does not mean that the interests of consumers and investors under the Act are to be regarded in the ratio of four to one. But it does make clear that the Act was motivated and is designed certainly as much in the interest of the consumer as for the protection of the investor. The same point is made throughout the Act by standards admonishing the Commission to act "in the public interest and for the protection of investors and consumers" and to prohibit various transactions if they are found to be "detrimental to the public interest or the interest of investors or consumers."

To one who considers the matter superficially, it may seem that Congress has charged the Commission with an impossible task; that the Commission cannot at the same time protect the interests of investors and consumers because the interests of the two groups are essentially antagonistic. It may not be necessary for me to endeavor to show this group that this argument is generally fallacious, as applied to the electric and gas industries, in whatever context it is used. President Roosevelt has pointed out that "True regulation is for the equal benefit of the consumer and the investor. The only man who will suffer from true regulation is the speculator, or the unscrupulous promoter who levies tribute equally from the man who buys the service and the man who invests his savings in this great industry. I seek to protect both the consumer and the investor."

I am not prepared to say that in all industries and at all times the interests of investors and consumers are harmonious, so that a program of reform and regulation operates to the advantage of both. But I do say that this is the case in the electric and gas industries. The electric

industry, particularly, is a growing one; there is substantial reason to believe that the possibilities of increased use of power are very great. There exists in this country potential consumer demand which may perhaps be compared to the demand for automobiles in the early days of mass production. I suppose that in the early days of the automobile many believed that the interest of the investor and the entrepreneur was in a high unit price; that the interest of the consumer was in a low unit cost; and that consequently the interests of the two were irreconcilable. Events proved that such people were taking a foreshortened view of the situation. Mass production and low unit price brought a mass market, and the combination of improved production methods, promotional distribution, low costs, low prices and increased use brought good fortune to investors and an improved standard of living to consumers.

I think that this is a good analogy for the electric industry. The potential market is here; this country is power hungry and power conscious. Just as in the old days, the remarkable progress of the early automobile made the nation hungry for automobiles, so today the marvels of technical achievement of the electrical industry have made us power hungry; and, as in those days, the snorting and explosion of an early two-cylinder horseless carriage made a nation automobile conscious, so today the rantings and roarings induced by the New Deal's power program have made us power conscious. Similarly, too, the very best thing that can happen in the utility field is that the utility business be streamlined -- that waste be eliminated, production be rationalized, power be produced in great quantities, use of power promoted, and that costs and prices be slashed. I think it is clear that the results will be a very substantial increase in the use of power with benefits to both consumers and investors.

We have already had ample evidence to support this. Time and time again, it has been demonstrated that low rates mean increased use of power and greater returns to investors. Time and time again, companies have bitterly fought rate reductions, only to discover, when the reductions are put into effect, that they were breaking their lance in quixotic battle. Time and time again, it has been shown that management policies which encompass low rates, promotion of use and development of better load factors redound to the benefit not only of the consumer, but of the investor as well.

Under the Holding Company Act, the SEC is not directly concerned with rates. This is the function of local agencies and of the Federal Power Commission. Our job lies elsewhere. It is, so to speak, on the financial and production level. Our interest is in putting the industry in a position where it can produce and sell energy at low rates to a mass market. Under various sections of the Act, we must see to it that income is not improperly siphoned away in the form of fees for services; that securities are not issued of types or in amounts prejudicial to the company as well as to investors; that properties are not acquired on improvident terms, or of such character or so located as to make for inefficient or uneconomic operation; and under section 11(b) (which is my particular concern today) we are charged with the task of reshaping utility systems so that their sphere of operations and their technical, economic and financial organization is such as to make for economical functioning and sound management. In short, our job is to see to it that the utility industry reshapes itself so that it can bring to itself and to the country the maximum benefits of its superb technical accomplishments. To achieve this we must, in

collaboration with the industry, undo many things that were done in the roaring twenties; we must unscramble senseless jumbles of properties; and we must cut away corporate excrescences and eliminate deformities in the financial organization of many companies.

The heart of our powers to do this job, as I have already noted, is found in the relatively brief provisions of section 11(b)(1) of the Act. This section provides that the Commission must "require that each registered holding company, and each subsidiary shall take such action as the Commission shall find necessary to limit the operations of the holding company system of which such company is a part to a single integrated public utility system and to such other businesses as are reasonable, incidental, or economically necessary or appropriate to the operations of such integrated public utility system." In addition, under certain circumstances the Commission may permit a registered holding company to continue to control one or more additional integrated public utility systems.

Now follow me while we look at the definition of an integrated public utility system in the Act.

"Integrated public-utility system' means --

(A) As applied to electric utility companies, a system consisting of one or more units of generating plants and/or transmission lines and/or distributing facilities, whose utility assets, whether owned by one or more electric utility companies, are physically interconnected or capable of physical interconnection and which under normal conditions may be economically operated as a single interconnected and coordinated system confined in its operations to a single area or region, in one or more States, not so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operation, and the effectiveness of regulation; and

(B) As applied to gas utility companies, a system consisting of one or more gas utility companies which are so located and related that substantial economies may be effectuated by being operated as a single coordinated system confined in its operations to a single area or region, in one or more States, not so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operation, and the effectiveness of regulation; Provided, That gas utility companies deriving natural gas from a common source of supply may be deemed to be included in a single area or region."

An integrated public utility system must be an electric system which under normal conditions may be "economically operated" or a gas system of such a nature that "substantial economies may be effectuated" by being operated as a single co-ordinated system. Now the "economical operation" of an electric utility system or the effectuation of "substantial economies" in gas operations are essentially meaningless unless such economical operation or those substantial economies are translated into benefits for both consumers and security holders. They must cut both ways. They must work out to the investor's benefit through the reduction of expense and the furtherance of efficient operation in the system. They must redound to the benefit of consumers in the form of a greater and more reliable supply of power and the lowest possible rate consistent with a reasonable return on the honest and legitimate investment in the utility.

To effect these benefits - to accomplish the economies which are a basic objective - the Act lays down two criteria; first, that the electric or gas facilities of the system be interconnected or operated as a coordinated system, or capable of such interconnection or coordination; and second, that the system be confined to a single area or region of such limited size as to realize the efficiencies of localized management and to permit of efficient operation. I shall not attempt to elaborate the engineering and operating factors upon which these standards are predicated. This job has been well done in Chairman Douglas' speech, to which I have heretofore referred. I will content myself with a few general observations about these provisions, and I shall make a slight detour before reaching them.

You can readily see that in some respects, these provisions of the Act which I am discussing are like an anti-trust statute. One of their objectives is to break up the private empires which are our great holding company systems - to put an end, in the words of the National Power Policy Committee, to this "form of private socialism inimical to the functioning of democratic institutions and the welfare of a free people".* I need not recount to you the known and potential dangers of this concentration of power over other peoples' money and lives. Congress has ruled that there are limits beyond which it may not be tolerated. The Holding Company Act approaches the problem of reducing the concentration of control from the viewpoint of economics and operating realities. It does not say that mere size, mere combination is prohibited. It does say that size and combination in excess of economical limits of operation and management are bad and must be reduced. They are bad, first, because the accumulation of power and the concentration of control in a democratic society can be justified only if they can be justified in terms of efficiency and economy; and second, because this nation must and will have the products of this vital industry, economically, efficiently and abundantly produced, and made available at the lowest possible price.

The test, then, of the permitted size of a holding company system is a component of engineering, economic and operating factors. It is to be determined in light of the power economics of the area and the managerial realities. The purpose and objective of the section 11(b)(1) of the Act is to promote, and to weld together, the most efficient combination of generating, transmission and distribution facilities. As I have indicated, this is not merely a matter of determining engineering facts such as whether City A can be efficiently served by power generated at station B, taking into account distances, reliability of supply, load factors and similar matters; it is also a management and operating question. We have ample evidence, for example, that localized management can be much more efficient and economical than the kind of remote control exercised by some holding companies. We know, for example; that a holding company with most of its properties west of the Mississippi River, and its personnel in Chicago, cannot efficiently control the operations of an electric system in Connecticut. And we also know that there are benefits of localized management and freedom from dependence upon and control by a remote parent company other than efficiency of operation - such as freedom from the

* Report of National Power Policy Committee (1935) H.R. Doc. No. 137, 74 Cong., 1st Sess. at 4.

necessity of paying out funds, to meet the needs of a remote company, regardless of the needs of the local enterprise. And we know that localized management is more responsive to the demands of its consumers for improved service and adequate maintenance, than is holding company management insulated by hundreds of miles and other interests from the needs and pressures of the localities served.

In other respects, too, the principles of section 11(b)(1) promise great public benefit. This is because of its express insistence upon shaping holding company systems with regard to the effectiveness of regulation. This means, I believe, that in determining the size and location of properties which may be retained by a holding company, the Commission must be careful to see that they are such as will not interfere with the doing of an effective regulatory job by state, as well as federal agencies. To some extent, a natural result of the "localizing" of holding company systems will be to increase the effectiveness of local regulation. But the statute does not leave this to the logic of events; it expressly adjures the Commission to heed this objective.

In short, then, looking at the integration provisions of the Act from a broad public viewpoint, I see the following benefits; a prohibition of the concentration of control over the vital electric and gas industries beyond the point of efficiency and economy; a grouping of these industries, in terms of centralized control, in such fashion as to permit effective local regulation of rates, financial and operating policies; a localizing of management so as to permit a greater degree of wise selfishness in the interests of the companies and the people they serve; and a great incentive to efficient and economic organization and development of the power resources of this country. I think it is not idle to predict that the successful consummation of this program will result in streamlining the production and distribution of power; greater use of power at lower rates; and benefits to both consumers and investors.

Let me point out that it is not visionary to speak of electricity as a great liberating force - as a prime necessity in a society which considers itself technologically as well as intellectually civilized.

If millions on millions of our people are to have that more abundant life, one of the essentials which they require is electricity counted not in multiples of one or ten kilowatt hours per month, but in units and multiples of 100 kilowatt hours per month. President Roosevelt has said:

"Electricity is no longer a luxury. It is a definite necessity it can become the willing servant of the family in countless ways. It can relieve the drudgery of the housewife and lift the great burden off the shoulders of the hard working farmer.

"I say 'can become' because we are most certainly backward in the use of electricity in our American homes and on our farms. In Canada the average home uses twice as much electric power per family as we do in the United States.

"What prevents our American people from taking full advantage of this great economic and human agency? The answer is simple. It is not because we lack undeveloped water power or undeveloped supplies of coal and oil.

"The reason is that we cannot take advantage of our own possibilities. The reason is frankly and definitely that many selfish interests in control of light and power industries have not been sufficiently far-sighted to establish rates low enough to encourage widespread use The price you pay for your utility service is a determining factor in the amount you use of it."

And the price you pay for your utility service depends to a considerable extent upon the sound utilization, coordination and operation of the power facilities in your region.

We approach the work ahead in a cooperative spirit. In the six and a half years which have elapsed since the words I quoted a moment ago were uttered, many of those in the high places of control of the utility industry have seen that it was to their own interest and to the interest of their security holders to become less selfish and more farsighted. Domestic consumption of electricity has increased by approximately one-third since then. Rates have gone down. The place of the federal government in the regulatory scheme is recognized and no longer causes the utterance of the dire prophesies of doom that attended the passage of the Holding Company Act. Our job may, therefore, resolve itself more into one of working out the problems by conference rather than by litigation. In any event the SEC has shown that it intends to be guided in exercising its function by the thesis laid down by the President that:

"The regulating commission must be a Tribune of the people, putting its engineering, its accounting and its legal resources into the breach for the purpose of getting the facts and doing justice to both the consumers and investors in public utilities."